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Securities Regulation in Virtual Space

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I. Introduction

On July 6, 2016, Niantic, Inc. released *Pokémon Go*, a mobile app for iOS and Android devices.[1] The premise of this game is that players locate and interact with virtual creatures, known as Pokémon.[2] However, unlike traditional video games, which allow

1. *See Pokémon Go*, POKÉMON CO., http://www.pokemon.com/us/pokemon-video-games/pokemon-go/ (last visited Sept. 21, 2017) (providing an overview of *Pokémon Go*) (on file with the Washington and Lee Law Review).

2. *See* Clara Ferreira-Marques, *Pokémon Game Adds $7.5 Billion to Nintendo Market Value in Two Days*, REUTERS (July 11, 2016), http://reut.rs/29wIhiJ (last visited Sept. 21, 2017) ("[*Pokémon Go*], which marries a classic 20-year old franchise with augmented reality, allows players to walk around real-life neighborhoods while seeking virtual Pokémon game characters on their smartphone screens—a scavenger hunt that has earned enthusiastic early reviews.") (on file with the Washington and Lee Law Review); Nick Wingfield & Mike Isaac, *Pokémon Go Brings Augmented Reality to a Mass Audience*, N.Y. TIMES (July 11, 2016), http://nyti.ms/29CGXJr (last visited Sept. 21, 2017) ("In the case of Pokémon Go, players traverse the physical world following a digital map, searching for cartoon creatures that surface at random. People look through their smartphone cameras to find Pokémon.") (on file with the Washington and Lee Law Review); Dave Thier, *What Is 'Pokémon GO,' And Why Is Everybody Talking About It?*, FORBES (July 11, 2016), https://www.forbes.com/sites/davidthier/2016/07/11/facebook-twitter-social-what-is-pokemon-go-and-why-is-everybody-talking-about-it/#12ad69fc1758 (last visited Sept. 21, 2017) ("[*Pokémon Go*] takes place in a world full of Pokémon, monsters of various sizes that can be captured in tiny red balls and tamed by Pokémon trainers, who use them to fight.") (on file with the Washington and Lee Law

players to interact with virtual characters in virtual settings, *Pokémon Go* is an augmented reality game that places virtual characters in real world settings using a mobile device's GPS and camera capabilities.[3] In short, *Pokémon Go* was designed to transform a player's world for purposes of game play. Based upon its immediate popularity, *Pokémon Go* has also transformed the world of video games as well.[4] In doing so, this app has created a number of new legal issues that implicate a variety of different areas, including criminal law, privacy law, property law, and tort law.[5]

Review).

3. *See* David E. Fink & Jamie N. Zagoria, *VR/AR in a Real World*, ENT. & SPORTS LAW., Fall 2016, at 2 ("For the uninformed, Pokémon Go is a game that uses the player's smartphone camera and augmented reality to insert virtual Pokémon (fictitious creatures) into the user's real world."); Cristin Wilson, *How Can Employers Reduce the Risk of Pokémon Go?*, ABA JOURNAL (Oct. 1, 2016), http://www.abajournal.com/magazine/article/pokemon_go_at_work (last visited Sept. 21, 2017) ("[*Pokémon Go*] is indeed a phenomenon . . . . The app works in conjunction with the GPS on your phone, and the goal is for users to capture the virtual characters they see around them.") (on file with the Washington and Lee Law Review); Larry N. Zimmerman, *Pokémon Go*, J. KAN. B. ASS'N, Sept. 2016, at 10 ("The app is GPS-connected and your onscreen avatar moves on a Google map as you walk the streets of your city, burg, or village searching . . . . A tracker vaguely points to nearby Pokémon requiring you to walk and explore until the monsters finally pop up onscreen.").

4. *See* Ferreira-Marques, *supra* note 2 ("In the United States, by July 8—two days after its release—[*Pokémon Go*] was installed on more than 5 percent of Android devices in the country, according to web analytics firm SimilarWeb."); Zimmerman, *supra* note 3, at 10 ("Pokémon Go is the biggest mobile game release in U.S. history, attracting more users than Twitter within just three days of its release on July 6 of this year."); Wingfield & Isaac, *supra* note 2 ("Pokémon Go represents one of those moments when a new technology—in this case, augmented reality or A.R., which fuses digital technology with the physical world—breaks through from a niche toy for early adopters to something much bigger.").

5. *See* Tamara Chuang, *Playing Pokémon Go? Here's How to Stay Safe*, DENVER POST (July 15, 2016), http://www.denverpost.com/2016/07/15/pokemon-go-safety-online/ (last visited Sept. 21, 2017) ("By now, you've probably heard of the new mobile game craze Pokémon Go. And perhaps you've heard there were some privacy concerns—like the app requiring full access to a user's Google account for those who chose to sign into the game using Google. Those were real.") (on file with the Washington and Lee Law Review); Joseph Rothberg, *'Pokémon GO' Field Guide: What You Need to Know About Civil Trespass Laws*, FORBES (July 21, 2016), https://www.forbes.com/sites/legalentertainment/2016/07/21/a-field-guide-to-civil-trespass-in-the-age-of-pokemon-go/#75e0c5236b6f (last

Technology invariably creates new legal questions of how to apply existing law to new circumstances. As *Pokémon Go* evidences, courts, lawmakers, and commentators are often forced to struggle with how to address these new issues hurriedly after they arise. In such instances, developers, platform owners, and users encounter a great deal of uncertainty regarding the lawfulness of their behavior and potential liability.

This Article is designed to educate, explore, and analyze when and how federal securities regulation applies to video games, virtual worlds, virtual reality, and augmented reality, i.e., securities that exist entirely within virtual space. "Virtual space" is a term coined within this Article to designate any software created environment, including the virtual elements of augmented reality. It can be as simple as a virtual chess board for a game of chess or as complex as a well-developed virtual reality simulator. Although it is highly unlikely that federal securities regulation applies to *Pokémon Go*, what that game demonstrates is how quickly issues related to video games, virtual worlds, virtual reality, and augmented reality can appear and how useful it can be for developers and platform owners to comprehend the potential legal concerns before unleashing their creations into the world. Securities regulation is an important area of law to understand prior to a developer creating, distributing, and marketing any type of virtual experience that has investment-related aspects to it that are tied to real world currency. This application of securities law to virtual space is developing, and the question is more one of how the law *ought* to apply, rather than how it *does* apply, because the case law and commentary is so sparse.

This is not to claim that securities regulators have never found their jurisdiction extending into cyberspace. Initially, as the Internet came into being, regulators struggled with questions of

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visited Sept. 21, 2017) ("Since its launch, excited players have been venturing into closed public spaces after hours and even trespassing onto private properties in order to catch Pokémon and advance in the game. There have been multiple reports by home and business owners of players trespassing . . . .") (on file with the Washington and Lee Law Review); Zimmerman, *supra* note 3, at 10–11 ("The vast library of . . . stops in the game represents real places—some of them memorials, businesses, and even residences that did not ask to participate and do not want the traffic . . . . [T]raffic near sites also creates risks of trespass, vandalism, or disturbance from groups of players arriving to play.").

how to apply securities regulation when it was used as a means of communication.[6] In recent years, however, the Internet has become an omnipresent tool in the purchasing and selling of securities.[7] As a result, in many instances, investors can now feel assured that their investments are at least somewhat protected by state and federal securities regulation as it has evolved to address securities issues online.[8] This is not the case, however, when it

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6. *See* Anita Indira Anand, *Securities Law in the Internet Age: Is "Regulating by Analogy" the Right Approach?*, 27 QUEEN'S L.J. 129, 136 (2001) ("[R]egulators have struggled with how to integrate the Internet into concepts currently embedded in securities law."); Roberta S. Karmel, *Regulatory Initiatives and the Internet: A New Era of Oversight for the Securities and Exchange Commission*, 5 N.Y.U. J. LEGIS. & PUB. POL'Y 33, 33 (2002) ("The trading of securities over the Internet has challenged securities regulators to adjust old legal constructs to fit this new medium."); Lawrence J. Trautman & George P. Michaely, Jr., *The SEC & The Internet: Regulating the Web of Deceit*, 68 CONSUMER FIN. L.Q. REP. 262, 262 (2014) ("The Internet has created challenges for regulators of financial markets unimagined over eighty years ago by drafters of the Securities and Exchange Acts.").

7. *See* Tamar Frankel, *The Internet, Securities* Regulation*, and Theory of Law*, 73 CHI.-KENT L. REV. 1319, 1319–20 (1998) ("The Internet affects the environment in which securities markets operate and the laws that govern them. The use of the Internet has already begun to change the way information about securities is disseminated and the way securities are traded, two activities regulated by the securities laws."); Constance Z. Wagner, *Securities Fraud in Cyberspace: Reaching the Outer Limits of the Federal Securities Laws*, 80 NEB. L. REV. 920, 920 (2001) ("More and more securities activities in both the primary and the secondary markets are moving on-line these days.").

8. *See* Olufunmilayo B. Arewa, *Securities Regulation of Private Offerings in the Cyberspace Era: Legal Translation, Advertising and Business Context*, 37 U. TOL. L. REV. 331, 331–32 (2006) ("What is often termed the cybersecurities era refers to the process by which securities regulation has been translated to changing technological and business practices in the last two decades, particularly since the advent of the Internet."); Eric C. Chaffee, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: A Failed Vision for Increasing Consumer Protection and Heightening Corporate Responsibility in International Financial Transactions*, 60 AM. U. L. REV. 1431, 1437 (2011) ("The United States Securities and Exchange Commission (SEC) . . . has demonstrated little concern about broadening its reach to cover securities transactions occurring online, even in the absence of an edict from Congress to do so."); Michael L. Rustad, *Punitive Damages in Cyberspace: Where in the World is the Consumer?*, 7 CHAP. L. REV. 39, 105 n.402 (2004) ("Similarly, the SEC has been active in extending federal securities law to the enforcement of predatory, anti-fraud and anti-competitive practices in cyberspace. SEC actions may be brought for insider trading, pyramid schemes, fraudulent investment opportunities, and false and misleading information about securities and the companies that issue them.").

comes to securities existing entirely within the virtual space of video games, virtual worlds, virtual reality, and augmented reality. While securities regulation may extend into these realms, the case law is limited, and the legal commentary is meager at best.[9]

Regarding securities existing entirely within virtual space, this Article argues that securities law likely could be applied in these settings based upon the definition of "security" found within Section 2(a) of the Securities Act of 1933 and Section 3(a) of the Securities Exchange Act of 1934.[10] Based on the language found within both of these sections—which limits the application of this definition of a security if "the context otherwise requires"—however, regulators and courts should determine that these securities existing entirely within virtual space, which are dependent on virtual activity, are not securities for purposes of federal securities regulation.[11] As will be explained below, eliminating the application of the federal securities law is the correct solution because of the intended scope of federal securities regulation, various constitutional law principles, and concerns about hindering creativity and regulatory experimentation.[12]

This Article advances the existing scholarship in three main ways.[13] First, this Article thoroughly explores the multiple ways in

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9. Notably, in July 2017, the United States Securities and Exchange Commission (SEC) issued a report stating that certain cryptocurrencies could be subject to federal securities regulation, if they met the definition of a security. Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934, Exchange Act Release No, 81207 (July 25, 2017). In issuing the report, the SEC stated that the cryptocurrency in the matter was offered and sold by a "virtual organization" known as "The DAO." *Id.* at 1. Although this is an interesting development in securities regulation in cyberspace, the SEC report in no way resolves the issue presented in this paper because it did not involve securities existing within virtual space, i.e., video games, virtual worlds, virtual reality, and augmented reality.

10. 15 U.S.C. §§ 77b(a)(1), 78c(a)(10) (2012).

11. *Id.* §§ 77b(a), 78c(a).

12. *See infra* Part V (providing arguments for not applying federal securities regulation to securities existing entirely within virtual space).

13. Remarkably, the issues of when or how federal securities regulation in the United States applies to transactions in virtual worlds has been largely ignored in the existing legal scholarship and other commentary. The major published pieces on the topic consist of a book chapter and a student comment. *See* BENJAMIN TYSON DURANSKE, VIRTUAL LAW: NAVIGATING THE LEGAL LANDSCAPE

which securities can interact with virtual space, whereas the very limited previous scholarship focuses mainly on virtual securities in virtual worlds.[14] This Article is designed to be a foundational piece about how securities can relate to virtual space, which is defined to include a wide variety of environments existing within video games, virtual worlds, virtual reality, and augmented reality. Second, this Article updates the very limited prior scholarship in light of the recent enactment of the Jumpstart Our Business Startups Act (JOBS Act).[15] The JOBS Act amended various portions of the Securities Act to allow for expanded purchases and sales via the Internet and mandated that the United States Securities and Exchange Commission (SEC) adopt a number of rules and regulations regarding the online purchase and sale of securities.[16] The JOBS Act may potentially have an impact on when and how federal securities laws apply to transactions in virtual space. Third, this Article offers a new solution to regulation of securities existing entirely within virtual space, i.e., to exclude them from the coverage of the federal securities law, and to allow other regulation to govern. Although federal securities regulation could apply to these securities, this is not the best means of regulating these realms. Unlike the previous limited scholarship, this Article argues that based upon the intended scope of federal securities regulation, various constitutional law principles, and concerns about hindering creativity and regulatory experimentation, a strong case exists for determining that securities existing entirely within virtual space should not be subject to federal securities law.[17]

OF VIRTUAL WORLDS 217–24 (2008) (exploring the consequences of cash economies within virtual worlds and the growth of virtual markets). *See generally* Shannon L. Thompson, Comment, *Securities Regulation in a Virtual World*, 16 UCLA ENT. L. REV. 89 (2009) (exploring the consequences of virtual securities within virtual worlds such as the game "Second Life").

14. *See* DURANSKE, *supra* note 13, at 217 (analyzing how securities regulation interact with virtual worlds); Thompson, *supra* note 13, at 98 ("[T]his Article examines whether virtual world securities are, in fact, securities subject to regulation under the federal securities laws.").

15. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified as amended in scattered sections of 15 U.S.C.).

16. *Id.*

17. *See infra* Part V (providing arguments for not applying federal securities

The remainder of this Article is structured as follows. Part II provides background on virtual space and its many forms including video games, virtual worlds, virtual reality, and augmented reality, and Part III offers a brief primer on federal securities regulation.[18] Part IV offers an analysis of how federal securities regulation might interact with securities existing entirely within virtual space and concludes that the virtual context should preclude the application of federal securities law.[19] Part V provides various arguments in support of that position based upon the intended scope of federal securities regulation, various constitutional law principles, and concerns about hindering creativity and regulatory experimentation.[20] Part VI addresses various counterarguments in favor of applying federal securities regulation, including that the application of federal securities regulation is necessary for investor protection, is required to prevent an unworkable patchwork of state regulation, and is needed to ensure that these rapidly developing and evolving virtual environments are properly regulated.[21] Finally, Part VII offers brief concluding remarks.[22]

II. A Brief Primer on Video Games, Virtual Worlds, Virtual Reality, and Augmented Reality

The term "virtual space" has been coined specifically for this Article. Within this paper, "virtual" is defined using the popular definition of "being on or simulated on a computer or computer network . . . such as . . . of, relating to, or existing within a virtual reality."[23] Virtual space designates any software-created environment, including the virtual elements of augmented reality.

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regulation to securities existing entirely within virtual space).

18. *Infra* Parts II, III.

19. *Infra* Part IV.

20. *Infra* Part V.

21. *Infra* Part VI.

22. *Infra* Part VII.

23. *Virtual*, MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/virtual (last visited Sept. 21, 2017) (on file with the Washington and Lee Law Review).

Virtual space entails a wide variety of realms including video games, virtual worlds, virtual reality, and augmented reality. Virtual space can designate everything from a simple video game chess board to a complex virtual reality environment. This space is different from cyberspace, although the two are closely related. Cyberspace designates "the online world of computer networks and especially the Internet."[24] Although virtual space and cyberspace do overlap in most instances, virtual space does exist beyond the world of networked computers. For example, an individual could create a computer with a video game, virtual reality experience, or augmented reality experience that is not networked with any other computer and is not in any way connected to the Internet. This virtual space would exist separate and apart from cyberspace. Thus, as used in this Article, virtual space is expansive, and it encompasses many different realms, including video games, virtual worlds, virtual reality, and augmented reality.

A. Exploring Virtual Space

Although an exhaustive discussion of video games, virtual worlds, virtual reality, and augmented reality is beyond the scope of this Article, a few words ought to be said about these media in which virtual space can exist. The vast majority of readers will have some familiarly with these media, but some discussion of their pervasiveness will demonstrate that it is a question of when, rather than if, securities regulation issues will arise in virtual space.

Video games are electronic games that allow a player to interact through a user interface with images on a video screen, such as a television or video monitor.[25] The first patent for a video

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24. *Cyberspace*, MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/cyberspace (last visited Sept. 21, 2017) (on file with the Washington and Lee Law Review).

25. *See Video Game*, MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/video%20game (last visited Sept. 21, 2017) (defining the term "video game" as "an electronic game played by means of images on a video screen and often emphasizing fast action") (on file with the Washington and Lee Law Review); *see also* Jethro Dean IV, Comment, *Would You Like to Play Again? Saving Classic Video Games from Virtual Extinction Through Statutory*

game was filed by Thomas T. Goldsmith Jr. and Estle Ray Mann on January 25, 1947, and it was issued on December 14, 1948.[26] During the 1950s and 1960s, video games were developed mainly for purposes of research, public displays, and instructional purposes, and they did not become popular until the 1970s and 1980s when video arcade games and video gaming consoles became widely available.[27] During the 1990s, the development of the Internet and reduced cost of home computers helped to fuel the growth of video games. Today, video gaming is a multi-billion-dollar industry with a multitude of different games available.[28] The amount and types of virtual space available within video games is substantial.

During the 2000s, the video game industry popularized a specific genre of virtual space known as virtual worlds.[29] The term

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Licensing, 35 SW. U. L. Rev. 405, 406 (2006) ("Originally, video game ROM files were fixed on memory boards installed inside large arcade cabinets that were primarily designed to hold the video monitor and controls.").

