

TRIFLING AND GAMBLING WITH VIRTUAL MONEY

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ABSTRACT

Gambling, in particular sports gambling, is one of the most pervasive illicit activities in the United States. In contrast to Europe and parts of Asia that have vast legal networks of both online and brick and mortar betting parlors, the United States has largely confined sports betting to the state of Nevada, while tolerating so-called daily fantasy sports in a number of additional states. Slightly less pervasive, though equally or perhaps more often associated with illegal activity, are virtual currencies. Indeed, the growth of the illegal gambling market is being partially fueled by virtual currencies. While bitcoin garners most of the media attention, often associated with volatile valuations or criminal activity, a variety of smaller scale virtual currencies have also emerged. The challenge for judges and an essential prerogative for lawmakers is to make sense of how to treat virtual currencies under antiquated statutes and interpretations of what constitutes money.

Some of the high-profile cases involving bitcoin—such as *United States v. Ulbricht*, and theft from the Mt. GOX exchange leading to its collapse—have raised questions as to whether bitcoin is money, or even property, the loss of which is compensable. Smaller, narrowly used, in-game virtual currencies have also emerged. Their unique distinction from bitcoin and first generation virtual currencies is that they have value within games, but purportedly have no value external to the game per terms of service agreements offered by game makers. No fewer than seven decisions have been issued addressing these in-game currencies, finding that despite the existence of secondary markets allowing users to transfer accounts for fiat currencies, the terms of service agreements control in determining the in-game currencies to be valueless.

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These federal holdings create a major problem for law enforcement and prosecutors. By awarding prizes with zero-value currencies, virtual games, casinos and sportsbooks bypass compliance with most gambling statutes. This problem is exacerbated by secondary markets that use market-based pricing to establish values for accounts contradicting the game makers' valuations. Skins gambling, a recently emerged ancillary feature of a popular video game, has already blossomed into a multi-billion-dollar industry that might be outside the reach of law enforcement, and almost no one has noticed.

TABLE OF CONTENTS

INTRODUCTION	43
I. REGULATING VIRTUAL CURRENCIES	55
A. <i>Federal Monopoly On Currency</i>	56
B. <i>Anti-Money Laundering Regulation</i>	57
C. <i>State Money Transmitter Laws</i>	60
D. <i>Federal Securities Regulations</i>	60
E. <i>Federal Banking Law</i>	62
II. BLOCKCHAIN	63
III. THE SENSATIONAL STORIES	65
A. <i>Mt. Gox</i>	65
B. <i>The Silk Road</i>	67
C. <i>State v. Espinoza</i>	69
D. <i>FIFA Coins</i>	71
IV. ILLEGAL GAMBLING	74
A. <i>The Wire Act</i>	74
B. <i>The Illegal Gambling Business Act</i>	76
C. <i>The Professional and Amateur Sports Protection Act</i>	77
D. <i>The Unlawful Internet Gambling Enforcement Act</i>	78
E. <i>State Law</i>	79
V. THE RISE OF SOCIAL CASINOS AND THE DECLINE OF GOVERNMENT REGULATION	81
A. <i>Sweepstakes Cases</i>	82
B. <i>Northern District of Illinois Cases</i>	83
C. <i>Dupee v. Playtika Santa Monica</i>	86
D. <i>Mason v. Machine Zone</i>	86
E. <i>Kater v. Churchill Downs</i>	88
VI. GRAY IS THE NEW BLACK MARKET	89
CONCLUSION	94

INTRODUCTION

There is a 50-square mile location inside Yellowstone National Park where violent felonies can be committed with impunity, or so Professor Brian Kalt hypothesized.¹ Kalt argued that because the federal District of Wyoming was granted exclusive jurisdiction over the entirety of the park, even though Yellowstone extends into both Montana and Idaho, a constitutional problem would likely emerge in the prosecution of any person who committed a crime sufficient to warrant a jury trial in either the Idaho or Montana portions of the enclave.² The constitutional dilemma arises because Article III, Section II stipulates that the trial must be held in the state where the crime is committed, but the Sixth Amendment requires that the jury be selected from the state and district of the crime, which is an impossibility.³ The Idaho section of Yellowstone has a population of zero, the Montana portion has only a few dozen residents and all of Yellowstone is within the District of Wyoming.⁴ Despite this apparent constitutional deficiency, Kalt noted a few issues that those looking to go on a crime spree should consider. First, many jurisdictions do not strictly adhere to the Constitutional requirement that jurors be drawn from the state and district of the crime. Second, that the law placing the entirety of Yellowstone within the District of Wyoming has been around for over 100 years does not render it *de facto* constitutional, or incapable of amelioration.⁵

In 2007, Kalt's theory was tested in court.⁶ In 2005, a man shot an elk illegally while standing in the Montana portion of Yellowstone and was subsequently indicted in the District of Wyoming.⁷ The judge dismissed the Kalt theory stating that a panel of jurors could be assembled from residents of the

1 Brian C. Kalt, *The Perfect Crime*, 93 GEO. L.J. 675 (2005).

2 *Id.* at 677. Kalt observed that Congress incorporated the entirety of Yellowstone into the District of Wyoming by the Act of May 7, 1894. *See id.* at 677, n. 17.

3 *See id.* at 678. The relevant portion of Article III states: "The trial of all crimes, except in cases of impeachment, shall be by jury; and such trial shall be held in the state where the said crimes shall have been committed; but when not committed within any state, the trial shall be at such place or places as the Congress may by law have directed." US CONST. art. III, § 2. Whereas, the relevant portion of the Sixth Amendment states: "In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law . . ." US CONST. amend. VI.

4 *See Kalt, supra* note 1, at 678.

5 *Id.* at 687–688.

6 *See* Brian C. Kalt, *Tabloid Constitutionalism: How A Bill Doesn't Become a Law*, 96 GEO. L.J. 1971 (2008) [hereinafter "*Tabloid Constitutionalism*"].

7 *Id.* at 1981–82 (citing Order Dismissing Objection to Jury Panel, *United States v. Belderrain*, No. 07-cr-66-D (D. Wyo. Aug. 8, 2007)). It should be emphasized that *Belderrain* was in the Montana portion of the park, not the Idaho portion that has a population of zero. Kalt noted that a jury could possibly be empaneled from the Montana portion's 41 residents. *Id.*

District of Wyoming.⁸ The decision to willingly deviate from strict textualism of the Constitution was in this case pragmatic.⁹ The practicality of traveling to Idaho to commit a crime in the legal quagmire of Kalt's "zone of death" is limited.¹⁰

However, there is an activity that millions of Americans continuously engage in from their homes, which would be a crime under a multitude of federal and state statutes if its criminality was not rendered suspect by a series of federal court decisions regarding virtual currencies.¹¹ Like Kalt's "zone of death," there is a textual problem with applying gambling laws to certain types of games where the transactions and prizes occur using virtual currencies with zero value according to the terms of service. Following a series of federal court decisions, there is an apparent gap in the law that has allowed a variety of online gambling operators to offer contests that appear in many ways to mirror illegal gambling sites, but by claiming that the in-game currency is of zero value they have managed to avoid liability. The claim is based on the classic conception of gambling being an activity that involves skill, a prize, and consideration, without a value associated with the currency used to participate there is in fact no consideration.

Globally, gambling is a big business. In 2014, Morgan Stanley estimated that global gaming revenues were valued at \$423 billion, flowing from land-based casinos, lotteries and other activities, including sports betting.¹² That figure is dwarfed when illegal gambling numbers are added. For instance, the International Center for Sport Security (ICSS) has estimated that the global value of both legal and illegal sports betting is between \$1.5 and \$2 trillion.¹³

8 *See id.*

9 *Id.*

10 Indeed, Kalt acknowledges the practicality of committing crimes in the fifty-square mile area is limited. *See Kalt, supra* note 1.

11 It is important to note that the author of this paper does not advocate for anyone to attempt to utilize the arguments in this paper to make a legal argument or execute a business plan. The arguments and illustrations are meant only to demonstrate the shortcomings of current laws in addressing new technologies. *See PART infra.*

12 Muhammad Cohen, *As VIP Play Shrinks and Shifts, Morgan Stanley Upbeat on Global Gaming*, FORBES (Apr. 7, 2015), <https://www.forbes.com/sites/muhammadcohen/2015/04/07/as-vip-play-shrinks-and-shifts-morgan-stanley-upbeat-on-global-gaming/#1a8827a233c1> [<http://perma.cc/RV9V-PTFA>]. The Morgan Stanley report noted that US land casinos accounted for 16 percent of global gaming revenue in 2014. *See GLOBAL GAMING GLOBAL INSIGHT: THREE KEY DEBATES*, MORGAN STANLEY RESEARCH (Mar. 25, 2015), *available at* <http://docslide.us/data-analytics/morgan-stanley-global-gamin-report-2015.html> [<http://perma.cc/T4YH-BCFD>].