26. Cathode-Ray Tube Amusement Device, U.S. Patent No. 2,455,992 (filed Dec. 14, 1948).

27. *See* Christian Genetski & Christian Troncoso, *Copyright Industry Perspectives: The Pivotal Role of TPMS in the Evolution of the Video Game Industry*, 38 COLUM. J.L. & ARTS 359, 359 (2015) ("Although there is considerable debate about the industry's precise birthdate, most point to the early- to mid-1970s as the point at which video games entered into the mainstream consciousness.").

28. *See* Andrew E. Jankowich, *Property and Democracy in Virtual Worlds*, 11 B.U. J. SCI. & TECH. L. 173, 175 (2005) ("Through widespread public adoption of the Internet in the 1990s, the increasingly mainstream appeal of video games, and continuing increases in computer power, the evolution of sophisticated virtual worlds became possible."); Jonathan M. Etkowicz, Comment, *Professional Athletes Playing Video Games—The Next Prohibited "Other Activity?"*, 15 VILL. SPORTS & ENT. L.J. 65, 79 (2008) ("Additional technological advancements in the 1990s ushered in the modern age of video games.").

29. *See* Christopher J. Cifrino, *Virtual Property, Virtual Rights: Why Contract Law, Not Property Law, Must Be the Governing Paradigm in the Law of Virtual Worlds*, 55 B.C. L. REV. 235, 240 (2014) ("Virtual worlds have exploded in popularity over the past decade."); Joshua A.T. Fairfield, *The End of the (Virtual) World*, 112 W. VA. L. REV. 53, 57 (2009) ("Despite this rapid evolution, virtual worlds have only truly entered the mainstream in the past decade with the breakout success of Blizzard Entertainment's *World of Warcraft*."); Trevor J. Smedley & Ross A. Dannenberg, *Enforceability of Machine Patents in Virtual Worlds*, J. INTERNET L., Jan. 2010, at 7 ("With the development of massively multiplayer online role-playing games (MMORPGs) employing 3D graphics in the late 1990s and three-dimensional virtual worlds such as Second Life in the early

"virtual world" designates an online, computer-created environment that allows users to interact using avatars.[30] An avatar is a digital representation of the user that allows the user to exist within the computer-created space.[31] These environments allow users to feel as though they are present in a space separate from the traditional world, which is why virtual worlds are worlds unto themselves.[32] These environments represent spaces in which the application of "real world" law can be highly uncertain. As a result, a number of law review articles have been authored regarding the application of real world law to virtual worlds,[33]

2000s, computer simulation has become part of mainstream culture and a significant part of the real-world economy.").

30. *See* GREG LASTOWKA, VIRTUAL JUSTICE 9 (2010) ("All virtual worlds . . . are Internet-based simulated environments that feature software-animated objects and events.").

31. *See id.* ("Users are represented in virtual worlds by 'avatars,' digital alter egos that both embody and enable users within the simulated space.").

32. *See id.* ("The social and interactive complexity of virtual worlds can be substantial, making users feel like they are truly 'present' somewhere else. This is why virtual worlds are truly called 'worlds.'").

33. *See generally* Jack M. Balkin, *Virtual Liberty: Freedom to Design and Freedom to Play in Virtual Worlds*, 90 VA. L. REV. 2043 (2004); Marc Jonathan Blitz, *A First Amendment for Second Life: What Virtual Worlds Mean for the Law of Video Games*, 11 VAND. J. ENT. & TECH. L. 779 (2009); Susan W. Brenner, *Fantasy Crime: The Role of Criminal Law in Virtual Worlds*, 11 VAND. J. ENT. & TECH. L. 1 (2008); Bryan T. Camp, *The Play's the Thing: A Theory of Taxing Virtual Worlds*, 59 HASTINGS L.J. 1 (2007); Joshua A.T. Fairfield, *Avatar Experimentation: Human Subjects Research in Virtual Worlds*, 2 U.C. IRVINE L. REV. 695 (2012); Joshua A.T. Fairfield, *Mixed Reality: How the Laws of Virtual Worlds Govern Everyday Life*, 27 BERKELEY TECH. L.J. 55 (2012); Joshua A.T. Fairfield, *Nexus Crystals: Crystallizing Limits on Contractual Control of Virtual Worlds*, 38 WM. MITCHELL L. REV. 43 (2011); Jon M. Garon, *Beyond the First Amendment: Shaping the Contours of Commercial Speech in Video Games, Virtual Worlds, and Social Media*, 2012 UTAH L. REV. 607; Jon M. Garon, *Playing in the Virtual Arena: Avatars, Publicity, and Identity Reconceptualized Through Virtual Worlds and Computer Games*, 11 CHAP. L. REV. 465 (2008); Greg Lastowka, *User-Generated Content and Virtual Worlds*, 10 VAND. J. ENT. & TECH. L. 893 (2008); F. Gregory Lastowka & Dan Hunter, *The Laws of the Virtual Worlds*, 92 CAL. L. REV. 1 (2004); Leandra Lederman, *"Stranger Than Fiction": Taxing Virtual Worlds*, 82 N.Y.U. L. REV. 1620 (2007); Juliet M. Moringiello, *What Virtual Worlds Can Do for Property Law*, 62 FLA. L. REV. 159 (2010); John William Nelson, *A Virtual Property Solution: How Privacy Law Can Protect the Citizens of Virtual Worlds*, 36 OKLA. CITY U. L. REV. 395 (2011); Tyler T. Ochoa, *Who Owns an Avatar? Copyright, Creativity, and Virtual Worlds*, 14 VAND. J. ENT. & TECH. L. 959 (2012); Kevin W. Saunders, *Virtual Worlds—Real Courts*, 52 VILL. L. REV.

although the discussion of the application of securities regulation to this virtual space has been minimal.[34]

In addition, virtual reality is another popular technology for generating virtual space. Virtual reality refers to the use of software to generate realistic images, sounds, and other sensations to create a virtual environment.[35] Although virtual reality has a substantial history, this medium for virtual space has been particularly hot in the past few years based upon the widespread availability of virtual reality headsets.[36] As a result, virtual reality has become increasingly popular, including with academics, who have begun to explore the legal issues associated with it.[37]

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187 (2007); Theodore P. Seto, *When Is a Game Only a Game?: The Taxation of Virtual Worlds*, 77 U. CIN. L. REV. 1027 (2009); Robin Fretwell Wilson, *Sex Play in Virtual Worlds*, 66 WASH. & LEE L. REV. 1127 (2009).

34. *See supra* note 13 (discussing the very limited scholarship addressing the application of securities regulation to virtual worlds).

35. *See* Marc Jonathan Blitz, *The Freedom of 3D Thought: The First Amendment in Virtual Reality*, 30 CARDOZO L. REV. 1141, 1142 (2008) ("[A]nother kind of electronic environment . . . is more all-encompassing. It does not merely claim a small piece of our perceptual field. It swallows it entirely. It is not simply a virtual world on a screen—but a full-fledged virtual reality—a three-dimensional space that we seem to be within."); Gregory P. Joseph, *Virtual Reality Evidence*, 2 B.U. J. SCI. & TECH. L. 12, 12 (1996) ("'Virtual reality' refers to a category of computer-generated simulations—generally three-dimensional animations—that are designed to place the viewer in a simulated environment that reacts in a visually appropriate fashion to the viewer's actions."); Natalie Salmanowitz, *Unconventional Methods for a Traditional Setting: The Use of Virtual Reality to Reduce Implicit Racial Bias in the Courtroom*, 15 U. N.H. L. REV. 117, 138 (2016) ("[V]irtual reality is broadly defined as any technology in which the user experiences and interacts with a virtual environment, commonly (but not necessarily) through the perspective of an avatar.").

36. *See* Fink & Zagoria, *supra* note 3, at 1 ("[T]he headsets through which the world of virtual reality can be accessed, have been or will be made available for sale to the public this year, such as Facebook-owned Oculus VR's Oculus Rift, Samsung's Gear VR, Sony's PlayStation VR, HTC's Vive, etc. In other words, VR/AR is going mainstream.").

37. *See* Francis X. Shen, *Law and Neuroscience 2.0*, 48 ARIZ. ST. L.J. 1043, 1073 (2016) ("Virtual Reality . . . is now being explored for an incredible range of uses . . . . Regulators, legislators, practicing attorneys, and scholars have already begun to weigh in on issues such as intellectual property, privacy, and constitutional law."); Mark A. Lemley & Eugene Volokh, *Law, Virtual Reality, and Augmented Reality* 2 (Mar. 17, 2017) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2933867 (last visited Sept. 21, 2017) ("AR and VR both present legal questions for courts, companies, and users. Some are new takes on classic legal questions. People will die using AR and

As discussed above, augmented reality, based on the popularity of *Pokémon Go*, is also a hot medium for virtual space.[38] This is true despite augmented reality having existed for roughly half a century.[39] Typically, augmented reality places virtual characters and objects in real world settings using a mobile device's GPS and camera capabilities.[40]

In short, virtual space is plentiful and constantly evolving. As a result, now is the time to discuss how legal issues might arise in this space before these issues appear and end up being addressed haphazardly.

B. Securities Solely Existing in Virtual Space

Securities regulation issues could easily find—and in many cases already have found—their way into virtual space. The best way to illustrate how easily issues relating to securities solely existing in virtual space could come into being is to consider the following hypothetical:

> Adam Anderson sits at a computer in his home office. Financial newspapers and books on investing are piled high around him. He reaches for the mouse to start his work, and he knocks over his cup of coffee that he left on the edge of his desk. The cup's

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VR—indeed, some already have. They will injure themselves and others. Some will use the technology to threaten or defraud others.") (on file with the Washington and Lee Law Review).

38. *See supra* notes 1–5 and accompany text (providing an overview of *Pokémon Go* and its popularity).

39. *See* Scott R. Peppet, *Freedom of Contract in an Augmented Reality: The Case of Consumer Contracts*, 59 UCLA L. REV. 676, 689 (2012) ("Augmented reality has been developing for decades. In 1968, Ivan Sutherland created . . . the first augmented reality system. The system consisted of a helmet with a digital display that the user could wear to look around the room and see digital information overlaid on the physical world.").

40. *See* Marc Jonathan Blitz, *The Right to Map (and Avoid Being Mapped): Reconceiving First Amendment Protection for Information-Gathering in the Age of Google Earth*, 14 COLUM. SCI. & TECH. L. REV. 115, 128 (2012) ("[N]ew 'augmented reality' applications for iPhones, Blackberries, and other smartphones superimpose words or icons on images of the surrounding terrain . . . ."); Wilson, *supra* note 28, at 1131–32 ("These 'augmented reality' technologies push virtual experiences and object down into real space, erasing the boundary between the virtual world and the real world.").

> lukewarm contents splash onto his new pants. Anderson mumbles a few inaudible words.
>
> Anderson returns to staring at the screen. He checks the values of his investments. A number of his stocks are performing very well. He notices his stock in Global Giant Corporation has dropped substantially based on claims of accounting misstatements that spread across the Internet yesterday. With a few keystrokes, his shares of Global Giant Corporation are sold. He decides to use the profits to purchase shares of Pear Inc., a computer company that has been promising the announcement of a new and innovative smartphone. He purchases 200 shares of Pear Inc., and he turns off the computer.

Situations similar to the hypothetical above occur regularly throughout the United States. When these events are occurring in the "real world," the application of federal securities regulation is undeniable. The facts of this hypothetical, however, could easily be incorporated into a video game, a virtual world, a virtual reality experience, or an augmented reality experience.

If the hypothetical above occurs in a virtual space, investors cannot currently feel assured that state and federal securities regulation will apply because of the limited amount of case law and other guidance regarding this issue. This is particularly troubling because the ubiquity and anonymity of the Internet makes virtual environments very well suited for fraud and other sorts of abusive transactions.

III. A Brief Primer on Federal Securities Regulation

Although some readers of this Article will have an extensive familiarity with federal securities regulation, a few words ought to be said about the consequences of participating in transactions involving securities for those readers who may not have spent a significant amount of time studying such regulation. This Part is not designed to be a comprehensive discussion of securities law. Many important aspects of federal securities regulation that may be applicable to virtual space will not be discussed within the pages of this Part, including such topics as exchange regulation, broker-dealer regulation, and investor adviser regulation. In addition, this Part focuses only on federal securities regulation,

rather than state securities regulation, even though such state regulation may have important consequences in transactions involving securities.[41] This Part is designed only to briefly introduce securities regulation and to highlight the importance of whether securities law is applicable to virtual space.

The current system of federal securities regulation in the United States came into being during the first half of the twentieth century. Prior to the development of federal securities law in the United States, securities transactions were regulated by general anti-fraud statutes that were supplemented in some instances by privately imposed regulation on certain exchanges.[42] Because general anti-fraud provisions and private exchange regulation proved ineffective to regulate securities markets, Kansas enacted the first state securities act in 1911.[43] Within two decades, the vast

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41. *See* Rutheford B. Campbell, Jr., *The Role of Blue Sky Laws After NSMIA and the JOBS Act*, 66 DUKE L.J. 605, 618 (2016) ("Blue sky laws have an important role in the governance of capital formation. States generally retain authority to make and enforce antifraud rules. States also retain significant authority over registration, although as a result of preemption, states have in recent years lost some authority in this area."); Cheryl Nichols, *H.R. 2179, The Securities Fraud Deterrence and Investor Restitution Act of 2004: A Testament to Selective Federal Preemption*, 31 SUFFOLK TRANSNAT'L L. REV. 533, 535 (2008) ("The Commission cannot go it alone—there must be continued cooperation and shared labor between the Commission and Blue Sky Administrators. Blue Sky Administrators have an incredibly important role to play in ensuring that individual investors and working people are treated fairly."); Marc I. Steinberg, *Enhanced "Blue Sky" Enforcement: A Path to Help Solve Our Public School Funding Dilemma*, 50 WASHBURN L.J. 563, 571 (2011) ("[T]he states in their enforcement of the blue sky laws are important to market integrity and investor protection. The SEC needs help.").

42. *See* Eric C. Chaffee, *Contemplating the Endgame: An Evolutionary Model for the Harmonization and Centralization of International Securities Regulation*, 79 U. CIN. L. REV. 587, 610 (2011) ("[Prior to the 1930s,] the United States employed a privatization approach to securities regulation under which securities exchanges determined rules governing issuers, investors, and other market participants. In addition, general provisions of tort and criminal law were used to prohibit fraud in the purchase or sale of securities.").

43. *See* Chris Brummer, *Disruptive Technology and Securities Regulation*, 84 FORDHAM L. REV. 977, 983 n.9 (2015) ("Kansas is largely credited with enacting the first blue sky law in 1911, which required companies selling securities in the state, as well as stockbrokers, to register with the bank commissioner and disclose information about their operations."); Ronald J. Colombo, *Merit Regulation Via the Suitability Rules*, 12 J. INT'L. BUS. & L. 1, 7 (2013) ("In 1911 Kansas enacted the first law in America regulating the sale of securities—and by the Great

majority of other states had enacted similar statutes, which became commonly known as "blue sky laws."[44] The patchwork of regulation created by these various state statutes proved ineffective to prevent the stock market crash of 1929.[45] In the wake of the crash and the ensuing Great Depression, Congress passed the Securities Act of 1933 (Securities Act)[46] and the Securities Exchange Act of 1934 (Exchange Act).[47] Although various other statutes regulate securities transactions within the United States, the Securities Act and Exchange Act are the primary sources of federal securities regulation.[48]

Depression, every state had followed suit. The Kansas law, like many, was enacted in response to widespread securities fraud in that state."); Arthur B. Laby, *Reforming the Regulation of Broker-Dealers and Investment Advisers*, 65 BUS. LAW. 395, 401 (2010) ("Starting with Kansas in 1911, most states passed laws to protect investors from nefarious sales practices and other peculation in the offer and sale of securities.").

44. *See* Benjamin P. Edwards, *Disaggregated Classes*, 9 VA. L. & BUS. REV. 305, 312 (2015); ("Kansas passed the first Blue Sky law in 1911. Other states soon joined and passed their own laws to protect their citizens from sellers of fraudulent securities."); Thomas Lee Hazen, *Crowdfunding or Fraudfunding? Social Networks and the Securities Laws—Why The Specially Tailored Exemption Must Be Conditioned on Meaningful Disclosure*, 90 N.C. L. REV. 1735, 1761 n.159 (2012) ("In 1911, Kansas enacted the first state securities act and other states followed suit by enacting state securities laws that are commonly referred to as blue sky laws."); Ruth O. Kuras, *Harmonization of Securities Regulation Standards Between Canada and the United States*, 81 U. DET. MERCY L. REV. 465, 466 (2004) ("The origin of modern securities regulation began in the state of Kansas in 1911 with the passage of the first state securities legislation. This Act was a prototype which other states soon followed.").

45. *See* Amanda M. Rose, *State Enforcement of National Policy: A Contextual Approach (with Evidence from the Securities Realm)*, 97 MINN. L. REV. 1343, 1376 (2013) ("[T]he New Deal Congress believed that state securities laws—known as 'Blue Sky Laws'—had been ineffective in deterring abuses that contributed to the Stock Market Crash of 1929 and the ensuing Great Depression."); Joel Seligman, *The Changing Nature of Federal Regulation*, 6 WASH. U. J.L. & POL'Y 205, 207 (2001) ("In the brutal glare that followed the 1929–1932 stock market crash, virtually all commentators and congressional witnesses on the subject agreed that the blue sky laws never really had a chance to succeed."); Robert E. Wagner, *Too Close for Comfort: The Problem with Stationary SEC Officers*, 15 NEXUS: CHAP. J. L. & POL'Y 91, 93 (2009) ("Before the creation of the SEC, states had enacted so-called Blue Sky laws to control the sales of securities, beginning in 1911 with Kansas. Nonetheless, these laws came to be viewed as ineffective.").

46. 15 U.S.C. §§ 77a–77aa (2012).

47. *Id.* §§ 78a–78pp.

48. *See* Stefan J. Padfield, *Who Should Do the Math? Materiality Issues in*

Federal securities regulation is, at its heart, business investment regulation. To understand the significance of being subject to federal securities law, this Part contains a discussion of the breadth of the definition of a security, the registration requirements for securities, and the broad scope of the anti-fraud provisions within the Acts. This Part is designed to demonstrate how quickly and easily someone can become subject to and violate the federal securities laws. Even for attorneys, understanding these laws can be a challenge. Securities law is a leading source of malpractice claims against business lawyers.[49]

A. Definition of a Security

The definition of a security is a key issue under any system of securities regulation because it determines the applicability and scope of that system. Under federal securities law, the term "security" is defined broadly and applies to a wide variety of investments.[50]

Disclosures that Require Investors to Calculate the Bottom Line, 34 PEPP. L. REV. 927, 931 (2007) ("The two main statutes making up federal securities law are the Securities Act of 1933 . . . and the Securities Exchange Act of 1934 . . . ."); Susanna Kim Ripken, *Paternalism and Securities Regulation*, 21 STAN. J.L. BUS. & FIN. 1, 2 n.1 (2015) ("The two main sources of federal securities laws are the Securities Act of 1933 . . . and the Securities Exchange Act of 1934 . . . ."); J. Parks Workman, *The South Carolina Uniform Securities Act of 2005: A Balancing Act Under a New Blue Sky*, 57 S.C. L. REV. 409, 411 (2006) ("The main sources of federal securities regulation are the Securities Act of 1933 . . . , which regulates the initial offering of securities, and the Securities Exchange Act of 1934 . . . , which regulates the trading of securities subsequent to their initial issue.").

49. *See* WILLIAM A. KLEIN, J. MARK RAMSEYER & STEPHEN M. BAINBRIDGE, BUSINESS ASSOCIATIONS 396 (9th ed. 2015) ("[S]ecurities regulation issues reportedly are the single most common source of legal malpractice claims against business lawyers. Why? Put bluntly, because there are so many ways the lawyer can go awry."); Wilburn Brewer, Jr., *Expert Witness Testimony in Legal Malpractice Cases*, 45 S.C. L. REV. 727, 754 (1994) ("To practice in the highly technical areas such as medical malpractice and securities regulation, practitioners must possess highly developed skills and knowledge."); Lauren Schulz & Michael Hunter Schwartz, *Lawyer, Know your Safety Net: A Malpractice Insurance Primer for New and Experienced Lawyers*, J. KAN. B. ASS'N, March 2013, at 22 ("[A]reas of law that are high risk for malpractice claims include intellectual property, patent, and securities law.").

50. *See* Reves v. Ernst & Young, 494 U.S. 56, 61 (1990) ("[Congress] enacted a definition of 'security' sufficiently broad to encompass virtually any instrument

The term "security" is defined within the definition sections of both the Securities Act and the Exchange Act. Section 2(a)(1) of the Securities Act provides:

> The term "security" means any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.[51]

Containing very similar language, Section 3(a)(10) of the Exchange Act provides:

> The term "security" means any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of

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that might be sold as an investment.").

51. 15 U.S.C. § 77b(a)(1) (2012).

> grace, or any renewal thereof the maturity of which is likewise limited.[52]

Although the language of the two sections varies slightly, courts have regularly held that the definitions are equivalent.[53] Any variation in language of the definitions is not significant in determining whether federal securities regulation applies to virtual space.

The definitions of a security found within Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act include some types of investments with narrow, well-settled definitions and some types of investments with broad, more flexible definitions.[54] Terms such as note, bond, and stock found within the definitions of a security carried well-settled meanings when Congress promulgated the Securities Act and Exchange Act.[55] Terms such as investment contract, transferrable share, and "in general any interest or instrument commonly known as a security" were included to be more descriptive and broad enough to catch a wide variety of investments within the scope of federal securities regulation.[56]

Although some of the other terms contained within the definitions of a "security" found in the Securities Act and Exchange Act may apply to securities existing entirely within virtual space, this Article focuses on the term "investment contract" within both

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52. *Id.* § 78c(a)(10).

53. *See* SEC v. Edwards, 540 U.S. 389, 393 (2004) (noting that the Supreme Court of the United States has treated the "slightly different formulations" of the definition of a security found in Sections 2(a)(1) of the Securities Act and 3(a)(10) of the Exchange Act "as essentially identical in meaning"); Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 n.1 (1985) (holding that definitions of a security found in Sections 2(a)(1) of the Securities Act and 3(a)(10) of the Exchange Act are "virtually identical and will be treated as such in [the Supreme Court's] decisions dealing with the scope of the term"); MARC I. STEINBERG, SECURITIES REGULATION 26 (rev. 5th ed. 2009) (noting that courts have interpreted the definition of a security within Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act "in an identical manner").

54. *See* SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943) (discussing the definitions of a security found within Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act).

55. *See id.* ("Some, such as notes, bonds, and stocks, are pretty much standardized and the name alone carries well settled meaning.").

56. *Id.*

definitions. Although the definition of an "investment contract" is not the same as the definition of a "security,"[57] the term "investment contract" is a "catch-all" that includes a wide variety of items that are considered securities.[58] Plus, the term "investment contract" covers a wide variety of circumstances involving non-traditional securities, making it an excellent starting place for considering whether the Securities Act and the Exchange Act apply to securities existing within video games, virtual worlds, virtual reality, and augmented reality.[59]

Because the Securities Act and Exchange Act do not provide a definition for "investment contract," the Supreme Court of the United States in *SEC v. W.J. Howey Co.*[60] developed and adopted the commonly used definition for this term.[61] In that case, writing for the majority, Justice Frank Murphy stated that in determining the existence of an investment contract, "[t]he test is whether the scheme involves an investment of money in a common enterprise

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57. *See* 15 U.S.C. § 77b(a)(1) (2012) (providing the definition of a security under the Securities Act); *see also id.* § 78c(a)(10) (providing the definition of a security under the Exchange Act).

58. *See* Benjamin Akins, Jennifer L. Chapman & Jason Gordon, *The Case for the U.S. Regulation of Bitcoin Mining as a Security*, 19 VA. J.L. & TECH. 669, 683 (2015) ("[T]he investment contract category is essentially a 'catch-all' provision whereby lots of unique instruments or interests constitute a security."); C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 30 ("The most expansive part of the definition of security, the catch-all category, is the term 'investment contract.'"); Jeanne L. Schroeder, *Bitcoin and the Uniform Commercial Code*, 24 U. MIAMI BUS. L. REV. 1, 16 n.49 (2016) ("'[I]nvestment contract' . . . is the catch-all category for an investment that does not otherwise fall within one of the other sub-categories listed in the term 'security' . . . .").

59. *See* Jonathan Macey et al., *Helping Law Catch Up to Markets: Applying Broker-Dealer Law to Subprime Mortgages*, 34 J. CORP. L. 789, 808 (2009) ("'Investment contract' is the catch-all for things that walk and talk like a security but do not fit into any of the other categories."); Anish Vashista, David R. Johnson & Muhtashem S. Choudhury, *Securities Fraud*, 42 AM. CRIM. L. REV. 877, 899 n.142 (2005) ("'Investment contract' has been the catchall phrase under which most non-traditional securities fall.").

60. 328 U.S. 293 (1946).

61. *See id.* at 298–99 ("[A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . .").

with profits to come solely from the efforts of others."[62] This test can be broken down into three questions. First, is there an investment of money? Second, is there a common enterprise? Third, is there an expectation of profits to come solely from the efforts of others? If all three of these questions are answered affirmatively, then an investment contract exists, and with limited exception, federal securities regulation will apply as well.[63]

The definition of an investment contract is extraordinarily broad and can apply to a wide range of situations. For example, in *Howey*, W.J. Howey Company (Howey Company) sold tracts of land containing citrus groves to the general public.[64] At the time of sale, Howey-in-the-Hills Service, Inc. (Howey-in-the-Hills), a corporation with the same management as Howey Company, offered service contracts for the cultivating, harvesting, and marketing of the groves on any land purchased.[65] The purchasers of the land could make other arrangements to have it tended, but 85% of the land sold was serviced by Howey-in-the-Hills.[66] The service contracts generally lasted for ten years with no option of cancellation and granted Howey-in-the-Hills "full and complete" possession of the land.[67] Howey-in-the-Hills pooled fruit from all of the land that it serviced and then made an allocation of the net profits to the land owners.[68] Despite this rather unconventional

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62. *Id.* at 301.

63. *See id.* ("If [the] test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value. The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae." (citations omitted)).

64. *See id.* at 295 ("During the past several years [Howey Company] has planted about 500 acres annually, keeping half of the groves itself and offering the other half to the public . . . .").

65. *See id.* ("Each prospective customer is offered both a land sales contract and a service contract, after having been told that it is not feasible to invest in a grove unless service arrangements are made.").

66. *See id.* ("Indeed, 85% of the acreage sold during the 3-year period ending May 31, 1943, was covered by service contracts with Howey-in-the-Hills Service, Inc.").

67. *Id.* at 296.

68. See *id.* ("The company is accountable only for an allocation of the net profits based upon a check made at the time of picking. All the produce is pooled by the respondent companies, which do business under their own names.").

arrangement, the Supreme Court of the United States held that it met the test for an investment contract, and as a result, it qualified as a security under the Securities Act and the Exchange Act.[69] This test for an investment contract has been used to bring a wide variety of investments within the ambit of the federal securities law.[70]

Notably, the definition sections found in the Securities Act and Exchange Act both begin with the prefatory language "unless the context otherwise requires."[71] This means that investments that would otherwise meet the definition of a security will not be considered a security if the context suggests that they should not be subject to federal securities regulation.[72]

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69. *See id.* at 300 ("The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise. It follows that the arrangements whereby the investors' interests are made manifest involve investment contracts, regardless of the legal terminology in which such contracts are clothed.").

70. *See* Harvey Bines & Steve Thel, *Investment Management Arrangements and the Federal Securities Laws*, 58 OHIO ST. L.J. 459, 487–88 (1997) ("Limited partnerships, participations in oil and gas investments, pyramid schemes, franchising arrangements, condominium sales, and a remarkable variety of other investment arrangements have all been held to be investment contracts . . . ."); Harry S. Gerla, *Issuers Raising Capital Directly From Investors: What Disclosure Does Rule 10b-5 Require?*, 28 J. CORP. L. 111, 121 (2002) ("A vast variety of business arrangements are securities by virtue of their being investment contracts. Condominiums pooled with rental programs, cattle feeding and marketing programs, beaver ranching schemes, and horse racing syndications are among the diverse endeavors deemed to be 'investment contracts' and, therefore, securities."); Elaine A. Welle, *Freedom of Contract and the Securities Laws: Opting Out of Securities Regulation by Private Agreement*, 56 WASH. & LEE L. REV. 519, 537 (1999) ("Courts have used the investment contract test to reach a wide variety of instruments, from interests in conventional investment vehicles (like limited partnerships, franchises, and certain general partnerships) to more unusual investment opportunities (such as schemes involving fruit trees, chinchillas, self-improvement courses, and cemetery lots).").

71. 15 U.S.C. §§ 77b(a), 78c(a) (2012).

72. *See* Janet Kerr & Karen M. Eisenhauser, Reves *Revisited*, 19 PEPP. L. REV. 1123, 1123–24 (1992) (explaining that "courts have universally agreed that the introductory language 'unless the context otherwise requires' in both definitions, read in light of the wide variety of transactions which are evidenced by 'notes,' means that not all notes are 'securities' under these acts"); Dmitri A. Pentsov, *American Securities Versus Russian "Securities": Caveat Emptor*, 12 TUL. J. INT'L & COMP. L. 153, 169 (2004) ("[T]he phrase 'unless the context otherwise requires' leads to the inevitable conclusion that even those instruments specifically included in the list of 'securities' would not be considered 'securities'

For example, in *Marine Bank v. Weaver*,[73] the Supreme Court of the United States held that a certificate of deposit was not a security under the federal securities law because the certificate of deposit was issued by a bank and subject to another comprehensive scheme of regulation.[74] In that case, Sam and Alice Weaver purchased a $50,000 certificate of deposit from Marine Bank.[75] The certificate of deposit was then used to guarantee a loan by Marine Bank to Raymond and Barbara Piccirillo.[76] The Weavers alleged that Marine Bank had promised to allow the Piccirillos to use the proceeds from the loan to run a business that the Piccirillos owned.[77] Instead, Marine Bank used the proceeds from the vast majority of the loan to pay the Piccirillos's existing debt.[78] As a result, the business owned by the Piccirillos declared bankruptcy, and Marine Bank decided to claim the certificate of deposit to offset the default on the loan.[79] The Weavers sued asserting that Marine Bank had violated Section 10(b).[80] The United States District

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in certain instances."); Elaine A. Welle, *Limited Liability Company Interests as Securities: An Analysis of Federal and State Actions Against Limited Liability Companies Under the Securities Laws*, 73 DENV. U. L. REV. 425, 488 (1996) ("Courts have interpreted the context clause as authorizing judicial exclusion of certain instruments on the basis of factual circumstances, even if an instrument falls within the statutory definition of a security.").

73. 455 U.S. 551 (1982).

74. *See id.* at 560 ("Accordingly, we hold that this unique agreement, negotiated one-on-one by the parties, is not a security.").

75. *See id.* at 552 ("Respondents, Sam and Alice Weaver, purchased a $50,000 certificate of deposit from petitioner Marine Bank on February 28, 1978.").

76. *See id.* at 553 ("The Weavers subsequently pledged the certificate of deposit to Marine Bank on March 17, 1978, to guarantee a $65,000 loan . . . .").

77. *See id.* ("The Weavers allege that bank officers told them [the business the Piccirillos owned] would use the $65,000 loan as working capital . . . .").

78. *See id.* ("[I]nstead [the loan] was immediately applied to pay . . . overdue obligations [of the business that the Piccirillos owned].").

79. *See id.* at 553–54 ("[The business the Piccirillos owned] became bankrupt four months later. Although the bank had not yet resorted to the Weavers' certificate of deposit at the time this litigation commenced, it acknowledged that its other security was inadequate and that it intended to claim the pledged certificate of deposit.").

80. *See id.* at 554 ("These allegations were asserted in a complaint filed in the Federal District Court for the Western District of Pennsylvania in support of a claim that the bank violated § 10(b) of the Securities Exchange Act

Court for the Western District of Pennsylvania granted summary judgment for Marine Bank on the ground that the alleged wrongful conduct did not occur in relation to the purchase or sale of a security.[81] A divided panel of the United States Court of Appeals for the Third Circuit reversed the lower court on the ground that the certificate of deposit could potentially be considered a security.[82]

The Supreme Court reversed the Third Circuit and held that bank certificates of deposit do not constitute securities under federal securities law because such instruments are covered by another comprehensive regulatory scheme.[83] In reaching this holding, the Court noted that Congress did not intend to adopt a remedy for all fraud in promulgating the federal securities law.[84] Writing for a unanimous Court, Chief Justice Warren Burger wrote, "[d]eposits in federally regulated banks are protected by the reserve, reporting, and inspection requirements of the federal banking laws; advertising relating to the interest paid on deposits is also regulated. In addition, deposits are insured by the Federal Deposit Insurance Corporation."[85] He continued, "[t]he definition of 'security' in the 1934 Act provides that an instrument which seems to fall within the broad sweep of the Act is not to be considered a security if the context otherwise requires."[86] As a result of the existence of a comprehensive regulatory scheme governing bank issued certificates of deposit, the Court held no need existed for them to be classified as a security under federal securities law.[87]

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of 1934 . . . .").

81. *See id.* ("The District Court granted summary judgment in favor of the bank. It concluded that if a wrong occurred it did not take place 'in connection with the purchase or sale of any security,' as required for liability under § 10(b).").

82. *See id.* ("The Court of Appeals for the Third Circuit reversed.").

83. *See id.* at 555 ("We hold that neither the certificate of deposit nor the agreement between the Weavers and the Piccirillos is a security under the antifraud provisions of the federal securities laws.").

84. *See id.* at 556 ("Moreover, we are satisfied that Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud.").

85. *Id.* at 558.

86. *Id.* at 558–59.

87. *See id.* at 559 ("It is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws

Similarly, in *International Brotherhood of Teamsters v. Daniel*,[88] the Supreme Court of the United States held that a noncontributory, compulsory pension plan should not be considered a security for purposes of application of the federal securities law.[89] One of the rationales for reaching that holding was that the Employee Retirement Income Security Act (ERISA) sufficiently regulated this type of plan.[90] Writing for the majority, Justice Lewis Powell wrote, "[t]he existence of this comprehensive legislation governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans."[91] He continued, "[n]ot only is the extension of the Securities Acts by the court below unsupported by the language and history of those Acts, but in light of ERISA it serves no general purpose."[92] Both *Daniel* and *Weaver* stand for the proposition that instruments that may look like securities can be excluded from coverage under the federal securities laws if the context suggests that they are covered by some other system of regulation.

B. Registration

Should something qualify as a security under the Securities Act and Exchange Act, it must be registered with the SEC, unless exempted. Section 5 of the Securities Act provides: "Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly . . . to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security . . . ."[93] In

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since the holders of bank certificates of deposit are abundantly protected under the federal banking laws.").

88. 439 U.S. 551 (1979).

89. *See id.* at 570 ("We hold that the Securities Acts do not apply to a noncontributory, compulsory pension plan.").

90. *See id.* at 569–70 (discussing the Employee Retirement Income Security Act).

91. *Id.*

92. *Id.*

93. 15 U.S.C. § 77e(a) (2012).

addition, a prospectus must be delivered to a purchaser before any sale.[94] The registration process is both time-consuming and costly because of the amount of information that must be disclosed.[95] In the event registration is required, however, failing to file a registration is grounds under Section 12(a)(1) of the Securities Act for rescinding any transactions involving the unregistered securities, even in the absence of any showing of fraud or other wrongdoing.[96]

Although registration is the default rule, certain exemptions from registration do exist. Because of the time and cost associated with registration, issuers often use these exemptions to avoid the burdens of the registration process.[97] Section 3 of the Securities

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94. *See id.* § 77e(b) ("It shall be unlawful for any person, directly or indirectly . . . to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus . . . .").