13 *See* David Purdum, *World Looks to U.S. to Legalize Sports Betting, Fight Match-Fixing*, ESPN (May 21, 2015), http://www.espn.com/chalk/story/_/id/12925786/why-legalization-sports-betting-only-first-step-us-gambling [<http://perma.cc/6JF8-YTEF>]. The Purdum article notes that the \$1.5 to 2 trillion (USD) figure is roughly the gross national product of Russia. The ICSS previously posited that in 2011, Americans wagered 200 € billion online in 2011. *See* PANTHEON SORBONNE UNIVERSITE PARIS, PROTECTING THE

The 1999 congressionally-commissioned National Gambling Impact Study estimated that Americans wagered between \$80 and \$380 billion on sports.¹⁴ The American Gaming Association (AGA) has estimated that \$4.7 billion was illegally wagered on Super Bowl 51, while just \$132 million in legal wagers were placed in Nevada. These numbers reflect an 11 percent growth over the previous year.¹⁵ The AGA similarly estimated that the 2017 NCAA Men's Basketball Championship tournament will generate an estimated \$10.4 billion wagered illegally, compared to the \$300 million to be legally wagered in Nevada.¹⁶ Some authors have questioned the estimates of the illegal sports-betting market size, though few dispute its significance.¹⁷

Outside of the legal and illegal sports gambling markets in the United States, there exists a grey market that is either partially legal under certain circumstances or of indeterminate legality. This market encompasses two primary betting products: daily fantasy sports and skins betting. Daily fantasy sports emerged as a shortened version of traditional season-long fantasy sports, but was somewhat similar to prohibited forms of sports betting.¹⁸ While

INTEGRITY OF SPORT COMPETITION: THE LAST BET FOR MODERN SPORT 1–142 (2014).

- 14 NAT'L GAMBLING IMPACT STUDY COMM'N, GAMBLING IN THE UNITED STATES 2–14 (1999), *available at* <http://govinfo.library.unt.edu/ngisc/reports/2.pdf> [<http://perma.cc/4DD3-4K38>].
- 15 *See Super Bowl 51 - By the Numbers*, AMERICAN GAMING ASSOCIATION (Jan. 31, 2017), <https://www.americangaming.org/research/infographics/super-bowl-51-numbers> [<http://perma.cc/CB68-QVCW>].
- 16 *See* Daniel Roberts, *March Madness 2017 is Setting Gambling Records*, YAHOO (Mar. 17, 2017), <http://finance.yahoo.com/news/march-madness-2017-is-setting-gambling-records-175703785.html> [<http://perma.cc/99WP-GL3G>].
- 17 Jordan Weissmann expressed skepticism as to the size of the illegal gambling market following an op-ed by National Basketball Association (NBA) commissioner Adam Silver who articulated a monumental shift in American sports league policy, when in 2014, he argued that the United States should reconsider its federal prohibition against the practice. Jordan Weissmann, *Big Bucks or Bogus Betting Baloney*, SLATE (Nov. 21, 2014 2:19PM), http://www.slate.com/articles/business/moneybox/2014/11/adam_silver_says_there_s_400_billion_per_year_of_illegal_sports_betting.html [<http://perma.cc/9GUZ-9SAV>]. Silver estimated the size of the illegal market to be \$400 billion. *Id.* Weissmann noted that \$400 billion is the equivalent of every American betting \$1,700 on an annual basis. *Id.* Silver reportedly drew his \$400 billion figure from a variety of sources though according to Weissmann only specifically cited the 1999 Gambling Commission report. *Id.* The source in the report attributed the number to a Las Vegas newspaper article from 1999 and not an academic or industry report. *Id.* It is also a possibility that the upper bound of the 1999 Commission's estimate was derived from a rough 100-fold multiple of the amount legally wagered in Nevada, as it has been estimated by the AGA that only one percent of sports gambling in the United States happens legally. *See* Geoff Baker, *Battle is on for Legal Slice of Sports-Gaming Industry*, SEATTLE TIMES (Jan 25, 2015 3:55PM), http://old.seattletimes.com/html/seahawks/2025545229_bakercolumn26xml.html [<http://perma.cc/3BLR-J4CG>].
- 18 While there are a variety of different types of fantasy leagues, traditional season-long leagues involve a group of individuals who generally take turns through a predetermined

several states have taken steps to clarify the legal status of daily fantasy sports, many other states have taken no affirmative steps to elucidate the legal status of the daily variety of fantasy contests despite their apparent similarities to prohibited forms of sports betting, such as parlay-style wagering.¹⁹ Much of the confusion regarding the legal status of daily fantasy contests originated from a 2006 statute that contained an exemption from the statute's application for certain fantasy sports contests and educational games that met specific requirements under the definition of "bet or wager."²⁰ However, the 2006 statute's Rule of Construction—which stated that the statute does not alter, limit, or extend any other Federal or State law or Tribal compact regulating

draft order and select real professional athletes to compromise a fictional team to compete over the length of a real professional sports season. In contrast, daily fantasy leagues typically involve individuals who select a team of real world athletes to compete against a stranger or strangers' selection(s) of real-world athletes on a fictional team for a period of hours or days. See Michael Trippiedi, *Daily Fantasy Sports Leagues: Do You Have the Skill to Win at These Games of Chance*, 5 UNLV GAMING L.J. 201, 207–210 (2014). Daily fantasy sports function similarly to a parlay style form of sports wagering where a bettor selects multiple players to compose her team in hopes that her team outperforms others.

- 19 Parlay wagering involves a bettor selecting two or more outcomes, and needing both outcomes to occur in order for the bet to pay. See *Parlay Betting*, Odds Shark (2017), <https://www.oddsshark.com/sports-betting/parlay-betting> [<http://perma.cc/TV94-64ZD>]; See also Ryan Rodenberg, *Daily Fantasy Sports State-by-State Tracker*, ESPN (last updated Jun. 9, 2017), http://www.espn.com/chalk/story/_/id/14799449/daily-fantasy-dfs-legalization-tracker-all-50-states [<http://perma.cc/HX3B-EXVY>].
- 20 See Unlawful Internet Gambling Enforcement Act, 31 U.S.C § 5362(1)(E)(ix) (2006). The conditions necessary for fantasy contests to qualify for the exemption are as follows:
 - (ix) participation in any fantasy or simulation sports game or educational game or contest in which (if the game or contest involves a team or teams) no fantasy or simulation sports team is based on the current membership of an actual team that is a member of an amateur or professional sports organization (as those terms are defined in section 3701 of title 28) and that meets the following conditions:
 - (I) All prizes and awards offered to winning participants are established and made known to the participants in advance of the game or contest and their value is not determined by the number of participants or the amount of any fees paid by those participants.
 - (II) All winning outcomes reflect the relative knowledge and skill of the participants and are determined predominantly by accumulated statistical results of the performance of individuals (athletes in the case of sports events) in multiple real-world sporting or other events.
 - (III) No winning outcome is based—
 - (aa) on the score, point-spread, or any performance or performances of any single real-world team or any combination of such teams; or
 - (bb) solely on any single performance of an individual athlete in any single real-world sporting or other event.

Id.

gambling—limited the scope of the exemption,²¹ and preserved the role that states have traditionally had in regulating which activities constituted gambling.²²

In addition to the emergence of daily fantasy sports, the post-Unlawful Internet Gambling Enforcement Act (UIEGA) era²³ has seen the emergence of skins betting. Skins are decorative covers for weapons in certain video games, amongst the most prominent of which is Counter-Strike: Global Offensive (CS:GO).²⁴ Skins can be acquired in a number of different ways, including through playing the game, through promotions from the game vendor, and through purchase or trade.²⁵ In August 2013, Valve, the makers of CS:GO, introduced decorative weapon skins that players were able to trade using the Valve-owned Steam platform.²⁶ The openness of the software's application programming interface (API) allowed users to transfer weapons skins as they wished. Secondary sites where users could trade, purchase, or make purchases with their skins also developed.²⁷ While skins betting does exist in several other games, estimates placed CS:GO's market share at 80 percent.²⁸ On September 27, 2016, the Washington State Gambling Commission sent a letter to Valve demanding that Valve "cease violating Washington State gambling laws," and "stop facilitating the use of 'skins' for gambling activities through its Steam Platform."²⁹ Valve responded to the Gambling Commission with the company's position that it does not facilitate illegal gambling and noted that "Valve does not allow Steam customers to cash out skins . . . for real world money."³⁰ The status of the Washington State Gambling Commission's concern remains

21 See Unlawful Internet Gambling Enforcement Act § 5361 (b).

22 See *Internet Gambling Prohibition Act of 1999 Hearing before the Subcomm. on Telecommunications, Trade and Consumer Protection of the H. Comm. on Commerce*, 106th Cong. 1 (2000) (statement of Assistant Attorney General Kevin DiGregory).

23 UIGEA is the first statute to regulate internet gambling, and remains one of the primary restrictions limiting the expansion of online gambling. See 31 U.S.C. §§ 5361-5367 (2006).

24 Evan Lahti, *CS:GO's Controversial Skin Gambling, Explained*, PC GAMER (July 6, 2016), <http://www.pcgamer.com/csgo-skin-gambling> [<http://perma.cc/A45R-YFN3>].

25 CHRIS GROVE, NARUS ADVISORS, UNDERSTANDING SKIN GAMBLING 2 (2016).

26 Christopher Paspalaris, *Report: Timeline – Gambling in Esports*, ESPORTS OBSERVER (Oct. 20, 2016), <http://esportsobserver.com/report-timeline-gambling-in-esports> [<http://perma.cc/AM39-YPB3>].

27 In March 2015, CSGO Lotto, an early online gambling site that transacted primarily in CS:GO skins was founded. *Id.*

28 *Id.*

29 Letter from David E. Trujillo, State of Washington Gambling Commission to Gabe Newell, Valve Corporation, *Re Cease Facilitating Gambling Activities through Valve Corporations Steam Platform*, (Sep. 27, 2016).