95. *See* Jeffrey E. Alberts & Bertrand Fry, *Is Bitcoin a Security?*, 21 B.U. J. SCI. & TECH. L. 1, 5 (2015) ("Registration of securities under the Securities Act is time-consuming, expensive, and typically necessitates the involvement of attorneys, accountants, and other professionals."); Hazen, *supra* note 44, at 1744 ("Registering securities under the 1933 Act is an expensive and otherwise burdensome process that presents barriers to small businesses' access to the U.S. capital markets."); Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 908 (2011) (providing a lengthy list of expenses associated with registering an initial public offering with the SEC).

96. 15 U.S.C. § 77*l*(a)(1) (2012)

> Any person who . . . offers or sells a security in violation of [registration requirements] . . . shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

97. *See* Gavin Clarkson, *Wall Street Indians: Information Asymmetry and Barriers to Tribal Capital Market Access*, 12 LEWIS & CLARK L. REV. 943, 957 (2008) ("Registration of securities is an expensive proposition, and the required reporting costs the issuing entity approximately two million dollars per year . . . . Securities that are exempt from registration avoid these costs while still being available for purchase by both institutional investors and individual retail investors."); Andrew A. Schwartz, *Crowdfunding Securities*, 88 NOTRE DAME L. REV. 1457, 1474 (2013) ("[S]ecurities registration is an onerous and expensive process, companies often prefer to raise capital in ways that will avoid the registration requirement."); Cheryl L. Wade, *The Integration of Securities Offerings: A Proposed Formula That Fosters the Policies of Securities Regulation*,

Act exempts certain types of securities from registration completely.[98] In addition, in promulgating the Securities Act, Congress opted to exempt certain transactions from registration as well; most of these exemptions appear in Section 4 of the Act.[99]

A complete discussion of the types of securities and transactions exempted from the registration requirements under Section 5 of the Securities Act is beyond the scope of this Article. This is especially true regarding the transactions exempted from registration under the Securities Act, due to the complexity and narrowness of these rules. For example, Section 4(2) of the Securities Act appears broad on its face and exempts "transactions by an issuer not involving any public offering."[100] However, the Supreme Court of the United States held in *SEC v. Ralston Purina Co.*[101] that, for the exemption to apply, offerees should "have access to the kind of information which registration would disclose."[102]

Until recently, this focus on access to information, which permeates Section 4(2) and all aspects of the Securities Act and Exchange Act, severely limited issuers' ability to sell securities via the Internet through general solicitations without registering.[103]

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25 LOY. U. CHI. L.J. 199, 205–06 (1994) ("Issuers do not have to register their securities offerings when they can satisfy all of the requirements under an exemption, thereby avoiding the delay and expense of the registration process that impedes their ability to raise capital.").

98. *See* 15 U.S.C. § 77c (exempting from registration a number of types of securities).

99. *See id.* § 77d (exempting from registration a number of categories of securities transactions).

100. *Id.* § 77d(a)(2).

101. 346 U.S. 119 (1953).

102. *Id.* at 127.

103. *See* Michael B. Dorff, *The Siren Call of Equity Crowdfunding*, 39 J. CORP. L. 493, 501 (2014) ("Until the JOBS Act, it was not legally possible for a new business to sell equity or a share of its future profits over the Internet without registering the sale under the Securities Act of 1933 (the '33 Act)."); Joan MacLeod Heminway, *Investor and Market Protection in the Crowdfunding Era: Disclosing to and for the "Crowd"*, 38 VT. L. REV. 827, 835 (2014) ("[P]rior to the adoption of the JOBS Act in the spring of 2012, the most promising registration exemptions, those in Regulation D under the 1933 Act, prohibited general solicitation and advertising, making them unavailable for open Internet securities offerings."); Ryan Sanchez, *The New Crowdfunding Exemption: Only Time Will Tell*, 14 U.C. DAVIS BUS. L.J. 109, 110 (2013) ("Prior to the JOBS Act, existing securities regulations prevented the use of the Internet in marketing

On April 5, 2012, President Barack Obama signed the JOBS Act into law.[104] The JOBS Act mandated that the SEC adopt various rules and regulations regarding the online purchase and sale of securities, which the Act refers to as "crowdfunding."[105] Section 302 of the JOBS Act amended Section 4 of the Securities Act to provide that registration is not required for the following:

> (6) transactions involving the offer or sale of securities by an issuer (including all entities controlled by or under common control with the issuer), provided that—
>
> (A) the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, is not more than $1,000,000;
>
> (B) the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, does not exceed—
>
> (i) the greater of $2,000 or 5 percent of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000; and
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> (ii) 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate

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securities to investors without adhering to sophistication requirements—greatly limiting the potential pool of investors.").

104. Jumpstart Our Business Startups Act, Pub. L. No. 112–106, 126 Stat. 306 (2012) (codified as amended in scattered sections of 15 U.S.C.).

105. *Id.*; *see also* Roberta S. Karmel, *Disclosure Reform—The SEC is Riding Off in Two Directions at Once*, 71 BUS. LAW. 781, 820 (2016) ("Crowdfunding uses the Internet to raise capital for a wide range of projects, typically seeking small contributions from a large number of individuals."); Alma Pekmezovic & Gordon Walker, *The Global Significance of Crowdfunding: Solving the SME Funding Problem and Democratizing Access to Capital*, 7 WM. & MARY BUS. L. REV. 347, 356 (2016) ("'[C]rowdfunding' enables entrepreneurs who traditionally face financing constraints to obtain capital from anyone in the world via the Internet. Crowdfunding—as a form of crowdsourcing—is designed to facilitate raising capital."); Christina Parajon Skinner, *Whistleblowers and Financial Innovation*, 94 N.C. L. REV. 861, 875–76 (2016) ("The crowdfunding model of capital raising relies on Internet platforms (crowdfunding sites) to raise money from the general public, again, accumulating small contributions from many investors.").

> amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000;
>
> (C) the transaction is conducted through a broker or funding portal that complies with the requirements of section 4A(a); and
>
> (D) the issuer complies with the requirements of section 4A(b).[106]

As amended, Section 4 of the Securities Act dramatically alters the ability of issuers to raise capital via the Internet.[107] The JOBS Act also required the SEC to amend the exemptions found in Rule 506 and Regulation A to make the transactions in securities via the Internet easier.[108] Issuers now have greater access to capital, if they are willing to comply with the relevant statutes and regulations.[109]

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106. 15 U.S.C. § 77d (2012).

107. *See* Darian M. Ibrahim, *Equity Crowdfunding: A Market for Lemons?*, 100 MINN. L. REV. 561, 562 (2015) ("The JOBS Act allows general solicitation of accredited investors, a move that makes online matchmaking and investing legally possible in a way that it was not before."); Seth C. Oranburg, *Bridgefunding: Crowdfunding and the Market for Entrepreneurial Finance*, 25 CORNELL J.L. & PUB. POL'Y 397, 400 (2015) ("In 2012, Congress amended securities law to enable a new way to finance startups. The Jumpstart Our Business Startups (JOBS) Act of 2012 is a law that creates a new exemption to securities laws."); Andrew A. Schwartz, *Keep It Light, Chairman White: SEC Rulemaking Under the CROWDFUND Act*, 66 VAND. L. REV. EN BANC 43, 45 (2013) ("Securities crowdfunding holds great promise for entrepreneurs and public investors who will be able to connect without going through the cumbersome and expensive initial public offering ('IPO') process.").

108. *See infra* notes 166–74 and accompanying text (discussing the amendments that the SEC was required to make to Rule 506 and Regulation A under the JOBS Act).

109. *See* Joan MacLeod Heminway, *Business Lawyering in the Crowdfunding Era*, 3 AM. U. BUS. L. REV. 149, 155 (2014) ("Crowdfunding results from the application of innovative technology to the practice of business finance and the applicable law. . . . The Internet facilitates the efforts of businesses or their principals in reaching out to the crowd for business capital . . . ."); Andrew A. Schwartz, *The Digital Shareholder*, 100 MINN. L. REV. 609, 640 (2015) ("[O]ne of the foundational purposes of crowdfunding is to be a simple securities market that poses extremely low costs of raising capital and is therefore accessible to a wide swath of early-stage entrepreneurs."); Andrew A. Schwartz, *Teenage Crowdfunding*, 83 U. CIN. L. REV. 515, 516 (2014) ("[I]n Title III of the JOBS Act of 2012, known as the CROWDFUND Act, Congress created a new method of financing startup companies . . . . [,] the sale of securities over the Internet to large numbers of investors (the crowd), each of whom invests a small amount.").

C. Anti-Fraud

The Securities Act and Exchange Act also contain various anti-fraud provisions that are designed to encourage honesty and transparency in securities transactions.[110] For example, Section 11 of the Securities Act creates a private cause of action for individuals who are the victim of a registration statement that "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading."[111] In addition, Section 12(a)(2) of the Securities Act creates a private cause of action against a person offering or selling a security "by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading."[112]

Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder are almost certainly, however, the most important anti-fraud provisions of the federal securities laws. Section 10(b) makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . any manipulative or

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110. *See* SEC v. Capital Gains Res. Bureau, Inc., 375 U.S. 180, 186 (1963) ("A fundamental purpose, common to . . . [the federal securities laws], was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry."); *see also* Mike Koehler, *Foreign Corrupt Practices Act Ripples*, 3 AM. U. BUS. L. REV. 391, 437 (2014) ("The securities laws are based on the general premise that issuers must make full and complete disclosure of all material facts relevant to its business."); Anthony Michael Sabino & Michael A. Sabino, *From* Chiarella *to* Cuban*: The Continuing Evolution of the Law of Insider Trading*, 16 FORDHAM J. CORP. & FIN. L. 673, 683 (2011) ("Viewed as one great edifice, our federal securities laws have proven to be a durable and effective means of assuring the sanctity of the American capital markets by imposing a discipline of transparency, disclosure, and honesty."); Welle, *supra* note 65, at 540–41 ("By prohibiting fraud and mandating disclosure, the securities laws protect investors and promote honesty, trust, and ethical behavior in . . . transactions. The securities laws set standards that serve to socialize, to educate, and to direct individuals toward more morally appropriate forms of behavior.").

111. 15 U.S.C. § 77k (2012).

112. *Id.* § 77*l*(a)(2).

deceptive device or contrivance."[113] This provision also empowers the SEC to prescribe "such rules and regulations . . . as necessary or appropriate in the public interest or for the protection of investors."[114] In 1942, using the power granted by Section 10(b), the SEC promulgated Rule 10b-5, which provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.[115]

Although no private right of action is provided for in the language of these provisions, in *Kardon v. National Gypsum Compan*y,[116] the United States District Court for the Eastern District of Pennsylvania became the first court to hold that a private right of action exists under Section 10(b) and Rule 10b-5.[117] In *Superintendent of Insurance v. Bankers Life & Casualty Co.*,[118] the Supreme Court acquiesced to the existence of this implied private right of action.[119]

Section 10(b) and Rule 10b-5 are important because of the breadth of their coverage. These provisions apply to both

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113. *Id.* § 78j(b).

114. *Id.*

115. 17 C.F.R. § 240.10b-5 (2016).

116. 69 F. Supp. 512 (E.D. Pa. 1946).

117. *See id.* at 514 ("[I]n view of the general purpose of the act, the mere omission of an express provision for civil liability [in a private right of action under section 10(b) and Rule 10b-5] is not sufficient to negative what the general law implies.").

118. 404 U.S. 6 (1971).

119. *See id.* at 13 n.9 ("It is now established that a private right of action is implied under § 10(b).").

registered and unregistered securities, which means that, even if an issuer is able to find a registration exemption, they can still be in violation of Section 10(b) and Rule 10b-5.[120] In addition, Section 10(b) and Rule 10b-5 are commonly referred to as "catch-all" provisions because they generally prohibit fraud in securities transactions.[121] The SEC, the Department of Justice, and private parties are all permitted to pursue violations of these provisions.[122] The private right of action under these provisions has a breadth similar to a common law fraud claim.[123]

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120. *See* 15 U.S.C. § 78j(b) (2012) (providing that Section 10(b) applies to "any security registered on a national securities exchange or any security not so registered").

121. As evidenced by the legislative history, Congress drafted Section 10(b) as a "catch-all" anti-fraud provision. *See Stock Exchange Regulation: Hearing on H.R. 7852 and H.R. 8720 Before the H. Comm. on Interstate and Foreign Commerce*, 73d Cong. 115 (1934) (statement of Thomas G. Corcoran, Counsel, Reconstruction Finance Corporation) ("[Section 10(b)] is a catch-all clause to prevent manipulative and deceptive devices I do not think there is any objection to that kind of a clause. The commission should have the authority to deal with new manipulative devices."). The Supreme Court has recognized in numerous opinions that Section 10(b) is a "catch-all" antifraud provision. *See, e.g.*, *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983) ("Section 10(b) is a 'catchall' antifraud provision . . . ."); *Chiarella v. United States*, 445 U.S. 222, 226 (1980) ("Section 10(b) was designed as a catch-all clause to prevent fraudulent practices."); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 202 (1976) ("This brief explanation of [Section] 10(b) by a spokesman for its drafters is significant. The section was described rightly as a 'catchall' clause to enable the Commission 'deal with new manipulative (or cunning) devices.'").

122. *See* 15 U.S.C. § 78u (2012) (granting the SEC the power to undertake civil enforcement actions to punish violations of Section 10(b) and Rule 10b-5); *id.* § 78ff (granting the DOJ the power to criminally prosecute violations of Section 10(b) and Rule 10b-5).

123. *See* Stoneridge Inv. Partners, LLC v. Scientific–Atlanta, Inc., 552 U.S. 148, 157 (2008)

> In a typical § 10(b) private action a plaintiff must prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.

IV. The Application of Federal Securities Regulation to Virtual Space

The existing scholarship regarding the application of securities regulation to video games, virtual worlds, virtual reality, and augmented reality is extremely limited.[124] Most of this scholarship only analyzes whether securities that exist entirely within virtual space are subject to federal securities law. To fully understand the application of federal securities regulation to virtual space, four contexts should be considered: (1) securities purchased and sold in real world transactions based upon real world activity; (2) securities purchased and sold in real world transactions based upon virtual activity; (3) securities purchased and sold in virtual space based upon real world activity; and (4) securities purchased and sold in virtual space based upon activity in that space.

Regarding these four contexts, a couple of things ought to be noted. First, as discussed below, only the last category, i.e., securities purchased and sold in virtual space based upon activity in that space, is controversial. In the other contexts, federal securities regulation almost certainly applies. Second, also regarding the last category, the main source of controversy is whether securities can exist within video games, virtual worlds, virtual reality, and augmented reality. Although this Article concludes that securities could potentially exist within virtual space, this Article argues that securities do not exist based upon the definition of a "security" found in Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act because the context requires that virtual realms remain beyond the reach of federal securities regulation.[125] Each of the four contexts mentioned above will be examined in turn.

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124. *See supra* note 13 (discussing the limited scholarship addressing the application of federal securities regulation to video games, virtual worlds virtual reality, and the virtual elements of augmented reality).

125. 15 U.S.C. §§ 77b(a)(1), 78c(a)(10) (2012).

A. Securities Purchased and Sold in Real World Transactions Based Upon Real World Activity

Securities purchased and sold in real world transactions based upon real world activity, excluding exceptional cases, are covered by federal securities regulation. For example, securities sold by numerous corporations, such as Apple, Chipotle, IMAX, and Starbucks, all clearly lie within the ambit of federal securities law. In fact, this is the exact context that Congress intended to regulate when it promulgated the Securities Act of 1933 and Securities Exchange Act of 1934.[126]

B. Securities Purchased and Sold in Real World Transactions Based Upon Virtual Activity

Securities purchased and sold in real world transactions based upon virtual activity are also covered by federal securities law, except in extraordinary situations.[127] Easy examples of this include companies such as Facebook, Snap, and Twitter.[128] Each of these companies is founded upon virtual interaction among members of these social networks, and each of these companies is a publicly traded company under federal securities law.

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126. *See* James D. Cox, *Choice of Law Rules for International Securities Transactions?*, 66 U. CIN. L. REV. 1179, 1187 (1998) ("The U.S. securities laws were enacted in the aftermath of the Great Depression and their history and content were much influenced by our experience and faith that fair and orderly markets are a cornerstone for not just economic stability, but social stability."); Steven A. Ramirez, *The Virtues of Private Securities Litigation: An Historic and Macroeconomic Perspective*, 45 LOY. U. CHI. L.J. 669, 680 (2014) ("The federal role in securities regulation thus has its roots in the financial and macroeconomic catastrophe of the Great Depression. The President and Congress intended to insure disclosure to investors." (footnotes omitted)).

127. *See infra* Part IV.D (explaining that only virtual securities sold in virtual space are controversial because of their lack of anchor in the real world).

128. *See Will Snap Be the Next Facebook—or Twitter?*, KNOWLEDGE@WHARTON (Feb. 9, 2017), http://knowledge.wharton.upenn.edu/article/will-snap-next-facebook-twitter/ (last visited Sept. 21, 2017) ("Since Snap filed its S-1 publicly with the SEC last week, there has also been a lot written already comparing the attributes of Snap, as it gets ready for its IPO, to those of Facebook and Twitter—both leading social media companies when they went public.") (on file with the Washington and Lee Law Review).

Moreover, publicly traded companies commonly create their business models upon activities occurring in virtual space. Activision Blizzard, Inc. is the parent company of Blizzard Entertainment, which is the maker of the video game World of Warcraft,[129] and it is a good example of a company that bases a substantial portion of its profits on users interacting within a virtual space. The company's profitably is heavily dependent on online users continuing to use the virtual world created by this video game maker.[130] Put simply, just because a company founds its business model on behavior that occurs within virtual space does not mean that it is excluded from the ambit of federal securities regulation.

C. Securities Purchased and Sold in Virtual Transactions Based Upon Real World Activity

Securities purchased and sold in virtual transactions based upon real world activities are also covered by the federal securities law, except in extraordinary situations.[131] For example, just because an individual begins soliciting friends and family members via LinkedIn, Facebook, Twitter, Snapchat, or a variety of other social networks to become passive investors in a new venture—i.e., to purchase investment contracts, which are a form of security—does not mean that individual has avoided the application of the federal securities law. The same would be true if real world companies began to offer their shares and to engage in securities transactions within virtual space. In fact, because of the ubiquity of the Internet and email in securities transactions, the application of federal securities regulation in this context, except in certain extraordinary situations, is almost beyond question.[132] Even if virtual space is used to conduct transactions in real

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129. *See* ACTIVISION BLIZZARD, http://www.activisionblizzard.com/about-us (last visited Sept. 21, 2017) (discussing Activision Blizzard's corporate structure) (on file with the Washington and Lee Law Review).

130. *Id.*

131. *See supra* note 8 and accompanying text (discussing how securities regulation has adapted to cover online transactions).

132. *See supra* note 7 and accompanying text (discussing that the Internet is an omnipresent tool in the purchasing and selling of securities).

securities, the federal securities law almost certainly applies because it is being used as a means of communication similar to email or the Internet.

D. Securities Purchased and Sold in Virtual Transactions Based Upon Virtual Activity

Of the four contexts discussed in this Article, the most controversial is securities purchased and sold in virtual transactions based upon virtual activity. Unlike the three previous contexts discussed above, these securities have no anchor in the real world because they exist completely within virtual space. Terming these virtual things "securities" is in itself controversial because concluding that they are securities within the definitions found in Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act means that the federal securities law applies.[133]

This Article loosely employs the term "securities" for two reasons. First, using the term loosely provides a much easier shorthand for the Article's subject matter. For example, referring to the subject matter within this Article as "online elements of video games, virtual worlds, virtual reality experiences, and augmented reality experiences that may or may not be securities for purposes of federal securities law" would considerably lower the reader's enjoyment. Second, securities purchased and sold in virtual transactions based upon virtual activity technically fall under the definitions found within Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act, but as will be explained, because of their virtual context, should be excluded. The law is unsettled, however, and these virtual items might very well be considered securities under federal law. Thus, for the sake of ease, this Article will refer to these virtual items as securities.

Notably, in July 2017, the SEC did take a step toward addressing the topic presented in this Article when it issued a report stating that certain cryptocurrencies could be subject to federal securities regulation, if they met the definition of a

133. 15 U.S.C. §§ 77b(a)(1), 78c(a)(10) (2012).

security.[134] In the report, the SEC stated that the cryptocurrency in the matter was offered and sold by a "virtual organization" known as "The DAO."[135] Assuming that the judiciary agrees with the SEC's assessment, which it may not, when the issue ultimately is litigated in some case, this offers a partial answer to when securities purchased and sold in virtual transactions based upon virtual activity are subject to federal securities regulation. With that said, the SEC report in no way resolves the issue presented in this paper because it did not involve securities existing within virtual space, i.e., video games, virtual worlds, virtual reality, and augmented reality. In addition, the report does not have the precedential value of a decision by any federal court.

If the securities existing entirely within virtual space are securities under federal law, the most likely rationale would be their classification as investment contracts. As previously explained, the definitions of a security found within Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act include some types of investments with narrow, well-settled definitions and some types of investments with broad, more flexible definitions.[136] For purposes of analyzing whether securities existing entirely within virtual space are securities under federal securities law, this Article focuses on the term "investment contract." This is useful because the term is found both in Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act, and it covers a wide variety of circumstances involving non-traditional securities, i.e., it is a catch-all.[137] As provided in *Howey*, "[t]he test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."[138] Satisfying the test requires affirmatively answering three questions. First, is there an

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134. Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934, Exchange Act Release No. 81207 (July 25, 2017).

135. *Id.* at 1.

136. *See supra* Part III.A (discussing the definition of a security under the Securities Act and Exchange Act).

137. *See supra* notes 49–65 and accompanying text (explaining the breadth of the term "investment contract" under federal securities law).

138. SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

investment of money?[139] Second, is there a common enterprise?[140] Third, is there an expectation of profits to come solely from the efforts of others?[141] Unless the virtual context requires a different result, the applicability of the *Howey* test to virtual space in some instances is almost certain.[142]

For example, a video game or augmented reality game developer could create a game in which an individual uses real world currency to purchase virtual currency that would then be used to purchase passive investments in a virtual business with the expectation that the management of the virtual business generate a virtual profit that the investor could eventually convert back into real world currency. In this situation, federal securities law likely applies, unless the context otherwise requires. The facts that the transaction is completed via avatar and that the profits are eventually converted into real world currency are irrelevant for purposes of the *Howey* test—unless the context calls for what would otherwise be treated as a securities transaction to be treated differently.

Notably, Second Life, an online virtual world, created and owned by Linden Lab, which was popular during the 2000s, allows such virtual securities transactions to occur.[143] Throughout its existence, Second Life has had securities exchanges operating that are potentially governed by state and federal securities regulation.[144] Despite Second Life's waning popularity, similar

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139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.*

143. *See* SECOND LIFE, http://secondlife.com/ (last visited Sept. 21, 2017) (providing the official webpage for Second Life) (on file with the Washington and Lee Law Review).

144. *See* Neil A. Beekman, *Virtual Assets, Real Tax: The Capital Gains/Ordinary Income Distinction in Virtual Worlds*, 11 COLUM. SCI. & TECH. L. REV. 152, 159 (2010) ("Some virtual worlds provide users with opportunities to invest their virtual world money . . . . Second Life has user-created virtual stock exchanges in which users buy and sell shares of Second Life companies."); Robert J. Bloomfield & Young Jun Cho, *Unregulated Stock Markets in Second Life*, 78 SOUTHERN ECON. J. 6, 7 (2011) ("This article examines data on issue activity and investor returns in the Second Life Capital Exchange (SLCapex), an exchange created and operated by residents of the virtual world Second Life."); Thompson, *supra* note 13, at 94–95 ("Some Second Life entrepreneurs have taken virtual

elements that satisfy the *Howey* test could easily be incorporated into other video games, virtual reality experiences, and augmented reality experiences. This could potentially create unintended liability for developers, platform owners, and users of this virtual space.

The case law on the application of federal securities regulation to securities existing solely in virtual space is sparse. The United States Court of Appeals for the First Circuit is the sole federal circuit court that has addressed the issue. In *SEC v. SG Ltd.*,[145] the court held that securities purchased and sold in virtual transactions based upon virtual activity are governed by federal securities law.[146] In that case, the SEC brought a civil action against SG Ltd., a Dominican company, for operating an online investment game, called "StockGeneration," which offered players the ability to purchase shares in eleven different "virtual companies" that were listed on a "virtual stock exchange."[147] The SEC was concerned about representations regarding a virtual enterprise, known as the "privileged company," that SG promised would increase in value based on the inflow of capital from new participants, which would create liquidity for players' shares.[148] SG claimed it had various measures in place to keep the price of the shares of the privileged company from declining rapidly in the event that the share prices did begin to decline.[149] At least 800

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consumption so far as to build stock exchanges, which often imitate many of the characteristics of a real world stock exchange.").

145. 265 F.3d 42 (1st Cir. 2001).

146. *See id.* at 55 ("[W]e hold that the SEC has alleged a set of facts which, if proven, satisfy the three-part *Howey* test and . . . constituted an invitation to enter into an investment contract within the jurisdictional reach of the federal securities laws.").

147. *See id.* at 44 ("The underlying litigation was spawned by SG's operation of a 'StockGeneration' website offering on-line denizens an opportunity to purchase shares in eleven different 'virtual companies' listed on the website's 'virtual stock exchange.'").

148. *See id.* ("According to SG's representations, capital inflow from new participants provided 'liquidity' for existing participants who might choose to sell their virtual shareholdings.").

149. *See id.* at 44–45 ("While SG conceded that a decline in the share price was theoretically possible, it assured prospective participants that 'under the rules governing the fall in prices, [the share price for the privileged company] cannot fall by more than 5% in a round.'").

United States residents purchased shares of the virtual companies using real money, and investments in the StockGeneration game totaled millions of real dollars.[150] The value of the shares of all of the virtual companies listed on the virtual stock exchange in StockGeneration eventually plummeted, including the shares of the privileged company.[151] The SEC brought a civil action for injunctive relief and disgorgement under Section 5 of the Securities Act for the offer, sale, and delivery of unregistered securities; Section 17(a) of the Securities Act for fraud in the offer and sale of securities; and Section 10(b) of the Exchange Act and Rule 10b-5, promulgated thereupon, for fraud in connection with the purchase and sale of securities.[152] The United States District Court for the District of Massachusetts granted SG's motion to dismiss for failure to state a claim on the ground that the virtual shares were not securities because StockGeneration was a game that lacked a business context.[153]

The First Circuit reversed and held that federal securities law can apply to virtual securities purchased and sold in virtual transactions based upon virtual activity, even within the context of a video game.[154] The First Circuit determined that the *Howey* test was the most appropriate to determine whether federal securities law applies within virtual space.[155] Writing for the three

150. *See id.* at 45 ("At least 800 United States domiciliaries, paying real cash, purchased virtual shares in the virtual companies listed on the defendants' virtual stock exchange.").

151. *See id.* (discussing the eventual dramatic decline of the value of the virtual securities within the StockGeneration game).

152. *See id.* ("The SEC's complaint alleged, in substance, that SG's operations constituted a fraudulent scheme in violation of the registration and antifraud provisions of the federal securities laws.").

153. *See id.* at 46 ("The SEC's success was short-lived; after some skirmishing, not relevant here, the district court granted SG's motion to dismiss the complaint for failure to state a cognizable claim on the ground that the virtual shares were a clearly marked and defined game lacking a business context.").

154. *See id.* at 48 ("[T]he language on SG's website emphasizing the game-like nature of buying and selling virtual shares of the privileged company does not place such transactions beyond the long reach of the federal securities laws.").

155. *See id.* ("To sum up, *Howey* supplies the appropriate template for identifying investment contracts within the overarching ambit of the federal securities laws. Contrary to the district court's conclusion, this template admits of no exception for games or gaming.").

judge panel, Chief Judge Michael Boudin stated, "*Howey* supplies the appropriate template for identifying investment contracts within the overarching ambit of the federal securities laws. Contrary to the district court's conclusion, this template admits of no exception for games or gaming."[156] He continued: "[T]he language on SG's website emphasizing the game-like nature of buying and selling virtual shares of the privileged company does not place such transactions beyond the long reach of the federal securities laws."[157] Thus, the First Circuit held that because all of the elements of the *Howey* test could potentially have been proven, the case was improperly dismissed. As a result, the First Circuit reversed the district court, which allowed the matter to proceed.[158]

If securities existing entirely within virtual space are securities under federal regulation, that entire body of law would apply, including both the registration and anti-fraud provisions discussed above.[159] The simplest and probably most effective means of preventing securities existing entirely in virtual space from being covered by federal securities law is to eliminate any sort of monetary investment within the game. Under the *Howey* test, the investment of money is an essential element of an "investment contract."[160] Because virtual space can be an extension of the real world, however, software developers may wish to allow real world currency to be exchanged for virtual currency.[161] In those circumstances, software developers must be especially wary of creating investment contracts and subjecting themselves, platform owners, and users to federal securities law.

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156. *Id.*

157. *Id.*

158. *See id.* at 55 ("Accordingly, we reverse the order of dismissal and remand the case for further proceedings consistent with this opinion.").

159. *See supra* Part III (providing a brief introduction to the registration requirements and antifraud provisions under federal securities law).

160. *See* SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946) (providing that the test for an investment contract is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others").

161. *See supra* Part II.A (offering a brief primer on video games, virtual worlds, virtual reality, and augmented reality).

Any attempt to limit the application of federal securities law to virtual space through end-user license agreements or any other sort of agreement will prove ineffective. Section 14 of the Securities Act provides: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void."[162] Moreover, Section 29(a) of the Exchange Act provides: "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of a self-regulatory organization, shall be void."[163] As a result, the application of the federal securities law cannot be waived or contracted around.[164]

In addition, despite having a major impact on how securities offerings and transactions can occur online, the provisions of the JOBS Act are likely to be relatively useless to software developers, platform owners, and users in shielding them from the application of federal securities law because of how onerous it would be to comply with the mandates of the JOBS Act.[165] The JOBS Act amended various portions of the Securities Act to allow for expanded offerings, purchases, and sales via the Internet and mandated that the SEC adopt various rules and regulations regarding the online purchase and sale of securities.[166]

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162. 15 U.S.C. § 77n (2012).

163. *Id.* § 78cc(a).

164. *Id.* §§ 77n, 78cc(a).

165. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified as amended in scattered sections of 15 U.S.C.).

166. *Id.*; *see* Nicholas Herdrich, *Just Say No to Crowdfunding*, 6 U. PUERTO RICO BUS. L.J. 157, 158 (2015)

> In an effort to address this problem and fuel economic growth in the United States with increased access to capital, the federal government passed the Jumpstart Our Business Startups Act . . . in 2012, which gave early-stage businesses the ability to participate in crowdfunding and raise capital by selling securities over the Internet.

Sean M. O'Connor, *Crowdfunding's Impact on Start-Up IP Strategy*, 21 GEO. MASON L. REV. 895, 895 (2014) ("JOBS Act provides a mechanism for ordinary investors and start-ups to use 'enterprise crowdfunding,' in which the start-ups can offer and sell their stock widely through the Internet."); Henry H. Perritt, Jr., *Uber TV: Internet Only TV Stations*, 23 UCLA ENT. L. REV. 65, 89 (2016) ("The Congress, in the JOBS Act . . . now permit small enterprises to raise investment

Specifically, Title III of the JOBS Act—known as the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012 (CROWDFUND Act)—added Section 4(a)(6) to the Securities Act, which creates an exemption from registration for certain limited online offerings facilitated by brokers or a new type of entity called a "funding portals."[167] In addition, the CROWDFUND Act created Section 4A of the Securities Act, which places substantial requirements upon the intermediaries—i.e., brokers and funding portals—facilitating transactions and issuers undertaking transactions under the Section 4(a)(6) exemption.[168] Section 4A also places substantial restrictions on the resale of securities purchased under the Section 4(a)(6) exemption.[169] Based on the congressional mandate found in the JOBS Act, the SEC has promulgated Regulation Crowdfunding (Regulation CF), which places even more requirements to comply with the crowdfunding exemption.[170]

Also, the JOBS Act altered two existing exemptions in ways that might have an impact upon the lawfulness of securities transactions within virtual space. Section 201(a)(1) of the JOBS Act required the SEC to amend Rule 506.[171] The amendment allows for general solicitation and advertising of securities

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capital through Internet-based crowdsourcing.").

167. 15 U.S.C. § 77d(a)(6) (2012).

168. *Id.* § 77d-1(b) (2012) (providing a lengthy list of requirements for issuers offering or selling securities under the section 4(a)(6) exemption); *Id.* § 77d-1(a) (2017) (providing a lengthy list of requirements for intermediaries involved in the offer or sale of securities under the section 4(a)(6) exemption).

169. *Id.* § 77d-1(e). Section 4A provides that securities sold under the Section 4(a)(6) exemption can only be transferred within one year of the purchase, if they are transferred "(A) to the issuer of the securities; (B) to an accredited investor; (C) as part of an offering registered with the Commission; or (D) to a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance, in the discretion of the Commission." *Id.* § 77d-1(e)(1). These limitations on resale can be supplemented because transfer of securities under Section 4(a)(6) "shall [also] be subject to such other limitations as the Commission shall, by rule, establish." *Id.* § 77d-1(e)(2).

170. *See* 17 C.F.R. § 227 (2017) (adding various financial qualifications to invoke the exemption).

171. *See* Jumpstart Our Business Startups Act, Pub. L. No. 112–106, 126 Stat. 306, 313 (2012) ("[T]he Securities and Exchange Commission shall revise its rules issued in section 230.506 of title 17, Code of Federal Regulations . . . .").

otherwise covered by the Rule's exemption, as long as the purchasers of the of the securities are accredited investors within the definition found within Rule 501.[172] For individuals, Rule 501 limits "accredited investor" status to people with a high net worth, with a substantial income, or with certain types of governance statuses within the issuer, including directors, executive officers, and general partners.[173] Substantial restrictions are also placed on the resale of securities purchased under the Rule 506 exemption.[174]

Finally, Section 401 of the JOBS Act amended the Securities Act and required the SEC to amend Regulation A to what has become known as Regulation A+.[175] Regulation A+ allows issuers

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172. *Id.*; *see also* Harvey Bines & Steve Thel, *The Varieties of Investment Management Law*, 21 FORDHAM J. CORP. & FIN. L. 71, 161 (2016) ("In July 2013, the SEC amended Rule 506 . . . . General solicitation is [now] not prohibited in a Rule 506 offering so long as all purchasers are accredited investors and the issuer takes reasonable steps to assure that all purchasers are accredited investors."); Wulf Kaal, *The Post Dodd-Frank-Act Evolution of the Private Fund Industry: Comparative Evidence from 2012 and 2015*, 71 BUS. LAW. 1151, 1166 n.100 (2016) ("Section 201 of the JOBS Act directed the SEC to lift the prohibition against general solicitation and general advertising, allowing a broadening of marketing efforts provided that all purchasers of the securities are accredited investors."); Neal Newman, *Let Sleeping Regs Lie: A Diatribe on Regulation A's Futility Before and After the J.O.B.S. Act*, 18 U. PA. J. BUS. L. 65, 84 (2015) ("Title II of the J.O.B.S. Act changed the solicitation rules. Now, under added Regulation D Rule 506(c), issuers can solicit and advertise for investors with the caveat that actual investors must be accredited.").

173. *See* 17 C.F.R. § 230.501(a) (2017) (providing the definition of an "accredited investor" as used within Rule 506).

174. *See id.* § 230.502(d) (providing the limitations on resale of securities sold under the exemption found within Rule 506).