30 Letter from Liam Lavery, Valve Corp. to David E. Trujillo, State of Washington Gambling Commission (Oct. 17, 2016). As discussed *infra*, it is likely significant that Valve views the purchasing of decorative skins as a one-way transaction, where the company enables the sale of the in-game items, but does not assign any real-world value to the item, in so much as allowing a Steam Platform user the ability to sell skins back to Valve.

unaddressed, but, as will be discussed in this Article, the Commission likely faces long odds in any prosecution as a result of a lack of legislative direction and poor applicability of laws that never conceived of social gaming, virtual currencies or decorative weapons skins.

Efforts to combat internet gambling emerged shortly after the first internet casinos began popping up online with physical addresses located in Antigua and Curaçao.³¹ The first congressional hearing to oppose the rise and rapid expansion of internet gambling was held in 1997.³² However, it would not be until 2006 that Congress would pass the first statute directly combating internet gambling, the UIGEA.³³ In the interim, the Fifth Circuit Court of Appeals decided the matter in *In re: Mastercard International Inc.*, holding the 1961 Federal Wire Act did not encompass all forms of internet gambling, such as casino style gambling, but exclusively applied to sports betting.³⁴ This opinion would be re-emphasized by the Department of Justice's Office of Legal Counsel in response to requests by the states of Illinois and New York seeking clarification on whether the Wire Act prohibited the sale of intra-state lottery tickets through an out-of-state provider.³⁵ The interpretation of the Wire Act's application to only online sports betting enabled states to enact their own laws to legalize intra-state wagering by residents on virtually any games other than sports betting.³⁶ While some states have moved to enact legislation authorizing online gambling, many have remained reluctant.

31 ROBERT J. WILLIAMS ET AL., ROUTLEDGE INTERNATIONAL HANDBOOK OF INTERNET GAMBLING (2012).

32 See generally *Internet Crimes Affecting Consumers: Hearing on S. 474 before the Subcomm. on Technology, Terrorism and Government Information of the S. Comm. on the Judiciary*, 105th Cong. 1 (1997).

33 See Unlawful Internet Gambling Enforcement Act § 5361.

34 313 F.3d 257 (5th Cir. 2002). The Wire Act restricts the transmission of wagering information relating to sporting events across state lines by those in the business of betting or wagering. 18 U.S.C. § 1084.

35 Whether Proposals by Illinois and New York to Use the Internet and Out-of-State Transaction Processors to Sell Lottery Tickets to In-State Adults Violate the Wire Act, 35 Op. O.L.C. 1 (Sep. 20, 2011).

36 This position has been attacked by several prominent Republicans, including Senators Lindsey Graham and Marco Rubio, as well as Republican member of the House, Jason Chaffetz of Utah. Chaffetz reportedly stated:

In yet another example of executive branch overreach, the DOJ crossed the line by making what amounts to a massive policy change without debate or input from the people or their representatives. We must restore the original interpretation of the Wire Act. If there is justification and support for a change, the Constitution designates Congress as the body to debate that change and set that policy.

See Steve Ruddock, *Jason Chaffetz Doesn't Want to Restore the Wire Act- He Wants to Rewrite It*, ONLINE POKER REPORT (Apr. 8, 2015), <http://www.onlinepokerreport.com/16263/rawa-wants-wire-act-rewrite> [<http://perma.cc/4X49-N4LX>]. Indeed, the Ruddock article title is likely correct, as a review of the legislative history associated

Despite restrictions on online gambling, many people have continued to gamble. In the presence of restrictive sports betting regulations, Americans have found new ways to gamble online. One of the most reliable means of accessing offshore gambling establishments has been through the utilization of virtual currencies, which grant the user a degree of anonymity not available to those using traditional money-transmitting businesses like banks, wire services and credit cards.

The emergence of virtual currencies has resulted in a great deal of confusion for both legislators and the judiciary. Virtual currencies are “digital representations of value that is neither issued by a central bank or a public authority . . . ,” but which are used for many of the same transactions as currencies issued under the auspices of governmental authority.³⁷ There are more than 1000 virtual currencies, but bitcoin is regarded as the most prominent.³⁸

with the Wire Act reveals that Chaffetz’s position is not based in historical fact. Robert F. Kennedy, then Attorney General and architect of the Wire Act, very clearly articulated in his testimony before the Senate in June 1961, that the statute was intended to be narrowly crafted and target sports gambling businesses, not non-professional gamblers. Kennedy’s testimony refers specifically to wagering involving sporting contests, as opposed to the listing of numerous gambling activities to be encompassed by the statute. *See The Attorney General’s Program to Curb Organized Crime Hearings on S. 1653, S. 1654, S. 1955, S. 1656, S. 1657, S. 1658 & S. 1665 Before the S. Comm. on the Judiciary*, 87th Cong. 1 (1961). Minton notes that Kennedy’s testimony focused “explicitly and exclusively on wagering related to ‘horse racing’ and ‘such amateur and professional sports events as baseball, basketball, football and boxing.’” *See* MICHELLE MINTON, UNLV CENTER FOR GAMING RESEARCH, *THE ORIGINAL INTENT OF THE WIRE ACT AND ITS IMPLICATIONS FOR STATE-BASED LEGALIZATION OF INTERNET GAMBLING* (2014) available at http://gaming.unlv.edu/papers/cgr_op29_minton.pdf [<http://perma.cc/89HP-CXZV>]. While much of the focus of legislators, with regard to the Wire Act, has been on whether the statute applies to betting beyond sporting events; there is a potentially an even larger issue with the statute for lawmakers diametrically opposed to sports gambling. The statute is also not intended to apply to wireless communications and while most communications still require transmission through wired communications facilities that era may soon be coming to an end with technological advancements. Kennedy stated: “[i]n fact, wireless communication was not included in this bill because it is our belief that the Federal Communications Commission has ample authority to control the misuse of this means of communication.” *See The Attorney General’s Program to Curb Organized Crime Hearings on S. 1653, S. 1654, S. 1955, S. 1656, S. 1657, S. 1658 & S. 1665 Before the S. Comm. on the Judiciary*, 87th Cong. 1 (1961). This statement would later be recorded in the Senate Report accompanying the bill, which would become the Wire Act. *See* S. Rep. 588 (July 21, 1961). For perhaps the most in depth examination of the conditions that facilitated the Wire Act *see* DAVID G. SCHWARTZ, *CUTTING THE WIRE: GAMING PROHIBITION AND THE INTERNET* (2005).

37 EUROPEAN BANKING AUTHORITY OPINION ON ‘VIRTUAL CURRENCIES’, EBA/Op/2014/08 (July 4, 2014), available at: <http://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-08+Opinion+on+Virtual+Currencies.pdf> [<http://perma.cc/YN3L-N3TZ>].

38 Divya Joshi, *List of Top Virtual Currencies in 2017 and What Differentiates Them*, INVESTOPEDIA (Oct. 19, 2017 5:07 PM), <http://www.businessinsider.com/>

Bitcoin does not fit the traditional understandings of what constitutes a currency, as it is not issued by any government or backed by a precious metal or other commodity.³⁹ As will be discussed in this Article, virtual currencies have evolved to encompass many more forms than the currently well-recognized bitcoin, including so-called “zero-value currencies.” The term “zero-value currencies” is as deceptive as their use. Although the issuer establishes that these currencies have no cash value, they enter a secondary market that is, in some cases, sufficiently liquid to enable holders of these currencies to exchange their virtual money into bitcoin, Euros, or U.S. dollars. Several federal courts have expanded the potential usefulness of zero-value currencies, fueling the gambling industry that handles more than \$5 billion U.S. dollars.⁴⁰ This Article examines the emergence of virtual currencies and the nascent case law that has struggled to interpret traditional virtual currencies, creating a legal vortex. The Article discusses and analyzes a series of cases decided in various federal courts that seemingly render federal gambling prohibitions obsolete through Terms of Service agreements.

Bitcoin was first recognized as a currency by some regulators in 2013.⁴¹ The recognition of bitcoin or other virtual currencies creates additional compliance burdens on companies who are required to keep detailed records if transacting in a recognized currency.⁴² For instance, an exchange that converts virtual currencies to U.S. dollars would be required to comply with the Currency Transaction Report requirements established by the Internal Revenue Service (IRS).⁴³ The Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) defined currency as “the coin or paper money of the United States or of any other country that is designated as legal tender and that circulates and is customarily accepted as a medium of exchange in the country of issuance.”⁴⁴ The 2013 FinCEN definition clearly does not encapsulate virtual

list-top-cryptocurrencies-analysis-comparison-2017-10 [http://perma.cc/U5ZX-5B2U].

39 See Reuben Grinberg, *Bitcoin: An Innovative Alternative Digital Currency*, 4 HASTINGS SCI. & TECH. L.J. 159, 160 (2001).

40 See Katie Barlowe, *\$5 Billion in Skins Wagered in 2016 Despite Valve Shutdown*, CASINO.ORG (Jan. 24, 2017), <https://www.casino.org/news/5-billion-skins-wagered-2016-despite-valve-shutdown> [http://perma.cc/J74S-C8B6]. The term ‘handle’ is a gambling phrase that refers to the total amount of money that a bookmaker receives in bets. See *Betting Glossary Common Terms: “Handle”*, ESPN (Sep. 4, 2014), http://www.espn.com/chalk/story/_/id/11457015/betting-glossary-common-betting-terms [http://perma.cc/GVC3-RTL6].