175. Jumpstart Our Business Startups Act, Pub. L. No. 112–106, § 401, 126 Stat. 306, 323–25 (2012) (codified as amended at 15 U.S.C. § 77c(b) (2012)); s*ee also* Rutheford B. Campbell, Jr., *The SEC's Regulation A+: Small Business Goes Under the Bus Again*, 104 KY. L.J. 325, 325–26 (2016) ("Title IV of the JOBS Act, which is entitled 'Small Company Capital Formation,' requires the Securities and Exchange Commission to adopt new rules regarding offerings under Regulation A . . . . The new regime is generally referred to as Regulation A+."); Michael K. Molitor, *Business Associations*, 60 WAYNE L. REV. 837, 840 n.21 (2015) ("Title IV of the JOBS Act amended section 3(b) of the Securities Act to direct the SEC to adopt an exemption allowing public offerings of up to $50 million (subject to periodic increases to be determined by the SEC) of equity or debt securities in a 12-month period."); John S. Wroldsen, *The Crowdfund Act's Strange Bedfellows: Democracy and Start-Up Company Investing*, 62 U. KAN. L. REV. 357, 372 n.81 (2013) ("[T]he JOBS Act directs the SEC to create a new regulation for offerings up to $50 million—informally known as Regulation A+ because Regulation A

to engage in certain limited offerings with more limited disclosure requirements than what would otherwise be required by registering the securities.[176] Under the exemption, an issuer who raises up to $20 million in any twelve-month period must provide investors with an offering circular, and an issuer who raises between $20 million and $50 million in any twelve-month period must provide investors with an offering circular and make certain periodic disclosures to the SEC.[177] Notably, those entities employing Regulation A+ can engage in general solicitation and advertising.[178] Additionally, securities sold under Regulation A+ are not restricted and can be immediately resold.[179]

Notwithstanding the expanded exemptions from registration created by the JOBS Act, the Act offers little relief for software developers, platform owners, and users involved in securities transactions based upon virtual activity in virtual space. First, through the JOBS Act, Congress enacted an exemption from registration only for certain sorts of online securities transactions, not a general exemption from federal securities regulation for securities existing entirely in virtual space.[180] Even if these

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offerings are capped at $5 million—and grants the SEC discretion to require issuers that rely on Regulation A+ to file periodic disclosures.").

176. *See* Merritt B. Fox, *Regulating Public Offerings of Truly New Securities: First Principles*, 66 DUKE L.J. 673, 723 (2016) ("Regulation A+ in many ways resembles the traditional registration process but is simpler and less burdensome on issuers."); Christina Parajon Skinner, *Whistleblowers and Financial Innovation*, 94 N.C. L. REV. 861, 877 (2016) ("Now, pursuant to Regulation A+, small companies can offer and sell up to $50 million (an increase from the previous $5 million limit) in equity securities without the need to comply with traditional registration and reporting requirements.").

177. 17 C.F.R. § 230.251 (2017).

178. *See* Dale A. Oesterle, *Intermediaries in Internet Offerings: The Future is Here*, 50 WAKE FOREST L. REV. 533, 544 (2015) ("Regulation A, in essence a form of public offering with lighter registration and offering rules (often described as a 'mini-public offering'), has always had the advantage . . . of allowing general solicitation and advertising . . . .").

179. *See id.* (noting that one of the advantages of the Regulation A+ exemption is "avoiding resale restrictions on the securities issued in the offering").

180. *See* Carlos Berdejó, *Going Public After the JOBS Act*, 76 OHIO ST. L.J. 1, 26 n.137 (2015) ("It is worth noting that while the JOBS Act eases the limitation on offers imposed by the Securities Act, it does not exempt such offers from potential anti-fraud liability under Rule 10b-5 of the Exchange Act or Section 12(a)(2) of the Securities Act.").

securities could be shoehorned into the exemptions created by the JOBS Act, software developers, platform owners, and users would still be subject to the other provisions of federal securities law, including the anti-fraud provisions.[181]

Second, the exemption created by the CROWDFUND Act is so onerous to comply with that no software developer, platform owner, or user is likely going to take the time and expense to comply with it, especially considering the required disclosures and prohibitions on resale.[182] Similarly, even with the modifications to Rule 506 and Regulation A, complying with those exemptions is likely to be beyond the abilities and interest of those who might be contemplating dealing with securities existing entirely within virtual space.[183] Although this might be somewhat palatable because it could limit fraud in virtual space by dissuading developers from creating anything that appears to be similar to a security, limiting the development and growth of these virtual spaces is likely undesirable because it would hinder these virtual realms from evolving and growing.

Third, the JOBS Act is unlikely to be very helpful to software developers, platform owners, and users because they are unlikely to be well versed in securities regulation. Although larger game developers are likely to have legal counsel, many software developers, platform owners, and users will not. Even if securities

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181. *See* Harry S. Gerla, *Issuers Raising Capital From Investors*, 28 J. CORP. L. 111, 112 (2002) ("Even though an offering of securities is exempt from registration, it is not exempt from the antifraud provisions of the federal securities laws, principally Rule 10b-5 under section 10(b) of the Securities Exchange Act of 1934."); Elizabeth Pollman, *Information Issues on Wall Street 2.0*, 161 U. PA. L. REV. 179, 214 n.200 (2012) ("Compliance with a registration exemption does not preclude liability under anti-fraud provisions of the securities laws, such as Rule 10b-5 governing omissions or misstatements."); Marc I. Steinberg & Emmanuel U. Obi, *Examining the Pipeline: A Contemporary Assessment of Private Investments in Public Equity ('PIPEs')*, 11 U. PA. J. BUS. & EMP. L. 1, 12 (2008) ("[I]rrespective of the availability of an exemption from registration, the antifraud provisions of both federal and state securities laws apply.").

182. *See supra* notes 161–165 and accompanying text (discussing the exemption created by the CROWDFUND Act).

183. *See supra* notes 166–170 and accompanying text (discussing the modifications made by the JOBS Act to the exemptions under Rule 506 and Regulation A).

existing entirely in virtual space could be shoehorned into the exemptions created by the JOBS Act, considering how regularly individuals, including lawyers, blunder into trouble with securities law, most software developers, platform owners, or users will be unlikely to make use of these exemptions based upon either not knowing they exist or not understanding how to make use of them.[184]

As a result, in the absence of congressional action, the only way that securities existing entirely in virtual space are going to escape being subject to federal securities regulation is if the definition of a security found within the Securities Act and Exchange Act allows those securities to escape the purview of federal securities law. As explained above, the definition sections found in the Securities Act and Exchange Act both begin with the prefatory language "unless the context otherwise requires."[185] Thus, the question becomes whether the virtual context of these securities should be grounds for precluding the application of federal securities law.

V. The Arguments for Not Applying Federal Securities Regulation to Securities Existing Entirely Within Virtual Space

Even though the prefatory language of the definition sections of both the Securities Act and Exchange Act contain the phrase "unless the context otherwise requires," this phrase is not defined anywhere within those acts or by SEC rules and regulations.[186] As a result, the phrase's exact meaning has been left to judicial development. As discussed above, the Supreme Court of the United States examined this language in cases such as *Daniel* and *Marine Bank*.[187] The Court's unwillingness to find the existence of

184. *See supra* note 44 and accompanying text (reporting that even attorneys often have difficulty dealing with federal securities law because of its complexity).

185. 15 U.S.C. §§ 77b(a), 78c(a) (2012); *see also supra* notes 66–87 and accompanying text (discussing the significance of the "unless the context otherwise requires" language found within the definition of a security in the Securities Act and the Exchange Act).

186. 15 U.S.C. §§ 77b(a), 78c(a).

187. *See supra* notes 68–87 and accompanying text (discussing *Marine Bank* and *Daniel*).

securities in either of those opinions based upon the "unless the context otherwise requires" language turned largely on the existence of another comprehensive scheme of federal regulation.[188] But the Court has never opined whether the existence of another comprehensive scheme of federal regulation is the only context in which things that otherwise would be securities would be held not to be.

Thus, one starts with a relatively blank slate in determining whether the "unless the context otherwise requires" language excludes securities entirely within virtual space from coverage by federal securities law. Of course, as previously mentioned, a federal court of appeals opinion has addressed whether securities contained within virtual worlds should be considered securities under the federal securities law.[189] In *SEC v. SG Ltd.*, the First Circuit did not directly address the "unless the context otherwise requires" language. However, the court held irrelevant, for purposes of determining whether a security existed under federal securities law, the fact that the investments at issue existed in a game-like environment.[190] This supports the argument that the "unless the context otherwise requires" language is not grounds to exclude securities existing entirely within virtual space from the definition of a security and the coverage of the federal securities law. For the reasons discussed in the remainder of this Part, this Article takes the position that *SG Ltd.* was wrongly decided. Courts deciding this issue in the future should reach the opposite holding from that court regarding whether securities existing entirely within virtual space are covered by federal securities regulation.

In addressing whether the "unless the context otherwise requires" language applies to securities existing entirely within

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188. *See supra* notes 68–87 and accompanying text (discussing *Marine Bank* and *Daniel*).

189. *See* SEC v. SG Ltd., 265 F.3d 42, 55 (1st Cir. 2001) ("[T]he opportunity to invest in the shares of the privileged company, described on SG's website, constituted an invitation to enter into an investment contract within the jurisdictional reach of the federal securities laws.").

190. *See id.* at 48 ("[T]he language on SG's website emphasizing the game-like nature of buying and selling virtual shares of the privileged company does not place such transactions beyond the long reach of the federal securities laws.").

virtual space, the proper place to begin is with the language of the phrase itself. The central word of this phrase is the term "context." A basic definition of the term "context" is "the interrelated conditions in which something exists or occurs."[191] As a consequence, the "unless the context otherwise requires" language means that if the surrounding conditions of the thing that might be a security dictate that it not be covered by the federal securities law, then it should not be covered. The issue becomes whether securities existing entirely within virtual space exist in proper conditions to be considered securities. Based upon the intended scope of the federal securities law, various constitutional law principles, and the importance of allowing experimentation within virtual space, this Article argues that securities existing entirely in virtual space are not securities for purposes of federal securities law.

A. The Intended Scope of Federal Securities Law

Securities existing entirely within virtual space are outside the intended scope of federal securities regulation. Because the context language in the Securities Act and the Exchange Act provides insufficient guidance regarding its meaning, one should attempt to derive the intended coverage of that language by looking at the Acts themselves. Congress promulgated the Securities Act to regulate the primary markets for securities, with a focus on public offerings, registration requirements, exemptions of registration, and issues of fraud that might occur within those primary markets.[192] Congress promulgated the Exchange Act to

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191. *Context*, MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/context (last visited Sept. 21, 2017) (on file with the Washington and Lee Law Review).

192. *See* Cory Alpert, *Financial Services in the United States and United Kingdom*, 5 B.Y.U. INT'L L. & MGMT. REV. 75, 76 (2008) ("The Securities Act regulates the primary market—direct sales from issuers—and requires issuers to register every offer or sale of a security in the United States, except for certain exempted transactions."); Browning Jeffries, *The Implications of* Janus *on Issuer Liability in Jurisdictions Rejecting Collective Scienter*, 43 SETON HALL L. REV. 491, 498 (2013) ("[T]he Securities Act can be thought of as regulating the disclosures provided to investors in the initial distribution of securities—i.e., through the primary market . . . ."); Stephen Kim Park, *Targeted Social Transparency as Global Corporate Strategy*, 35 NW. J. INT'L L. & BUS. 87, 97 (2014)

regulate the secondary markets for securities, with a focus on prevention of fraud within the secondary markets, periodic disclosure for public companies, shareholder voting, and various other issues.[193] As previously discussed, these Acts have been found to be applicable to securities transactions involving cyberspace.[194] But the Acts appear to be focused on securities transactions that have a substantial link to the real world. To put it a bit differently, when the Internet is used as a means of communication, i.e, similar to a telephone, television, or radio, the Acts apply. However, applying the Acts to securities solely within virtual space is beyond the regulatory scheme of federal securities law, which focuses on the regulation of investments in real world businesses.

Even if the language and structure of the provisions of the Securities Act and Exchange Act do not provide clear guidance as to the intended scope of the Securities Act and Exchange Act, the legislative history of those Acts provides additional support that these bodies of law were not intended to cover securities existing entirely within virtual space. In attempting to determine the meaning of the "unless the context otherwise requires"[195] language

("The Securities Act governs the disclosure requirements related to the issuance of securities in primary markets, primarily by requiring firms that wish to sell securities in the U.S. market to register with the SEC through the submission of a publicly available registration statement.").

193. *See* Susan B. Heyman, *Rethinking Regulation Fair Disclosure and Corporate Free Speech*, 36 CARDOZO L. REV. 1099, 1111 (2015) ("The Exchange Act was enacted after the 1929 stock market crash to restore confidence in the nation's securities market by governing securities transactions on secondary markets."); Kristin Johnson, Steven A. Ramirez & Cary Martin Shelby, *Diversifying to Mitigate Risk: Can Dodd–Frank Section 342 Help Stabilize the Financial Sector?*, 73 WASH. & LEE L. REV. 1795, 1824 (2016) ("[T]he Exchange Act regulates the disclosure of information related to securities traded on the secondary markets. Broadly prohibiting fraud in connection with the sale of securities is . . . an integral component of this legislation."); Tom C.W. Lin, *A Behavioral Framework for Securities Risk*, 34 SEATTLE U. L. REV. 325, 329 (2011) ("The Exchange Act . . . governs the subsequent trading of those securities in secondary markets. Like the Securities Act, the Exchange Act attempts to ensure that investors in those secondary markets receive accurate and meaningful information about the offered securities and their issuing firms.").

194. *See supra* Part IV (discussing the application of federal securities regulation to cyberspace).

195. 15 U.S.C. §§ 77b(a), 78c(a) (2012).

found in the definition sections of the Securities Act and Exchange Act, one should attempt to understand the intent of Congress when it promulgated these bodies of law. The Securities Act and Exchange Act were passed in the shadow of the stock market crash of 1929 and during the ensuing Great Depression, which suggests that the drafters of these Acts were concerned about real world securities markets, rather than what might be going on within any sort of fantasy play.[196]

The drafters of the Exchange Act explicitly included the "Necessity for Regulation" in Section 2 of the Act.[197] Section 2, in part, provides:

> [T]ransactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, to remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions and the safeguarding of securities and funds related thereto, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the

196. *See* Shlomit Azgad-Tromer, *Corporations and the 99%: Team Production Revisited*, 21 FORDHAM J. CORP. & FIN. L. 163, 203 (2016) ("The federal securities laws enacted in the 1930s were a response to the 1929 stock market crash and the Great Depression."); Eric C. Chaffee, *Standing Under Section 10(b) and Rule 10b-5: The Continued Validity of the Forced Seller Exception to the Purchaser-Seller Requirement*, 11 U. PA. J. BUS. L. 843, 851 (2009) ("Federal securities regulation began in the United States when Congress passed the Securities Act of 1933 . . . and Securities Exchange Act of 1934 . . . . Congress enacted these statutes in response to the stock market crash of 1929 and the Great Depression."); Jill Gross, *The Historical Basis of Securities Arbitration as an Investor Protection Mechanism*, 2016 J. DISP. RESOL. 171, 180 ("After the stock market crash of 1929 led to the Great Depression, a concerned Congress enacted the federal securities laws to restore investor confidence in and facilitate the healthy functioning of capital markets.").

197. 15 U.S.C. § 78b (2012).

> national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets . . . .[198]

The drafters of Section 2 also noted that that Congress was especially concerned by:

> National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets, and to meet such emergencies the Federal Government is put to such great expense as to burden the national credit.[199]

As evidenced by Section 2, Congress was interested in preventing another stock market crash similar to the stock market crash that occurred in 1929, when it enacted the Exchange Act.[200] In short, Congress wanted to protect the securities markets that impact the national economy.[201] While a similar provision does not exist within the Securities Act of 1933, one can extrapolate that Congress was similarly motivated in promulgating that Act.

In addition, Supreme Court precedent, at least implicitly, supports that securities existing entirely within virtual space reside in a context separate and apart from the intended context of federal securities law. As the Supreme Court held in *SEC v. Capital Gains Research Bureau, Inc.*,[202] the "fundamental purpose" underlying both the Securities Act and the Exchange Act is to "substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry."[203] The focus of this often-quoted language is on "business," rather than fantasy play within virtual space.

Based upon the regulatory scheme of the Securities Act and Exchange Act, the provisions within those bodies of law, the

198. *Id.*

199. *Id.*

200. *See supra* notes 197–199 and accompanying text (stating the rationale provided by Congress in Section 2 of the Exchange Act).

201. *Id.*

202. 375 U.S. 180 (1963).

203. *Id.* at 186.

historical context in which those Acts were promulgated, and the intent of Congress in promulgating the federal securities law, it is difficult to believe that Congress had any intention to extend federal securities regulation into the fantasy play of virtual space. Although the Securities Act and Exchange Act extend broadly, especially based on the expansive definition of an "investment contract," extending their reach to cover the fantasy play within virtual space is not appropriate.[204] Although some legal relief obviously should be granted if real world money or other real world value is stolen in these virtual securities transactions, federal securities law is not the correct body of law to employ when securities existing entirely in virtual space are involved.

B. Constitutional Law and the Limits of Federal Securities Regulation

As the previous subpart demonstrates, a divide exists between the contexts of the real-world business transactions that the Securities Act and Exchange Act were intended to regulate and the fantasy play in securities found within virtual space. Even though securities existing entirely within virtual space may meet the test for an investment contract under the definition of a security, the virtual context makes the existence of a security for purposes of the Securities Act and Exchange Act a much closer call.[205] In addition to the intended scope of federal securities law, constitutional law also requires that securities existing entirely within virtual space should not be covered by federal securities law because of federalism, rule of lenity, and separation of powers concerns.

The United States Constitution created a limited federal government.[206] The Tenth Amendment makes clear that "[t]he

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204. *See supra* notes 45–52 and accompanying text (discussing the broad definition of a security under the Securities Act and the Exchange Act).

205. *See supra* Part IV.D (discussing the reasons why securities in virtual space may satisfy the definition of an investment contract under the Securities Act and the Exchange Act).

206. *See* Kevin M. Clermont, *The Repressible Myth of* Shady Grove, 86 NOTRE DAME L. REV. 987, 995–96 (2011)

powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."[207] Congress clearly has the power to regulate the vast majority of virtual space because the Constitution affords Congress the power to regulate interstate commerce,[208] and the Internet is a channel and instrumentality of interstate commerce.[209] However, when doubt exists as to whether Congress has exercised its power, the executive branch should err in enforcing the law and the judicial branch should err in interpreting the law in ways that reserve regulatory power to the states.