41 Matthew Kien-Meng Ly, *Coining Bitcoin’s “Legal-Bits”: Examining the Regulatory Framework for Bitcoin and Virtual Currencies*, 27 HARV. J.L. & TECH. 587, 588 (2014).

42 *Id.*

43 See *Frequently Asked Questions Regarding the FinCEN Currency Transaction Report*, FINANCIAL CRIMES ENFORCEMENT NETWORK (last visited Jun. 15, 2017), <https://www.fincen.gov/frequently-asked-questions-regarding-fincen-currency-transaction-report-ctr> [http://perma.cc/AZ33-5DKX].

44 Ly, *supra* note 41, at 589 (citing DEP’T OF THE TREASURY, FIN. CRIMES ENFORCEMENT

currencies such as bitcoin, which lack the tangibility of coin or paper money and are not issued by a country. In contrast, economists have attributed three defining attributes to money: “[I]t functions as a medium of exchange, a unit of account, and a store of value.”⁴⁵ The differences between FinCEN’s definition of currency and the definition favored by independent economists are stark. The government definition represents a traditional approach to the regulation of units of exchange, and the economists’ explanation does not require the intervention of government for currency to exist. Despite the differences in conceptualization, both definitions can be used to reach the same conclusion in respect to bitcoin or other virtual currencies: they do not satisfy the requirements traditionally used to define currency.

Professor David Yermack analyzed bitcoin in 2013, and looked to determine whether digital currency satisfies the three factors set forth by economists for determining whether bitcoin constitutes money.⁴⁶ Bitcoin almost certainly satisfies the criteria that currency functions as means of exchange, as bitcoin can be used to pay for items both online and, in limited circumstances, offline as well.⁴⁷ The second prong of the definition requires the currency serve as a

NETWORK, APPLICATION OF FINCEN’S REGULATIONS TO PERSONS ADMINISTERING, EXCHANGING, OR USING VIRTUAL CURRENCIES 1 (Mar. 18, 2013), *available at* <https://www.fincen.gov/resources/statutes-regulations/guidance/application-fincens-regulations-persons-administering> [<http://perma.cc/68JS-MF6Z>].

45 David Yermack, *Is Bitcoin A Real Currency? An Economic Appraisal* 1–22 (Nat’l Bureau of Econ. Research, Working Paper No. 19747, 2013).

46 *Id.*

47 *Id.* at 2. The first bitcoin transaction occurred around January 3, 2009, when the reported creator of bitcoin virtually mined 50 bitcoin. A short-time later, Hal Finney, a long-time pioneer in encryption, received ten bitcoins in a test transaction. See Andrea Perterson, *Hal Finney Received the First Bitcoin Transaction. Here’s How He Describes It*, WASHINGTON POST, Jan. 3, 2014, https://www.washingtonpost.com/news/the-switch/wp/2014/01/03/hal-finney-received-the-first-bitcoin-transaction-heres-how-he-describes-it/?utm_term=.4d4ec3c568ed [<http://perma.cc/UJ4E-QGQE>]. The history regarding which retailer was the first to accept a bitcoin transaction will likely be the subject of great debate forever, as some believe a Florida-based computer programmer who paid 10,000 bitcoins for two Papa John’s pizzas was the first; however, he paid the bitcoins to an England-based third party who called in the pizza order on his behalf and paid by credit card. Benjamin Wallace, *The Rise and Fall of bitcoin*, WIRED, Nov. 23, 2011, https://www.wired.com/2011/11/mf_bitcoin [<http://perma.cc/6WA5-VFCU>]. It is believed that the first business in the United States to accept bitcoin payments without a third party was David Forster, a Massachusetts man who sold alpaca socks. *Id.* By 2017, many mainstream global retailers accept bitcoin including: Subway, Virgin Galactic, Lionsgate Films and RE/MAX London. See Jonas Chokun, *Who Accepts Bitcoins As Payment? List of Companies, Stores, Shops, 99BITCOINS* Mar. 21, 2017, <https://99bitcoins.com/who-accepts-bitcoins-payment-companies-stores-take-bitcoins> [<http://perma.cc/KAL5-ZSZK>]. Though many big companies appear to be accepting bitcoins for some transactions, in many instances the companies have contracted with a third party who takes the bitcoin and immediately exchanges the bitcoin into U.S. dollars or whatever currency in which the company generally transacts business. See Jacob Davidson, *No, Big Companies Aren’t Really Accepting Bitcoin*, TIME,

unit of account.⁴⁸ For an item to be considered a unit of account, it must act as a recognized measure of value and be understood by consumers and retailers as such.⁴⁹ The wild fluctuations in value that have become a trademark of bitcoin have rendered its status as a unit of account spurious.⁵⁰ The fluctuations in value of bitcoin make its widespread adoption alongside traditional currencies impractical, though in theory the fluctuations would be less noticeable without the context of conventional currencies.⁵¹ Finally, under the third prong, the currency must function as a store of value.⁵² If a laborer works for one hour at a rate of twenty dollars per hour, the laborer expects that the twenty dollars will have the same purchasing power after he is paid as at the time he agreed to that rate of pay.⁵³ In this sense, the currency “stores” value. Historically, the stored value of currency made it susceptible to criminals who sought to dispose of the rightful owner, as traditionally, currency has functioned as bearer paper, meaning the possessor did not need to demonstrate how he or she acquired the currency to transact with it.⁵⁴ While several digital wallets are

Jan. 9, 2015, <http://time.com/money/3658361/dell-microsoft-expedia-bitcoin> [<http://perma.cc/P545-RTPE>]. In addition to the online use of bitcoins, some cities have bitcoin “ATMs,” though as the Consumer Financial Protection Bureau has noted, bitcoin ATMs are machines that allow customers to convert currency to bitcoin (or in some machines, convert bitcoin to traditional currencies). CONSUMER FINANCIAL PROTECTION BUREAU, CONSUMER ADVISORY: RISKS TO CONSUMERS POSED BY VIRTUAL CURRENCIES, March 2014, *available at*: http://files.consumerfinance.gov/f/201408_cfpb_consumer-advisory_virtual-currencies.pdf [<http://perma.cc/PE3T-BJDX>]. These bitcoin exchange machines appear to be a novelty. Much like ATMs placed in locations that accept only cash, such as casinos, bitcoin ATMs typically have large transaction fees and may not accurately reflect other exchange rates. *Id.*

48 See Yermack, *supra* note 45, at 11.

49 *Id.*

50 *Id.* For example, on January 4, 2017, a single bitcoin could be purchased for \$1139 and the same bitcoin could be purchased for \$885 the next day, a decrease in value of approximately 20 percent. Jason Murdock, *What’s Going On With Bitcoin? Dramatic Price Fluctuations Show Volatile Nature of Virtual Cash*, IB TIMES Jan. 6, 2017, <http://www.ibtimes.co.uk/whats-going-bitcoin-dramatic-price-fluctuations-show-volatile-nature-virtual-cash-1599686> [<http://perma.cc/5VHQ-T6XZ>].

51 See Yermack, *supra* note 45 at 11. Yermack notes that perhaps one of the biggest obstacles to the widespread adoption of bitcoin is the relatively high value that each bitcoin has and the uncommon practice of listing prices to four or five decimal places.

52 *Id.* at 14.

53 *See id.*

54 *Id.* The need to protect currency gave rise to banks, which in the United States eventually led to the formation of the Federal Deposit Insurance Corporation (FDIC), whereby the federal government insures deposits in registered institutions. *See generally About FDIC: Mission, Vision, and Values*, FEDERAL DEPOSIT INSURANCE CORPORATION, May 19, 2015, <https://www.fdic.gov/about/strategic/strategic/mission.html> [<http://perma.cc/J5DB-SB8D>]. The FDIC was created in response to thousands of bank collapses in the era of the Great Depression. *History of the FDIC*, FEDERAL DEPOSIT INSURANCE CORPORATION, Aug. 26, 2016, <https://www.fdic.gov/about/history> [<http://perma.cc/>

available for bitcoin, some being backed by insurers, these have not reached the levels of consistency and security associated with traditional banking.⁵⁵ Likely the greatest argument against finding bitcoin as an effective store of value is its volatility. Volatile currencies serve as poor stores of value because frequent price changes do not allow users a clear understanding of how much their currency is worth. In 2013, the bitcoin exchange rate volatility was 142 percent, whereas other currencies typically have rates between 7 and 12 percent; even the most speculative or risky stocks rarely exceed a volatility rate of 100 percent.⁵⁶ For the laborer who worked one hour, the volatility of bitcoin means that the \$20 he worked for could yield merely \$10 worth of purchasing power. While bitcoin may not satisfy Yermack's or others' conceptualizations of currency, others have continued to try to understand bitcoin within existing models of regulation.⁵⁷

Efforts to fit bitcoin and other virtual currencies into existing conceptualizations of currency have met with challenges. For instance, there is an ongoing debate as to whether bitcoin should be regulated as currency or property.⁵⁸ Professors Kevin V. Tu and Michael W. Meredith observed that many adopters of bitcoin view it as an investment, similar to a commodity or security.⁵⁹ Despite a lack of universally recognized definition "[b]itcoin is a medium of exchange that (1) is electronically created and stored, and (2) lacks the backing of a government authority, central bank, or a commodity like gold."⁶⁰ The fundamental difference between bitcoin and more traditional currencies is the absence of recognition of bitcoin as legal tender, which "must be accepted by a creditor towards the satisfaction of a debt . . ." ⁶¹ Instead, bitcoin is volun-

SJA2-YDMV].