Because substantial reasons exist to question whether securities existing entirely in virtual space are covered by federal securities law, the definition of a security under the Securities Act and the Exchange Act should be interpreted to exclude these securities from coverage to preserve power to the states as guaranteed by the Constitution and the Tenth Amendment. Other

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> Congress can use only reasonable means to effectuate its granted powers, and cannot unreasonably affect those primary decisions concerning human conduct that the Constitution did not subject to federal legislation and so reserved to the states. It is implicit in the very structure of the Constitution establishing a limited federal government.

Christo Lassiter, *The New Race Cases and the Politics of Public Policy*, 12 J.L. & POL. 411, 445 (1996) ("The drafters framed a constitution which positioned a limited federal government to address . . . public problems of a new republic, and, being fearful of tyranny, they restrained the federal government from doing more.").

207. U.S. CONST. amend. X.

208. *See id.* art. I, § 8, cl. 3 (granting Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes").

209. *See* Michele Martinez Campbell, *The Kids Are Online: The Internet, the Commerce Clause, and the Amended Federal Kidnapping Act*, 14 U. PA. J. CONST. L. 215, 243 (2011) ("There can be no dispute that the Internet is a facility or instrumentality of interstate commerce as that term is used in the Court's modern Commerce Clause jurisprudence."); Lauren Eisenberg et al., *Computer Crimes*, 50 AM. CRIM. L. REV. 681, 793 (2013) ("As the Internet is both a channel and instrumentality of interstate commerce, it falls under the Commerce Clause's broad power."); Peter J. Karol, *The Constitutional Limitation on Trademark Propertization*, 17 U. PA. J. CONST. L. 1065, 1076 (2015) ("Congress can regulate the channels of interstate commerce, such as the nation's highways, waterways, airways, and Internet.").

provisions of the federal law may cover these securities. For example, in the absence of the application of the federal securities law to virtual securities, the federal wire fraud statute may apply to fraudulent behavior relating to securities existing entirely in virtual space.[210] But, expanding the federal securities law beyond its intended metes and bounds to cover securities in virtual space is not appropriate.

In addition, expanding the scope of federal securities law when questions exist as to whether it was intended to apply to securities existing entirely within virtual space is especially inappropriate because violations of this law can be prosecuted criminally,[211] and as a result, the rule of lenity should be applied.[212] The rule of lenity provides that in interpreting an ambiguous criminal statute, the court should construe any ambiguity in favor of the defendant.[213]

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210. *See* 18 U.S.C. § 1343 (2012)

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined . . . or imprisoned not more than 20 years, or both.

211. *See* 15 U.S.C. § 77x (providing criminal penalties for violating the Securities Act); *id.* § 78ff (providing criminal penalties for violating the provisions of the Exchange Act).

212. *See* Patricia J. Falk, *A Curious Omission from Ohio's Rape Statute: Sexual Assault When the Victim Consents to Medical or Dental Drugging*, 82 U. CIN. L. REV. 1123, 1137 (2014) ("The rule of lenity provides that if a criminal statute is ambiguous, then that ambiguity must be resolved on the side of the criminal defendant."); Elliot Greenfield, *A Lenity Exception to* Chevron *Deference*, 58 BAYLOR L. REV. 1, 10 (2006) ("The rule of lenity complements the vagueness doctrine by providing that when a criminal statute is ambiguous, rather than vague, courts should resolve the ambiguity in the favor of the narrower scope of criminal liability."); Benjamin B. Nelson, *Regulation or Prohibition? The Troubled Legal Status of Internet Gambling Casinos in the United States in the Wake of the Unlawful Internet Gambling Enforcement Act of 2006*, 9 TEX. REV. ENT. & SPORTS L. 39, 47 (2007) ("The 'rule of lenity' complements the vagueness doctrine by providing that when a criminal statute is ambiguous, courts should resolve the ambiguity in favor of the narrower scope of criminal liability.").

213. *See* Patricia L. Bellia, *A Code-Based Approach to Unauthorized Access Under the Computer Fraud and Abuse Act*, 84 GEO. WASH. L. REV. 1442, 1472 (2016) ("[T]he rule of lenity instructs a court facing an ambiguous statute to choose the construction that favors the defendant."); Phillip M. Spector, *The*

The history of the rule of lenity extends back to English common law, as a means of preserving the rights of criminal defendants.[214] The rule of lenity also has roots in the United States Constitution within the Due Process Clause, which requires that individuals have clear notice of the criminal offenses of which they might be prosecuted.[215]

Because uncertainty exists as to whether securities existing entirely within virtual space are covered by federal securities law, the rule of lenity dictates that coverage not be extended to these securities. When the Internet is being used strictly as a tool for communication, similar to a telephone or radio, the drafters of the federal securities law intended that body of law to apply. When

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Sentencing Rule of Lenity, 33 U. TOL. L. REV. 511, 511–12 (2002)

> The rule of lenity counsels that criminal laws should be narrowly interpreted in favor of criminal defendants. Identified as one of the oldest and most 'venerable' canons of statutory interpretation, the rule of lenity is employed by federal courts reluctant to participate in the expansion of an already overzealous federal criminal regime.

Glen Staszewski, *Constitutional Dialogue in a Republic of Statutes*, 2010 MICH. ST. L. REV. 837, 857 ("The rule of lenity provides that ambiguous criminal statutes should be interpreted narrowly in favor of the accused based on constitutional principles of fair notice and a desire to limit the scope of discretionary authority that is delegated to prosecutors and judges.").

214. *See* Amy Coney Barrett, *Substantive Canons and Faithful Agency*, 90 B.U. L. REV. 109, 128–29 (2010) ("The maxim that penal statutes should be narrowly construed is one of the oldest canons of interpretation . . . . Schooled in the English tradition, American judges applied the principle of lenity from the start."); Patricia J. Chapman, *Has the* Chevron *Doctrine Run Out of Gas? Senza Ripieni Use of* Chevron *Deference or the Rule of Lenity*, 19 MISS. C. L. REV. 115, 141 (1998) ("[T]he rule of lenity developed in the seventeenth and eighteenth centuries as the result of severe English Parliament legislative mandates . . . ."); Zachary Price, *The Rule of Lenity as a Rule of Structure*, 72 FORDHAM L. REV. 885, 897 (2004) ("The rule of lenity has its oldest origins in the efforts of common law courts in the seventeenth and eighteenth centuries to limit the brutality of English criminal law.").

215. *See* William Eskridge, *Public Values in Statutory Interpretation*, 137 U. PA. L. REV. 1007, 1029 (1989) ("The rule of lenity rests upon the due process value that government should not punish people who have no reasonable notice that their activities are criminally culpable . . . ."); Cass R. Sunstein, *Nondelegation Canons*, 67 U. CHI. L. REV. 315, 332 (2000) ("The rule of lenity is inspired by the due process constraint on conviction pursuant to open-ended or vague statutes."); Anne R. Traum, *Constitutionalizing Immigration Law on Its Own Path*, 33 CARDOZO L. REV. 491, 525 (2011) ("The rule of lenity sounds in a due process-based concern about clear notice about the scope of a criminal statute.").

virtual spaces are created, however, that is a different context than the drafters of the federal securities law intended.[216] Extending the application of federal securities law to that context creates both rule of lenity and due process concerns, and as a result, such extension is not permissible.

Extending the application of federal securities law to securities existing entirely within virtual space also creates separation of powers concerns. Under the United States Constitution, the legislative branch enacts the law;[217] the executive branch enforces the law;[218] and the judicial branch interprets the law.[219] Although the creation of the administrative state has created some blurring among these branches and their respective functions, this separation of power remains the law of the United States.[220] Historically, the Supreme Court of the United States has shown some willingness to encroach upon the role of the legislature in regard to securities regulation, as evidenced most prominently by the creation of an implied private right of action under Section 10(b) and Rule 10b-5, when Congress did not provide for the existence of such a right.[221] The current Supreme Court,

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216. *See* Part V.A (discussing the intended scope of the federal securities law).

217. *See* U.S. CONST. art. I (defining the scope of the legislative branch of the United States federal government).

218. *See id.* art. II (defining the scope of the executive branch of the United States federal government).

219. *See id.* art. III (defining the scope of the judicial branch of the United States federal government).

220. *See* Jessica Bulman-Pozen, *From Sovereignty and Process to Administration and Politics: The Afterlife of American Federalism*, 123 YALE L.J. 1920, 1938 (2014) ("The rise of the administrative state has long fueled concerns about the aggrandizement of executive power and the attendant demise of the separation of powers and checks and balances within the federal government."); John C. Roberts, *The Struggle Over Executive Appointments*, 2014 UTAH L. REV. 725, 751 ("[The Supreme Court] has approved the transfer to executive offices and independent agencies of the power to create binding legislative rules and to adjudicate cases involving private parties. Without this modification of the traditional three branch governmental structure, the administrative state as we know it would be impossible."); Ilan Wurman, *Constitutional Administration*, 69 STAN. L. REV. 359, 377 (2017) ("[T]he administrative state exercises a combination of all three powers of government—legislative, executive, and . . . judicial.").

221. *See* Eric C. Chaffee, *An Oak Is an Oak Is an Oak Is an Oak: The Disappointing Entrenchment in* Halliburton Co. v. Erica P. John Fund *of the Implied Private Right of Action Under Section 10(b) and Rule 10b-5*, 9 N.Y.U. J.

i.e., the Roberts Court, however, has been conservative in interpreting the scope of the federal securities law. The Roberts Court has been unwilling either to expand or contract the scope of federal securities law beyond the metes and bounds established by Congress and the Court's previous case law.[222]

Because substantial reason exists to doubt that Congress intended the federal securities law to apply to securities in virtual worlds and the virtual elements of augmented reality games, courts should respect the separation of powers established by the United States Constitution and leave that issue to Congress, rather than extending federal securities regulation into a context that it was not intended to cover. Interpreting the term "security" in the Securities Act and Exchange Act to cover securities existing entirely within virtual space will create an unauthorized expansion of federal law, which is not appropriate.

C. Avoiding the Hindering of Creativity

The intended scope of federal securities regulation and various constitutional law principles suggest that securities existing entirely within virtual space should be excluded from the definition of a security for purposes of application of federal securities law. However, other policy reasons exist for reaching the

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L. & LIBERTY 92, 94 (2015) ("[T]he continued existence and modification of the implied private right of action under section 10(b) and Rule 10b-5 is an affront to Article I, section 7 of the Constitution, which gives Congress the power to pass laws, not courts."); Michael J. Kaufman, *Mending the Weathered Jurisdictional Fences in the Supreme Court's Securities Fraud Decisions*, 49 SMU L. REV. 159, 221 (1996) ("Viewed as a whole, the Supreme Court's securities fraud cases actually have flaunted the will of Congress. The Court initially permitted an expansion of its jurisdiction to entertain judicially-created private remedies where Congress had refused to do so.").

222. *See generally* Eric C. Chaffee, *The Supreme Court as Museum Curator: Securities Regulation and the Roberts Court*, 67 CASE W. RES. L. REV. 847 (2017) (analogizing the Roberts Court to a museum curator in the area of federal securities regulation because of the Court's unwillingness to expand or contract the scope of federal securities law beyond the scope of existing legislation and Supreme Court precedent). *See* A.C. Pritchard, *Securities Law in the Roberts Court: Agenda or Indifference?*, 37 J. CORP. L. 105, 107 (2011) ("The majority of the decisions of Roberts Court [relating to securities regulation] . . . if anything show a bias toward the status quo.").

same conclusion. These reasons are all rooted in the notion that subjecting these securities to federal securities regulation will hinder creativity in various unpalatable ways, such as by impeding the growth and evolution of virtual space, preventing regulatory experimentation, and interfering with the positive aspects of play.

Subjecting virtual space to federal securities regulation will prevent the growth and evolution of these environments. One of the most exciting things about video games, virtual worlds, virtual reality, and augmented reality is that they allow software developers the opportunity to reimagine existence and allow users to explore new domains and engage in new social interactions.[223] Subjecting these media to federal securities law means that these environments become constrained by a complex and at times onerous body of regulation.[224] Of course, one option for preventing this is severing the connection between virtual space and real world money. However, this solution limits creativity and the

223. *See* Miriam A. Cherry, *The Global Dimensions of Virtual Work*, 54 ST. LOUIS U. L.J. 471, 487 (2010) ("[O]ne of the most exciting elements of virtual worlds is the new technology allowing people to interact with each other even when separated by great distance. Expertise will no longer be bounded by geographical constraints, which will encourage cross-border collaborations and engagements to flourish."); Albert C. Lin, *Virtual Consumption: A Second Life for Earth?*, 2008 BYU L. REV. 47, 111 ("[V]irtual worlds offer far more excitement, with increasingly powerful graphic capabilities, than the video games of yesteryear."); Ryan Vacca, *Viewing Virtual Property Ownership Through the Lens of Innovation*, 76 TENN. L. REV. 33, 64 (2008) ("Considering the relatively new and exciting development of virtual worlds that is upon us, the creative developments occurring each day within the worlds, and the new sources of entertainment and cultural growth available from them, we should seize the opportunity to maximize this creativity and innovation.").

224. *See* Donald C. Langevoort, *United States Securities Regulation and Global Competition*, 3 VA. L. & BUS. REV. 191, 192 (2008) ("Various well-publicized, bipartisan blue-ribbon committee reports have criticized U.S. securities regulation for being unduly cumbersome, and, in part, blamed overregulation for a loss of competitiveness in the global capital marketplace."); Pritchard, *supra* note 217, at 106 ("To outsiders, securities law is not all that interesting. The body of the law consists of an interconnecting web of statutes and regulations that fit together in ways that are decidedly counter-intuitive. Securities law rivals tax law in its reputation for complexity and dreariness."); Anne Tucker, *Flawed Assumptions: A Corporate Law Analysis of Free Speech and Corporate Personhood in* Citizens United, 61 CASE W. RES. L. REV. 497, 544 (2010) ("Securities regulations can be onerous, requiring registration before a corporation can take a certain action, such as offering for sale a new class or series of securities (stock) in the company.").

potential evolution of virtual space in ways that may be interesting and in some instances socially beneficial.

Applying federal securities law to virtual space prevents regulatory experimentation. A number of commentators have noted the benefits of regulatory experimentation and diversity in regard to securities regulation.[225] The problem is that patchwork regulation does not work in regard to regulating markets as evidenced by the failure of state securities law to prevent the stock market crash of 1929 prior to the enactment of a system of federal securities regulation.[226] The patchwork of state blue sky laws needed to be replaced by a system of federal securities regulation to restore investor confidence and create strong and relatively stable securities markets.[227] Securities markets are now becoming

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225. *See* Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 950 (1998) ("[R]egulatory competition among countries will benefit investors and capital markets."); Kelli A. Alces, *Legal Diversification*, 113 COLUM. L. REV. 1977, 2010 (2013) ("[A]n investor can diversify among different kinds of securities by considering the important legal protections each kind of security offers and showing how those legal features can be profitable in different circumstances."); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2361 (1998) ("This Article contends that the current legislative approach to securities regulation is mistaken and that preemption is not the solution to frivolous lawsuits. It advocates instead a market-oriented approach of competitive federalism that would expand, not reduce, the role of the states in securities regulation.").

226. *See* THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 18 (6th ed. 2009) ("Following the enactment of the early state securities laws, federal legislation was successfully resisted for a while. However, the stock market crash of 1929 is properly described as the straw that broke the camel's back. The era that followed ushered in federal securities regulation."); Christine Lazaro & Benjamin P. Edwards, *The Fragmented Regulation of Investment Advice: A Call for Harmonization*, 4 MICH. BUS. & ENTREPRENEURIAL L. Rev. 47, 52–53 (2014) ("Securities regulation within the United States began at the state level. State laws creating liability for securities fraud, known as blue sky laws, first appeared in the 1910s . . . . Even though most states soon passed their own blue sky laws, state-by-state regulation proved ineffective."); Rose, *supra* note 40, at 1376 ("[T]he New Deal Congress believed that state securities laws—known as "Blue Sky Laws"—had been ineffective in deterring abuses that contributed to the Stock Market Crash of 1929 and the ensuing Great Depression.").

227. *See* Robert G. DeLaMater, *Recent Trends in SEC Regulation of Foreign Issuers: How the U.S. Regulatory Regime Is Affecting the United States' Historic Position as the World's Principal Capital Market*, 39 CORNELL INT'L L.J. 109, 109 (2006) ("Since World War II, the United States has been the world's principal capital market. This market has been uniquely broad and deep, with substantial

global,[228] and as a result, more harmonization and centralization is needed to limit future economic crises.[229] Moreover, the SEC's Office of International Affairs' International Technical Assistance Program has been very good at exporting the United States' theories of securities market regulation abroad.[230] In recent years, the Program has provided training to approximately two-thousand regulators in more than one hundred countries.[231] All of this means that experimentation and diversity relating to securities regulation is likely to become less and less common.

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retail participation by individual investors and small institutions, plentiful capital for equity financing and a willingness to hold long-term debt securities . . . ."); C. Nicholas Revelos, *Transnational Securities Regulation: Can U.S. Investors Have Their Cake and Eat It Too?*, 3 J. INT'L L. & PRAC. 87, 87 (1994) ("For many years, the U.S. securities markets were essentially the only game in the world.").

228. *See* MARC I. STEINBERG, FRANKLIN A. GEVURTZ & ERIC C. CHAFFEE, GLOBAL ISSUES IN SECURITIES LAW, at iii (2013) ("Turn on the CNBC or Bloomberg cable channels during the middle of the night in the United States and one quickly realizes that securities markets are global and that what goes on in European or Asian markets spills over into the United States."); Edward F. Greene*, Beyond Borders: Time to Tear Down the Barriers to Global Investing*, 48 HARV. INT'L L.J. 85, 85 (2007) ("There can be no argument that the securities markets are now global . . . ."); Michael D. Guttentag, *An Argument for Imposing Disclosure Requirements on Public Companies*, 32 FLA. ST. U. L. REV. 123, 128 (2004) ("Securities markets are increasingly global.").