55 One prominent example of the security issue surrounding the storage of bitcoin involves the theft of more than \$450 million worth of bitcoin from an exchange named Mt. Gox. This theft is examined in greater depth *infra*. See Robert McMillan, *The Inside Story of Mt. Gox, Bitcoin's \$460 Million Disaster*, WIRED, Mar. 3, 2014, <https://www.wired.com/2014/03/bitcoin-exchange> [<http://perma.cc/D3VU-NDG2>].

56 See Yermack, *supra* note 45, at 1415.

57 Bitcoin is used as a discussion point because of its prominence and history, but this discussion is relevant to many traditional virtual currencies.

58 *Id.* at 274. Indeed, as is discussed *infra*, the question of whether bitcoin is money or property has challenged judges and given the absence of clear federal guidance, the application of existing statutes to virtual currencies has, in some instances, produced seemingly absurd results. See, e.g., Order Granting Defendant's Motion to Dismiss the Information, State v. Espinoza, No. F14-2923, slip op. (Fl. Cir. Ct. July 22, 2016), available at [http://www.miamiherald.com/latest-news/article91701087.ece/BINARY/Read%20the%20ruling%20\(PDF\)](http://www.miamiherald.com/latest-news/article91701087.ece/BINARY/Read%20the%20ruling%20(PDF)) [<http://perma.cc/6RHT-CZ5P>].

59 Kevin V. Tu & Michael W. Meredith, *Rethinking Virtual Currency Regulation in the Bitcoin Age*, 90 WASH. L. REV. 271, 273 (2015).

60 *Id.* at 277. Tu & Meredith note that the term virtual currency lacks a universal definition. *Id.* at 277, n. 36.

61 *Id.* at 278.

tarily accepted by various consenting creditors or merchants who lack the legal obligation to receive a payment in virtual form, but instead choose to do so.⁶²

Those who choose to participate in bitcoin transactions often also contribute to the production of bitcoin itself through a process known as mining.⁶³ Bitcoin's design is such that there is a finite number of bitcoins that will ever be mined.⁶⁴ Users who contribute computing power to the bitcoin mining network and preform the essential third-party function of validating transactions are rewarded with a continually diminishing return of payment in bitcoins.⁶⁵ The miners are essential to Bitcoin as these individuals provide the computational labor to validate transactions, though they often receive a transaction fee.⁶⁶

The absence of government backing for bitcoin makes regulation difficult due to the decentralized and anonymous nature of the instrument.⁶⁷ The most prominently cited difficulty associated with is bitcoin is its anonymity.⁶⁸ Despite concerns about bitcoin users exploiting anonymity for illicit activities,

62 *Id.*

63 The presence of mining is not unique to bitcoin, but is not present in all virtual currencies. In a different, but related context there is relatively lengthy history of virtual mining (or farming). For instance, President Donald Trump's campaign CEO Steve Bannon worked for an entity that employed individuals in foreign countries (often China) to play video games for extended periods of time earning items for use within video games, but which could be sold on a secondary market for conventional currency. See Patrick Caldwell, *Trump Campaign CEO Once Worked for a World of Warcraft Marketplace*, MOTHER JONES, Sep. 1, 2016, <http://www.motherjones.com/politics/2016/08/stephen-bannon-world-warcraft-gold-farming-donald-trump> [<http://perma.cc/2NUW-ZSGM>]. The so-called "Virtual World Feudalism" has a history that dates to the early 2000s. See, e.g., Jon Garon, *Playing in the Virtual Arena: Avatars, Publicity, and Identity Reconceptualized Through Virtual Worlds*, 11 CHAP. L. REV. 465 (2008). See also James Grimmelmann, *Virtual World Feudalism*, 118 YALE L. PKT. PART 126 (2009).

64 See Rainer Bohme, et al., *Bitcoin, Economics, Technology, and Governance*, 29 J. ECON. PERSP. 213 (2015).

65 *Id.* at 218. The first bitcoin mining reward was 50 bitcoin, this was reduced to 25 and will continue to be reduced until all 21 million bitcoin have been virtually mined. *Id.*

66 *Id.* at 218–19.

67 Tu & Meredith, *supra* note 59, at 296–97.

68 *Id.* at 297. The anonymity associated with bitcoin is of concern for some U.S. government agencies. For instance, the Internal Revenue Service has sought access to certain bitcoin wallet and Coinbase accounts based on evidence they may have violated tax laws. See Joel Valenzuela, *Bitcoin Anonymity Over? United States Government Seeks Identity, Transaction Record of Coinbase Users*, COINTELEGRAPH, Nov. 18, 2016, <https://cointelegraph.com/news/bitcoin-anonymity-over-united-states-government-seeks-identity-transaction-records-of-coinbase-users> [<http://perma.cc/677X-VN-HG>]. See also United States' *Ex Parte* Petition for Leave to Serve "John Doe" Summons, United States v. John Doe, No. 3:16-cv-06658-JSC (N.D. Cal. Nov. 17, 2016), 2016 WL 7010560. This same anonymity, however, may be vital and allow for resources to reach those in countries with oppressive regimes, such as Iran. See e.g., *'Untapped Potential': bitcoin Poised to Profit from Iran's Ban on US Dollar*, RT, Feb. 13, 2017, <https://www.rt.com/business/377170-bitcoin-iran-dollar-ban> [<http://perma.cc/Q2Z8-QXTX>].

which have been the subject of highly sensationalized stories involving the dark web, many bitcoin users are law-abiding individuals.⁶⁹ According to a survey of more than 1200 bitcoin users, the ownership of bitcoin follows traditional wealth patterns, with individuals increasing their wealth prior to their 60s.⁷⁰ The survey administrators did observe that those individuals who used bitcoin for illicit transactions were more likely to possess more bitcoins than those who used them for legal transactions.⁷¹ One aspect that has hampered the adoption and broader use of bitcoin is the regulatory shortfall, which may deter the acceptance of bitcoin by some merchants. Some corporations may have the perception that bitcoin serves primarily illegal ends and that by accepting the currency, the company may be condoning the underlying activities or facilitating money launderers and tax evaders. Despite this perception, virtual currencies are likely to become more mainstream, given decreased reliance on the use of cash and concerns regarding the security of credit cards.⁷²

I. REGULATING VIRTUAL CURRENCIES

The implication that bitcoin and other virtual currencies are something other than currencies poses a unique challenge for regulators. Recognizing that transactions are occurring, regulators know there is a need to control and regulate the environment; but at the same time, regulators do not want to legitimize virtual money as an accepted form of payment akin to Franklins, Jacksons, Grants or Lincolns. Additionally, that bitcoin and other virtual currencies are used in international criminal transactions is a pressing concern for both law enforcement and legislators.⁷³ Scholars Tu and Meredith pointed out

69 Perhaps the most prominent story associated with bitcoin users is that of the illicit internet bazaar, Silk Road. The Silk Road was an online store found off the beaten path of the World Wide Web, in the dark web, where users could purchase and sell virtually anything from narcotics to weapons to the services of a contract killer. See generally Joshua Bearman & Tomer Hanuka, *The Rise and Fall of Silk Road*, WIRED, Apr. 2015, <https://www.wired.com/2015/04/silk-road-1> [<http://perma.cc/9PFZ-428S>]. See also David Kushner, *Dead End on Silk Road: Internet Crime Kingpin Ross Ulbricht's Big Fall*, ROLLING STONE, Feb. 4, 2014, <http://www.rollingstone.com/culture/news/dead-end-on-silk-road-internet-crime-kingpin-ross-ulbrichts-big-fall-20140204> [<http://perma.cc/NJG2-DEGK>].

70 Hal M. Bundrick, *Who Uses Bitcoin? The Answer May Surprise You*, INSIDE BITCOINS, Sep. 26, 2014, <http://insidebitcoins.com/news/who-uses-bitcoin-the-answer-may-surprise-you/24901> [<http://perma.cc/57UZ-LLLL>].

71 *Id.*

72 A 2016 Gallup poll showed that the number of Americans making all or most purchases with cash had decreased from 36 percent in 2011 to 24 percent in 2016. See *Americans Using Cash Less Compared with Five Years Ago*, GALLUP, July 12, 2016, <http://www.gallup.com/poll/193649/americans-using-cash-less-compared-five-years-ago.aspx> [<http://perma.cc/Q45P-6M5T>].