229. Elsewhere, I have written extensively on the benefits of harmonization and centralization of international securities law. *See generally* Chaffee, *supra* note 37; Chaffee, *supra* note 8; Eric C. Chaffee, *Finishing the Race to the Bottom: An Argument for Harmonization and Centralization of International Securities Law*, 40 SETON HALL L. REV. 1581 (2010); Eric C. Chaffee, *The Internationalization of Securities Regulation: The United States Government's Role in Regulating the Global Capital Markets*, 5 J. BUS. & TECH. L. 187 (2010); Eric C. Chaffee, *A Moment of Opportunity: Reimagining International Securities Regulation in the Shadow of Financial Crisis*, 15 NEXUS 29 (2010); Eric C. Chaffee, *A Panoramic View of the Financial Crisis that Began in 2008: The Need for Domestic and International Regulatory Reform*, 35 U. DAYTON L. REV. 1 (2009).

230. *See Securities and Exchange Commission's International Technical Assistance Program*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/offices/oia/oia_emergtech.shtml (last updated Apr. 8, 2014) (last visited Sept. 21, 2017) ("Utilizing a faculty of senior SEC and industry officials, and seasoned practitioners, the technical assistance program provides training to nearly 2000 regulatory and law enforcement officials from over 100 countries.") (on file with the Washington and Lee Law Review).

231. *See id.* (providing an overview of the SEC's Office of International Affairs' International Technical Assistance Program).

Virtual space offers an opportunity for regulatory experimentation by the states and by the software developers, platform owners, and users of these realms. The negative consequences of a securities market crash in a virtual space presents none of the risks of a securities market crash in the real world.[232] Useful data can be collected in video games, virtual worlds, virtual reality, and augmented reality, and it can help improve the understanding of how securities markets and regulation function and fail to function in the real world. Of course, all of this assumes that the entire body of federal securities regulation is not imposed upon all aspects of virtual space that touch the United States. Such an approach is not desirable and would be a genuine shame because of the potential lost opportunities for experimentation and data collection.

Finally, applying federal securities law to securities existing entirely within virtual space would also impede the positive aspects of play. Play has numerous psychological benefits.[233] Unnecessarily saddling virtual space with securities law—a difficult and at times overwhelming body of regulation—would create a harmful restriction on certain types of play. This is especially true because Congress never intended federal securities regulation to apply to this context, and various constitutional doctrines prohibit extending federal securities regulation into these virtual realms.

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232. *See* Arthur Acevedo, *How Sarbanes-Oxley Should Be Used to Expose the Secrets of Discretion, Judgment, and Materiality of the Auditor's Report*, 4 DEPAUL BUS. & COM. L.J. 1, 6 (2005) ("Although the reasons for the 2001–2002 financial crisis differ from those that caused the 1929 stock market crash, the economic and social consequences are similar—namely, unemployment, lost fortunes, mistrust, and lack of investor confidence."); Tracey M. Roberts, *Brackets: A Historical Perspective*, 108 NW. U. L. REV. 925, 934 (2014) ("The 1929 stock market crash heralded the onset of the Great Depression; bank failures, price deflation, unemployment, foreclosures, and a 50% drop in industrial output reduced tax revenues significantly.").

233. *See* Isabela Granic, Adam Lobel & Rutger C.M.E. Engels, *The Benefits of Playing Video Games*, 69 AM. PSYCHOLOGIST 66, 76 (2014) ("After pulling together the research findings on the benefits of video games, we have become particularly inspired by the potential that these games hold for interventions that promote well-being, including the prevention and treatment of mental health problems in youth.").

VI. The Arguments for Applying Federal Securities Regulation to Securities Existing Entirely in Virtual Space

A strong case exists for determining that securities existing in virtual space should not be subject to federal securities law because their "context . . . requires"[234] that they be excluded from the definition of a security. Still, a number of persuasive, but not prevailing, counterarguments exist for applying federal securities law. These counterarguments include that application of federal securities law is necessary for investor protection, is required to prevent an unworkable patchwork of state regulation, and is needed to ensure that these rapidly developing and evolving virtual environments are properly regulated. Although some of these counterarguments are valid, the case against applying federal securities law is stronger.

A. Virtual Investor Protection

In regard to the application of federal securities regulation to virtual space, although Congress's primary reason for enacting the Securities Act and Exchange Act was to protect the securities markets, protecting investors was an important goal as well.[235] The system of federal securities regulation in the United States is well-developed and provides a high level of investor protection.[236]

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234. 15 U.S.C. §§ 77b(a), 78c(a) (2012).

235. *See* Lawrence A. Cunningham, *The SEC's Global Accounting Vision: A Realistic Appraisal of a Quixotic Quest*, 87 N.C. L. REV. 1, 43 (2008) ("In the United States, investor protection is among the principal purposes of securities regulation . . . ."); Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 204 (2006) ("One of the fundamental purposes of securities regulation is to promote investor confidence and provide investor protection."); Nitzan Shilon, *CEO Stock Ownership Policies—Rhetoric and Reality*, 90 IND. L.J. 353, 400 (2015) ("Protecting investors by providing them with critical information about their investments is the basic purpose behind securities regulation.").

236. *See* Eric C. Chaffee, *The Role of the Foreign Corrupt Practices Act and Other Transnational Anti-Corruption Laws in Preventing or Lessening Future Financial Crises*, 73 OHIO ST. L.J. 1283, 1314 (2012) ("Congress . . . enact[ed] a robust and comprehensive system of securities regulation with the passage of the Securities Act of 1933 and the Securities Exchange Act of 1934 to restore

If this body was extended into virtual space, investors within these environments would receive the benefits of this system of regulation.

Although extending the reach of federal securities regulation to virtual space might be tempting, it would not be the right choice. The intended scope of federal securities regulation, various constitutional law principles, and concerns about hindering creativity and regulatory experimentation provide reasons why a court should determine that the "context . . . requires" that federal securities regulation not apply.[237] Securities regulation is not supposed to be all things to all people. As cases such as *Santa Fe Industries, Inc. v. Green*[238] evidence, the Supreme Court has held that federal securities regulation should not be co-opted for uses that it was not intended.[239] In that case, the Court refused to use the private right of action under Section 10(b) and Rule 10b-5 to remedy an allegedly abusive short-form merger that did not involve a misrepresentation or manipulation because the matter should have been addressed using state corporate law.[240] Though it might be tempting for a court to apply the federal securities law to regulate securities existing entirely in virtual space, a court

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public confidence and remove the specter of fraud and corruption."); Stephen Choi*, Regulating Investors Not Issuers: A Market-Based Proposal*, 88 CAL. L. REV. 279, 280 (2000) ("The present securities regulatory regime in the United States focuses on the protection of investors. Investor protection, in turn, leads to a robust capital market."); Ciara Torres-Spelliscy, Kathy Fogel & Rwan El-Khatib, *Running the D.C. Circuit Gauntlet on Cost-Benefit Analysis after* Citizens United*: Empirical Evidence from Sarbanes-Oxley and the JOBS Act*, 9 DUKE J. CONST. L. & PUB. POL'Y 135, 138 (2014) (reporting that some commentators argue "timely, robust disclosures and other securities regulations are precisely the reason that the American securities markets are the market of choice for investors around the world").

237. *See supra* Part V (providing arguments for not applying federal securities regulation to securities existing entirely within virtual space).

238. 430 U.S. 462 (1977).

239. *See id.* at 477 (refusing to recognize a private right of action under Section 10(b) and Rule 10b-5 when such an action is "unnecessary to ensure the fulfilment of Congress' purposes in adopting the [Exchange] Act" (internal quotations omitted)).

240. *See id.* (holding that plaintiffs could not proceed with a private right of action under Section 10(b) and Rule 10b-5 in the absence of a misrepresentation, in part because "[t]he result would be to bring within the Rule a wide variety of corporate conduct traditionally left to state regulation").

should not reach that holding because of separation of powers concerns.[241] If the determination is to be made that federal securities regulation applies to these securities, that decision should be left to Congress because it is the body with the power to create law and because Congress could regulate virtual space in most instances under the Interstate Commerce Clause.[242] Even though Congress has the power to regulate most, if not all, virtual space, it should not promulgate such regulation because, as discussed above, applying federal securities law to securities existing entirely within virtual space would hinder creativity by impeding the growth and evolution of such space—by preventing regulatory experimentation and by interfering with the positive aspects of play.[243]

In short, investor protection is not a persuasive enough reason to apply federal securities regulation to virtual space because it is not appropriate, and beyond that, it is not necessary. The regulation of these virtual realms should be left to other provisions of federal law, state law, and self-regulation.

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241. *See* Christopher T. Cline, *Perspectives of a Non-Party to the International Criminal Court Treaty*, 17 TRANSNAT'L L. & CONTEMP. PROBS. 107, 110 (2008) ("[T]he U.S. system of government is founded on the principle of checks and balances, with each branch of government—legislative, executive, judicial—fulfilling a role. Congress passes the laws, the executive enforces the laws, and the courts interpret the laws."); Jesse W. Markham, Jr., *The Supreme Court's New Implied Repeal Doctrine: Expanding Judicial Power to Rewrite Legislation Under the Ballooning Conception of "Plain Repugnancy"*, 45 GONZ. L. REV. 437, 466 (2010) ("Even where a court concludes that a statute is simply a bad idea or that it works poorly in practice, the judicial role is limited and does not include remedying even the most ill-considered legislation by repealing it or rewriting it to conform to the court's better judgment."); Lance McMillan, *The Proper Role of Courts: The Mistakes of* Leegin, 2008 WIS. L. REV. 405, 459 ("By design, the legislative and judicial functions are separated along distinct lines in the Constitution. Congress passes laws; the federal courts interpret them.").

242. *See* U.S. CONST. art. I, § 8, cl. 3 (granting Congress the power "to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes"); *see also supra* note 204 and accompanying text (discussing that the Internet is both a channel and an instrumentality of interstate commerce).

243. *See supra* Part V.C (arguing that federal securities regulation should not apply to securities existing entirely within virtual space because it would hinder creativity by impeding the growth and evolution of virtual space, preventing regulatory experimentation, and interfering with the positive aspects of play).

B. The Difficulties of Patchwork State Regulation

One of the benefits of federalized securities law is that it creates a relatively consistent floor for regulation of securities across the United States.[244] In the event that federal securities law is not applied to virtual space, a patchwork of regulation will be created because the regulation of these securities existing entirely within virtual space will fall largely to the states and to self-regulation by those owning and acting within these virtual environments. Of course, some federal provisions will still be available to punish bad behavior within virtual space, such as the wire fraud statute,[245] but regulation is going to be far from uniform. This creates two concerns, market instability and hindering the development of virtual space. Both these concerns are valid but are outweighed by the detriments of applying federal securities law to these virtual realms.

In regard to market instability, in the absence of a uniform system of securities regulation in virtual space, users may be unwilling to participate in these securities markets. As noted above, Congress enacted federal securities regulation in the United States to restore investor confidence in the wake of the Stock Market Crash of 1929 and the ensuing Great Depression after the failure of the patchwork of blue sky laws to provide an effective level of regulation.[246] If market crashes and fraud become rampant within virtual environments, users may no longer be willing to

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244. *See* Romano, *supra* note 220, at 2365 ("While the federal laws do not preempt all state regulation, states cannot lower the regulatory standards applicable to firms covered by the federal regime because its requirements are mandatory." (footnotes omitted)).

245. *See* 18 U.S.C. § 1343 (2012)

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined . . . or imprisoned not more than 20 years, or both.

246. *See supra* notes 37–43 and accompanying text (discussing the initial passage of blue sky laws in the United States and their subsequent inability to prevent the stock market crash of 1929).

participate in virtual markets. The short answer is that this is not a problem. Real world national economies, real world businesses, and real world people depend on the existence of viable real world capital markets.[247] The same is not true of virtual securities markets. Moreover, stock market crashes and fear of fraud within some virtual environments may not spill over into other virtual environments. In fact, how virtual markets interact among virtual realms would be an interesting question to answer.

A second concern about creating a patchwork of regulation is that it may hinder the development of virtual space. If software developers are required to comply with a patchwork of regulation across the United States, these developers may never bring their creations to market, or they may eliminate the securities contained within them. Perhaps, this is not a bad thing because it could prevent users of virtual environments from having their money stolen from them. Still, the regulation of technology can often hinder the beneficial growth and evolution of that technology.[248] Regardless, this does not justify applying federal securities regulation to virtual space. The virtual context requires that federal securities law not be applied because of the intended scope of federal securities regulation, various constitutional law principles, and concerns about hindering creativity.[249] Even if adhering to a patchwork of regulation will create compliance

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247. *See* Bernard S. Black, *The First International Merger Wave (and the Fifth and Last U.S. Wave)*, 54 U. MIAMI L. REV. 799, 810 (2000) ("Most of the U.S. population understands, more or less, the connection between the soaring stock market and overall prosperity . . . ."); James R. Doty, *The Relevance, Role, and Reliability of Audits in the Global Economy*, 90 TEX. L. REV. 1891, 1893 (2012) ("Many factors contribute to American prosperity, but a significant one is that our public securities markets provide a reliable funding mechanism for American and, increasingly, foreign businesses.").

248. *See* J. Howard Beales, III & Timothy J. Muris, *FTC Consumer Protection at 100: 1970s Redux or Protecting Markets to Protect Consumers?*, 83 GEO. WASH. L. REV. 2157, 2223 (2015) ("Regulation based on speculative problems, however, is far more likely to chill useful innovations than it is to prevent real harms."); Daniel F. Spulber & Christopher S. Yoo, *Rethinking Broadband Internet Access*, 22 HARV. J.L. & TECH. 1, 19–20 (2008) ("Blind application of a regulatory regime developed for a different technology and different market conditions can lead to regulation that lacks any theoretical justification and can impede technological innovation and consumer welfare.").

249. *See supra* Part V (providing arguments for not applying federal securities regulation to securities existing entirely within virtual space).

complexities and potentially hinder the development of virtual space, this does not justify the application of federal securities law.

C. The Rapid Development and Evolution of Virtual Space

One of the most exciting things about virtual space is that it is rapidly developing and rapidly evolving.[250] One argument for the application of federal securities regulation to securities existing entirely within virtual space is that regulation is needed to ensure that a growing and expanding realm is subject to some cohesive system of law.

This argument is flawed. Just because a body of law could be applied to a particular context does not mean that it should be applied to a particular context. As discussed in the previous Part, the intended scope of federal securities regulation, various constitutional law principles, and concerns about hindering creativity all provide reason why a court should determine that the "context . . . requires" that federal securities regulation not apply.[251] Because of the ubiquity and anonymity of the Internet and its relationship to virtual space, concerns definitely exist about how this space may develop. However, this does not mean that ill-suited bodies of law should be super-imposed upon it. In the event that this space evolves in ways that merit regulation under the federal securities law, Congress can make that decision then. As it stands, application of federal securities regulation is not warranted.

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250. *See* Michael Cerrati, *Video Game Music: Where It Came From, How It Is Being Used Today, and Where It Is Heading Tomorrow*, 8 VAND. J. ENT. & TECH. L. 293, 394 (2006) ("The dynamic and constantly-evolving creativity contributing to the design and development of today's games has helped establish the video game industry as a multi-billion dollar revenue force now attracting worldwide attention.").

251. *See supra* Part V (providing arguments for not applying federal securities regulation to securities existing entirely within virtual space).

VII. Conclusion

Virtual space existing within video games, virtual worlds, virtual reality, and augmented reality has become a regular part of most peoples' lives.[252] As with any technology-related advancement, new legal issues have been created as to how to apply and adapt law to this virtual space. The question regarding the application of federal securities regulation to virtual space is an interesting one that has not received significant academic treatment.[253] If securities existing entirely within virtual space are determined to be securities for purposes of federal securities law, software developers, platform owners, and users become subject to the registration requirements and anti-fraud provisions of that body of law, along with the rest of its provisions.[254] Based upon a strict reading of the definition of a security found within the Securities Act and the Exchange Act, securities can exist entirely within virtual space because investment contracts, a type of security, can be created in such space.[255] However, because the definition sections found in the Securities Act and Exchange Act both begin with the prefatory language, "unless the context otherwise requires,"[256] one must consider whether these securities, in the context of virtual space, should be excluded from the application of federal securities law. Based upon the intended scope of federal securities regulation, various constitutional law principles, and concerns about hindering creativity and regulatory experimentation, the virtual context requires that securities existing entirely within virtual space be excluded from the

252. *See supra* Part II.A (providing a brief overview of virtual space in various media, including video games, virtual worlds, virtual reality, and augmented reality).

253. *See supra* note 13 and accompanying text (discussing that the scholarship relating to the application of federal securities regulation to virtual space is very limited).

254. *See supra* Part III (providing a brief overview of federal securities regulation, including the definition of a security, registration requirements, and anti-fraud provisions).

255. *See supra* Part IV.D (examining the application of federal securities regulation to securities existing entirely within virtual space).

256. 15 U.S.C. §§ 77b(a), 78c(a) (2012).

application of federal securities law.[257] Various concerns exist regarding excluding such securities from the application of federal securities law. These concerns include whether the application of federal securities regulation is necessary for investor protection, is required to prevent an unworkable patchwork of state regulation, and is needed to ensure that these rapidly developing and evolving virtual environments are properly regulated.[258] Ultimately, the arguments for excluding such securities from the application of federal securities law outweigh the arguments for applying federal securities law.

Virtual space is rapidly developing and evolving in exciting ways in a variety of media, including video games, virtual worlds, virtual reality, and augmented reality. As a result, a plethora of new issues have been created that need to be considered and addressed. In regard to securities regulation, considering these issues now, rather than when they arise later, is important. Software developers, platform owners, and users need to have their rights and obligations clarified to allow maximum freedom for working in virtual space. Such an approach will allow virtual space to develop in exciting and useful ways without being weighed down by systems of regulation, such as federal securities law, that should not and need not apply to such virtual environments.

257. *See supra* Part V (providing arguments for not applying federal securities regulation to securities existing entirely within virtual space).

258. *See supra* Part VI (providing arguments for applying federal securities regulation to securities existing entirely within virtual space).