73 See Tu & Meredith, *supra* note 59, at 313. See also John Bohannon, *Why Criminals Can't Hide Behind Bitcoin*, SCIENCE MAGAZINE, Mar. 9, 2016, <http://www.sciencemag>.

five areas of law that are potentially relevant to the regulation of virtual currencies: first, the federal monopoly on currency; second, anti-money laundering regulations; third, state money transmitter laws; fourth, federal securities regulations; and fifth, federal banking laws.⁷⁴ The first category identified is the federal monopoly power to coin money and regulate its value.⁷⁵

A. *Federal Monopoly On Currency*

The right to issue currency is reserved to the federal government by virtue of Article I, Section 8 of the Constitution.⁷⁶ Indeed, the Constitution states explicitly that the legislative branch of the federal government possesses the right “[t]o coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures.”⁷⁷ At the time the Constitution was ratified, vesting the power to create money exclusively in the federal government was an important means of ensuring the success of the country. If states had been allowed to freely develop currencies on their own, regulation of the economy would have been nearly impossible for the nascent government.⁷⁸ The constitutional monopoly is supplemented by the 1862 Stamp Payments

org/news/2016/03/why-criminals-cant-hide-behind-bitcoin [http://perma.cc/W5MW-D4FM] (“Bitcoin’s anonymity is also a powerful tool for financing crime: The virtual money can keep shady transactions secret. The paradox of cryptocurrency is that its associated data create a forensic trail that can suddenly make your entire financial history public information.”). See also Tom Simonite, *Bitcoin’s Dark Side Could Get Darker*, MIT TECH. REV., Aug. 13, 2015, <https://www.technologyreview.com/s/540151/bitcoins-dark-side-could-get-darker> [http://perma.cc/Z6EB-KNEJ] (noting that there is also a derivative criminal enterprise fueled by virtual currencies and executed using smart “criminal contracts” that anonymize criminal contracts for activities such as hacking or virtually-enabled extortion through the use of ransomware. These contracts are created on platforms such as Ethereum, which acts as a verifier of sorts, assuring the performance of a unilateral contract.).

⁷⁴ See Tu & Meredith, *supra* note 59, at 314–15.

⁷⁵ *Id.* at 315. U.S. CONST. art. I, § 8, cl. 5.

⁷⁶ *Id.*

⁷⁷ U.S. CONST. art. I, § 8, cl. 5.

⁷⁸ DAVID F. FORTE & MATTHEW SPALDING, *THE HERITAGE GUIDE TO THE CONSTITUTION* 168–69 (2nd ed. 2014). It has been noted that prior to passage of the Constitution, the 13 colonies employed multiple money systems. In addition to transacting in multiple currencies including French, English, Spanish and Portuguese currencies, different colonies had different values associated with each. During the period where the colonies were governed by the Articles of Confederation, individual colonies possessed the ability to coin money, but its value was established by the Continental Congress. In continuing and expanding the system of the Continental Congress, the Constitution, passed in 1787, included not only the power for Congress to regulate the value of money, but also included a prohibition on states coin money. See ALONZO B. HEPBURN, *HISTORY OF COINAGE AND CURRENCY IN THE UNITED STATES AND THE PERENNIAL CONTEST FOR SOUND MONEY* (1903). See also U.S. CONST. art. 1, § 10, cl. 1 (“No State shall . . . coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts . . .”).

Act, which controls the issuance of private currencies.⁷⁹ The Stamp Payments Act prohibits the issuance of notes worth less than \$1 and its purpose was to stop the issuance of private currencies during the Civil War when some coins contained a greater value in metal than their face value.⁸⁰ The purpose of the statute may appear to implicate bitcoin, but to date it has not been used to prosecute any bitcoin miner or user.

Despite the deceptively clear allocation of power to the federal government, virtual currencies have proven problematic for regulators because they do not clearly fit within the constitutional prohibitions.⁸¹ Several factors have been identified by courts as weighing against the legality of bitcoin under the Stamp Payments Act: bitcoins do not circulate in a limited area⁸² and bitcoin is a potential competitor currency to the United States dollar.⁸³ However, the likelihood of the government pursuing an action against bitcoin or another virtual currency via the Constitution's Weights and Measures Clause or the Stamp Payments Act remains small, in part because the circulation of bitcoin remains relatively small in comparison to traditional fiat currencies.⁸⁴

B. *Anti-Money Laundering Regulation*

A second potential means of regulating virtual currencies is through anti-money laundering laws.⁸⁵ The anti-money laundering laws are enforceable against money-transmitters by virtue of the Bank Secrecy Act of 1970.⁸⁶ The Bank Secrecy Act requires certain entities that are money-transmitters to file a report with the federal government in instances where there is a transfer of greater than \$10,000.⁸⁷ FinCEN has issued several guidance opinions on how

79 Tu & Meredith, *supra* note 59, at 316 (noting that “the primary purpose of the Stamp Payments Act was to prevent the hoarding and destruction of U.S. government-issued currency. However, modern “[j]udicial interpretations of the Act . . . indicate the [true] touchstone of the Act is [the prevention of] competition with official currency”) (citing Reuben Grinberg, *Bitcoin: An Innovative Alternative Virtual Digital Currency*, 4 HASTINGS SCI. & TECH. L.J. 160 (2011)).

80 Robert McMillan, *Could a Civil War-Era Law Stamp Out Bitcoin?* WIRED Jan. 8, 2014, <https://www.wired.com/2014/01/stampact> [<http://perma.cc/494Z-4LE7>].

81 Tu & Meredith, *supra* note 59.

82 *Id.* (citing *United States v. Roussopulous*, 95 F. 977, 978 (D. Minn. 1899) (holding that tokens issued by a store and only redeemable at said store did not have sufficiently broad distribution to constitute a currency)).

83 Tu & Meredith, *supra* note 59, at 320 (noting that despite the apparent problems posed by the Stamp Payments Act for virtual currencies, the fact that most virtual currencies remain in digital form may lead a court to conclude that they are not competing currencies to the United States dollar.). The observation that bitcoin is a competitor currency to the U.S. dollar is evidenced by a variety of exchanges that facilitate the transfer of bitcoin to other currencies, including United States dollars.

84 *Id.* at 321.

85 *Id.*

86 *Id.* See also Currency and Foreign Transactions Reporting Act, 12 U.S.C. § 1724 (1970).

87 See generally *Bank Secrecy Act*, U.S. DEPT. TREASURY (last visited Jun. 15, 2017),

virtual currencies may be treated under the Bank Secrecy Act.⁸⁸ On March 18, 2013, the agency issued a six-page guidance memorandum “to clarify the applicability of the regulations implementing the Bank Secrecy Act . . . to persons creating, obtaining, distributing exchanging accepting, or transmitting virtual currencies.”⁸⁹ FinCEN defined virtual currency as “a medium of exchange that operates like a real currency in some environments, but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction.”⁹⁰ FinCEN’s 2013 guidance noted that a user of virtual currency is not regarded by the Treasury Department as a person who falls within the definition of money services business and thus is not under the scope of the Bank Secrecy Act.⁹¹ By contrast,

[a]n administrator or exchanger that (1) accepts and transmits a convertible virtual currency or (2) buys or sells convertible virtual currency for any reason is a money transmitter under FinCEN’s regulations, unless a limitation to or exemption from the definition applies to the person.⁹²

Importantly, FinCEN articulated that the definition of money transmitter does not differentiate between real currencies and convertible virtual currencies, provided there is a transmittal of something of value.⁹³ The final section of FinCEN’s March 2013 guidance on virtual currencies clarified that virtual currencies are not currencies in the eyes of the Treasury Department.⁹⁴ Therefore, those who operate exchanges where virtual currencies are exchanged for fiat currencies are not dealers. Thus, these exchange operators are outside the scope of relevant Bank Secrecy Act provisions.

The initial March 18, 2013 guidance was issued in response to requests from the bitcoin community for the government to provide some clarification of the legal status for users and merchants.⁹⁵ In January 2014, the agency

<https://www.occ.treas.gov/topics/compliance-bsa/bsa/index-bsa.html> [http://perma.cc/WQ3W-YGGW]. Because of the passage of the USA Patriot Act, financial institutions are under additional obligations to report suspicious transactions, even those involving less than \$10,000. Additionally, the statute requires the report of suspicious activities by underground banking systems, which could incorporate certain entities transacting in virtual currencies *See* 12 U.S.C. § 1829(b) (2013).

88 *See* Tu & Meredith, *supra* note 59, at 321–22.

89 DEP’T OF THE TREASURY, FIN. CRIMES ENFORCEMENT NETWORK, APPLICATION OF FINCEN’S REGULATIONS TO PERSONS ADMINISTERING, EXCHANGING, OR USING VIRTUAL CURRENCIES Mar. 18, 2013, *available at* <https://www.fincen.gov/resources/statutes-regulations/guidance/application-fincens-regulations-persons-administering> [http://perma.cc/G6PR-N9LY].

90 *Id.* at 1.

91 *Id.* at 2.

92 *Id.* at 3.

93 *Id.*

94 *Id.* at 5–6.

95 *See FinCEN Responds to Bitcoin Community’s Requests for Clarification*, BITCOIN FOUNDATION Jan. 30, 2014, <https://bitcoinfoundation.org/fincen-responds-to-bitcoin-communitys-requests-for-clarification> [https://perma.cc/6RSN-8UQA].

issued two additional administrative rulings.⁹⁶ The first ruling addressed the issue of whether certain ways of “disposing of . . . bitcoins mined . . .” by certain companies would make those companies money transmitters under the Bank Secrecy Act.⁹⁷ The guidance stated that the material action to determine whether a person engaged in mining bitcoin is within the scope of the statute’s requirements is what the individual uses virtual currency for and for whose benefit.⁹⁸ For instance, if an individual is engaged in mining for their own personal use, much like a tourist may mine for gold on an Alaskan vacation, the user is not within the scope of the statute.⁹⁹

The second ruling addressed regulations associated with virtual currency software development and the use of virtual currencies as investment vehicles by certain entities arguably rendering said entities money services businesses.¹⁰⁰ In regards to the development of software that would allow sellers to sell their virtual currency to a buyer company, FinCEN concluded that the particular business model articulated would not violate the Bank Secrecy Act by virtue of the “production and distribution of the software, in and of itself . . .”¹⁰¹ Likewise, the investment in virtual currencies may not bring an entity within the scope of the Bank Secrecy Act’s money services business provided that the investment is done for personal interests rather than at the employ of others.¹⁰² FinCEN’s responses were lauded by some within the bitcoin community who had long sought relief from concerns that recreational transactions using bitcoin or other virtual currencies may run afoul of federal law.¹⁰³ While bitcoin enthusiasts may rejoice, those in search of normative solutions for regulating bitcoin are left to determine how exactly virtual currencies are or can be regulated, in light of FinCEN’s “personal-use” approach.¹⁰⁴ The FinCEN rulings

96 *Id.*

97 DEP’T OF THE TREASURY, FIN. CRIMES ENFORCEMENT NETWORK, APPLICATION OF FINCEN’S REGULATIONS TO VIRTUAL CURRENCY MINING OPERATIONS, Jan. 30, 2014, *available at* <https://www.fincen.gov/sites/default/files/shared/FIN-2014-R001.pdf> [<https://perma.cc/T7EF-MCZL>].

98 *Id.* at 2.

99 *Id.* at 3; *cf.* with an instance where an individual is in the process of operating a bitcoin mining enterprise where bitcoin is obtained not for the benefit of the individual or company operating the harvesting business.

100 DEP’T OF THE TREASURY, FIN. CRIMES ENFORCEMENT NETWORK, APPLICATION OF FINCEN’S REGULATIONS TO VIRTUAL CURRENCY SOFTWARE DEVELOPMENT AND CERTAIN INVESTMENT ACTIVITY Jan. 30, 2014, *available at* https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2014-R002.pdf [<https://perma.cc/56HM-HQXM>].

101 *Id.* at 2.

102 *Id.* at 4.

103 *See FinCEN Responds to Bitcoin Community’s Requests for Clarification*, BITCOIN FOUNDATION, Jan. 30, 2014, <https://bitcoinfoundation.org/fincen-responds-to-bitcoin-communitys-requests-for-clarification> [<https://perma.cc/L344-T43H>].

104 “Personal-use” is in reference to parlance regarding certain amounts of narcotics possession are regarded as amounts suitable for personal-use, whereas above a certain

were important for clarifying that hobbyist users were not in danger of being prosecuted for engaging in small and mundane bitcoin transactions. The rulings were also significant to those who may have been skeptical of the legality of transacting or mining bitcoins.

C. *State Money Transmitter Laws*

In addition to the federal structure addressing the issuance and transmittal of currencies, many states possess their own laws. These state laws act as supplementary consumer protection regulation against unscrupulous money-transmitting entities operating within the state's jurisdiction.¹⁰⁵ Laws affecting money transmitters on the state level are typically relevant to businesses that transmit money from one individual to another. They often require businesses to obtain a license, post a bond, possess a minimum net worth, maintain certain levels of certain types of investments, retain certain business and transaction records, and periodically file reports.¹⁰⁶ On an individual basis, a bitcoin user is unlikely to be viewed as a money-transmitting business because there is no intermediary in a transfer of bitcoin.¹⁰⁷ The structure of bitcoin allows individuals to transfer the virtual currency peer-to-peer directly, it does not necessitate the use of traditional money-transmitting businesses such as Western Union.¹⁰⁸ While state consumer protection regulations are most certainly well-intended, their application to virtual currencies is unclear.¹⁰⁹

D. *Federal Securities Regulations*

Virtual currencies could also potentially be regulated through federal securities laws.¹¹⁰ Tu and Meredith note that one federal court has concluded that bitcoin may, under certain conditions, implicate federal securities statutes.¹¹¹ *SEC v. Shavers* centered on the operation of Bitcoin Savings and Trust

threshold the amount possessed may by default be considered trafficking and raise the associated punishments associated with possession. *See generally* Eric Blumenson & Eva Nilsen, *No Rational Basis: The Pragmatic Case for Marijuana Law Reform*, 17 VA. J. SOC. POL'Y & L. 43 (2009).

105 *See* Kevin V. Tu & Michael W. Meredith, *Rethinking Virtual Currency Regulation in the Bitcoin Age*, 90 WASH. L. REV. 271, 331 (2015).

106 *Id.* at 331–32.

107 Danton Bryans, *Bitcoin and Money Laundering: Mining for an Effective Solution*, 89 IND. L.J. 441, 458 (2014).

108 *See id.*

109 As illustrated by *State v. Espinoza*, in at least one instance state laws may be narrowly tailored and based on antiquated notions of currency having to be tangible so as to render them inapplicable to virtual currencies. Order Granting Defendant's Motion to Dismiss the Information, *State v. Espinoza*, F14-2923 (Fla. 11th Cir. Ct. Jul 22, 2016).

110 *See* Tu & Meredith, *supra* note 59, at 335–39.

111 *Id.* at 335–36 (noting that in *SEC v. Shavers* the Eastern District Court of Texas concluded that a Ponzi scheme involving investments in bitcoin was in violation of various provisions within the Securities Act of 1933.) *See* Sec. Exch. Comm'n v. Shavers, No.

(BTCST).¹¹² BTCST was an unregistered online investment brokerage that transacted in bitcoin.¹¹³ The defendant solicited investors by operating in various bitcoin-related internet chatrooms. He offered potential investors returns of 7 percent interest weekly, which he allegedly was able to secure by trading in currency markets.¹¹⁴ The *Shavers* scheme allegedly followed the classical structure of Ponzi-schemes, where the operation relies on new and continuous streams of investors in order to continue showing inflated returns and to satisfy withdrawal requests.¹¹⁵ The defendant's scheme cost victims the equivalent of \$149 million in U.S. dollars.¹¹⁶ In August of 2013, the *Shavers* court concluded that the bitcoin investment scheme fell within the definition of security and thereby triggered the SEC's jurisdiction.¹¹⁷ Specifically, the Eastern District of Texas held that the scheme constituted an investment contract for three reasons as articulated by the Supreme Court in *SEC v. W.J. Howey & Co.*¹¹⁸ First, because bitcoin could be exchanged for conventional currencies, it was a "form of money, and investors wishing to invest in BTCST provided an investment of money."¹¹⁹ Second, investors relied on Shavers' expertise (or purported expertise), which he touted, as well as his industry connections.¹²⁰ Third, the defendant had created an expectation of profits for investors.¹²¹ While the District Court of the Eastern District of Texas reached a conclusion that the *Shavers* scheme implicated the 1933 Securities Act,¹²² it does not immediately bring all virtual currency transactions within the scope of securities law

4:13-CV-416, 2014 WL 4652121 (E.D. Tex. Sept. 18, 2014).

112 *Shavers*, 2014 WL 4652121 at *1.

113 *Id.*

114 *Id.*

115 *Id.* at *3. The original Ponzi scheme was orchestrated by Charles Ponzi by utilizing international postage reply coupons (a way for a sender of letter to include return postage for the receiver). *Ponzi Scheme*, Smithsonian National Postal Museum, Ponzi Scheme, <https://postalmuseum.si.edu/behindthebadge/ponzi-scheme.html> [<https://perma.cc/965X-RY2Q>]. Ponzi recognized that the coupons had a greater value in the United States than in their countries of origin and started a scheme where he proposed to trade in the coupons. *Id.* Investors were promised profits far surpassing many conventional investments. *Id.* However, a newspaper article speculated that the international volume of coupons being bought and sold could not possibly support Ponzi's returns and he thus must not be operating in the manner he disclosed to investors. *Id.* Ponzi would eventually be convicted of mail fraud and other charges associated with his scheme. *Id.* For additional background on Ponzi schemes, see also MITCH FEIERSTEIN, PLANET PONZI, 1–384 (2012).

116 *Shavers*, 2014 WL 4652121 at *3.

117 Mem. Op. Regarding the Ct.'s Subject Matter Jurisdiction, Sec. Exch. Comm'n v. Shavers, No. 4:13-CV-416, 2013 WL 4028182 (E.D. Tex. Aug. 6, 2013).

118 *Id.* (citing *SEC v. W.J. Howey & Co.*, 328 U.S. 293, 298–99 (1946)).

119 *Id.* at *2.

120 *Id.*

121 *Id.*

122 *Id.*

because the *Shavers* decision was focused on the defendants inducements as opposed to the nature of bitcoin itself.

In some ways, the virtual currency market may resemble the unregulated securities market that led to major reforms such as the Securities Act of 1933.¹²³ Additionally, the large swings associated with the price of a bitcoin may lend support to an argument that the market is being driven by speculators and at risk of a potential correction or collapse.¹²⁴ While the *Shavers* scheme was found to implicate securities laws, it remains unlikely—or perhaps impractical—to envision that securities laws would make for a feasible means of regulating bitcoin.¹²⁵ In addition to the anonymity of bitcoin, which would likely greatly increase the size and cost of the bureaucracy associated with enforcement, virtual currencies do not operate as traditional securities. For instance, due to the decentralized mining of bitcoin, there is not an advantage that is gained by insiders. Indeed, “insiders” like those involved in insider trading scandals do not exist.¹²⁶ As Tu and Meredith note, bitcoin in particular behaves somewhat like other currencies, which are largely exempt from securities laws.¹²⁷ The inapplicability of securities laws to most virtual currency transactions does not foreclose their application to limit schemes intending to defraud investors.

E. *Federal Banking Law*

A fifth alternative for regulation may be the use of statutes designed to regulate the banking industry.¹²⁸ Bitcoin presently enjoys a status nearly opposite to that of the banking industry. Bitcoin is virtually unregulated, while banking is one of the most tightly supervised and monitored industries in both the United States and abroad.¹²⁹ Extensive banking regulations are justified by the substantial consequences associated with bank failure.¹³⁰ In order to justify the similar regulation in the virtual currency context, virtual currencies must

123 Kevin V. Tu & Michael W. Meredith, *Rethinking Virtual Currency Regulation in the Bitcoin Age*, 90 WASH. L. REV. 271, 337 (2015). The Securities Act of 1933 emerged from the stock market crash of 1929, which was blamed in part of the lack of regulation surrounding the sale of securities and the banking industry. See James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29 (1959). Similarly, virtual currencies exist within a largely unregulated market, that may be waiting for a crash to generate the political will to bring about reform.

124 *Id.* at 338.

125 *Id.*

126 *Id.*

127 *Id.* at 339.

128 *Id.*

129 *Id.*

130 *Id.* at 343. Indeed, there is support for this conclusion given the banking crisis of 2008. See generally *The Origins of the Financial Crisis: Crash Course*, THE ECONOMIST (Sept. 7, 2013), <http://www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article> [<https://perma.cc/479Z-KM2M>].

possess a form of special status.¹³¹ In their current incarnation, virtual currencies likely do not merit the special status associated with banks because the currencies do not fill many of the societal purposes that banks have traditionally served and thus the consequences of failure are limited.

Bitcoin and other virtual currencies presently exist in a regulatory void in the United States. As is the case with many new technologies, legislative change is reactive. While many have voiced concerns associated with the criminal elements and the associated anonymity with virtual currencies, there are, in fact, several technologies developing along with virtual currencies that have potential widespread benefits. Blockchain technology is being widely lauded as a tectonic shift in the way that the world conducts business.¹³² In the following section, the concept of blockchain will be discussed, as well as some of the benefits associated with the adoption of decentralized record-keeping systems.

II. BLOCKCHAIN

Bitcoin and many other virtual currencies rely on a technology called blockchain to facilitate the transfer of payments amongst users.¹³³ Blockchain is best understood as “a ledger or, more simply a chronological database of transactions recorded by a network of computers. The term ‘blockchain’ refers to these transactions being grouped in blocks, and the chain of these blocks forms the accepted history of transactions since the inception of the blockchain.”¹³⁴ Blockchain is a permanent and unalterable, open-access “repository of information.”¹³⁵ The open and transparent nature of blockchain technology makes it potentially attractive for a variety of different transactions, including “smart contracts” and “digital rights management.”¹³⁶ In understanding the blockchain technology, Professor Joshua Fairfield notes that “. . . [b]lockchain technology . . . represents a significant advance in tracking information about who owns what.”¹³⁷

131 *Id.*

132 See Bernard Marr, *How Blockchain Technology Could Change the World*, FORBES, May 27, 2016, <https://www.forbes.com/sites/bernardmarr/2016/05/27/how-blockchain-technology-could-change-the-world/#e202007725b2> [<https://perma.cc/3WH3-LPFR>].

133 See Lawrence J. Trautman, *Is Disruptive Blockchain Technology the Future of Financial Services?* 69 CONSUMER FIN L. Q. REP. 232, 237 (2016).

134 *Id.* at 237 (quoting Gareth W. Peters & Efstathios Panayi, *Understanding Modern Banking Ledgers through Blockchain Technologies: Future of Transaction Processing and Smart Contracts on the Internet of Money*, (Working Paper arXiv: 1409.1451, 2014), available at <https://arxiv.org/pdf/1511.05740.pdf> [<https://perma.cc/M7G2-HWQU>]).

135 *Id.*

136 *Id.* at 238. Trautman also identifies other potential areas that may find blockchain desirable including “business models for the Internet of Things (IoT); protecting personal data; digital content distribution; voting; and reputation system enhancement.” *Id.*

137 Joshua A. T. Fairfield, *Bitproperty*, 88 U. So. CAL. L. REV. 804, 808 (2015).

Bitcoin and blockchain are designed to curb the double-spending problem associated with many early virtual currencies.¹³⁸ The double-spending problem occurs when an individual duplicates a digital asset or, at minimum, represents to two different parties that he or she has twice the digital asset.¹³⁹ Obviously, a digital currency or digital asset that can be copied, such as a Microsoft Word document from one computer folder to another, will be of little value.¹⁴⁰ As a result, it became necessary to create a form of digital record keeping that would prevent users from being able to either duplicate their money or represent to multiple parties how much money they possess.¹⁴¹ Bitcoin and other technologies that use blockchain technology address the double-spending problem because the transfer of a bitcoin is publicly recorded on the ledger and the bitcoin's new owner is documented.¹⁴² The blockchain's integrity is supported by the mining process that rewards users who contribute to the computer power that solves complex math problems.¹⁴³ The blockchain is like a book, and every time a new block is mined the new block represents a new page that contains all transactions since the last block was mined.¹⁴⁴ As such, a perpetrator of fraud would have to replicate the entire history of the blockchain and falsify transactions at a speed faster than honest members of the community.¹⁴⁵

Some have proposed and tested betting markets using decentralized blockchain technology to report and verify the occurrence of real-world propositions.¹⁴⁶ On a market operated by Augur, users are rewarded for reporting

138 Misha Tsukerman, *The Block is Hot: A Survey of the State of Bitcoin Regulation and Suggestions for the Future*, 30 BERKELEY TECH. L.J. 1127 (2015).

139 *Id.* at 1133.

140 *Id.*

141 *Id.*

142 *Id.* at 1134.

143 The mining process is designed so that mining becomes increasingly resource dependent so as to mimic the mining of a gold mine. Each additional piece gold requires an additional exertion of energy, but in the case of the bitcoin mining process the solving of complex mathematical problems incrementally releases additional bitcoin with each piece requiring increased amounts of computing power to solve the increasingly complex equations. See Trevor I. Kiviat, *Beyond Bitcoin: Issues in Regulating Blockchain Transactions*, 65 DUKE L.J. 569, 576–77 (2015).

144 *Id.*

145 *Id.* Blockchain's protections are not theoretically insurmountable, but the resources to overcome the obstacles are a likely deterrent. Tsukerman further notes "[a]dditionally, a massive hacking of the entire blockchain would cause the value of bitcoins to plummet, thus making the loot of the crime substantially less valuable." *Id.* While the author references bitcoin specifically, it is likely true for any market-based priced item secured and transferred by blockchain technology.

146 See Jack Peterson & Joseph Krug, *Augur: A Decentralized, Open-Source Platform for Prediction Markets* (Working Paper arXiv:1501.01042, 2015), available at <https://arxiv.org/abs/1501.01042> [<https://perma.cc/3Z55-GW3Q>]. Prediction markets have many useful applications beyond serving as a source of betting propositions, though their

accurately on world events that are the subject of betting propositions by receiving reputation tokens which are Augur's virtual currency.¹⁴⁷ The reputation tokens function as a form of payment for assisting with maintaining the legitimacy of the market.¹⁴⁸

III. THE SENSATIONAL STORIES

Despite the many potential beneficial uses of blockchain technology, salacious events often generate the most attention. For instance, blockchain's irreversibility is a potential cause for concern, especially if bitcoin were widely adopted. Unlike the current banking and payment system, which is easily amenable to reversal of errors, blockchain is permanent. A user who receives payment in error would be required to initiate a repayment to the party who made the error in order to secure repayment. The concerns associated with blockchain and bitcoin have been fueled by incidents such as the theft of hundreds of thousands of bitcoins from the exchange known as Mt. Gox, which was revealed in 2013 and an association between virtual currencies and the dark web. Like Mt. GOX and the dark web's Silk Road, a variety of gambling operators have taken advantage of the anonymity associated with virtual currencies as an opportunity to blur the lines of legal and illegal gambling.

A. *Mt. Gox*

Mt. Gox was the largest bitcoin exchange in the world until it was the target of the largest theft in the history of the young virtual currency.¹⁴⁹ The theft of roughly 800,000 bitcoins had a value of approximately \$460 million.¹⁵⁰ Some commentators have assessed the theft and ensuing bankruptcy as the fault of individuals lacking in skills necessary to succeed in business, noting that Mt. Gox's CEO was obsessed with side projects and seemed uninterested in the day-to-day operations of the exchange.¹⁵¹ Mt. Gox was run by Mark Karpeles.¹⁵² The website and platform had been initially designed for trading playing cards, such as those associated with the game *Magic: The Gathering*.¹⁵³ Within a few years, Karpeles determined that The Magic: The Gathering

accuracy and usefulness are largely beyond the scope of this paper. See generally Kenneth J. Arrow et al., *The Promise of Prediction Markets*, 320 SCI. 877 (2008). See also Justin Wolfers & Eric Zitzewitz, *Prediction Markets*, 18 J. ECON. PERSP. 107 (2004).

147 See Peterson & Krug, *supra* note 146, at 2.

148 *Id.*

149 Robert McMillan, *The Inside Story of Mt. Gox, Bitcoin's \$460 Million Disaster*, WIRED, Mar. 3, 2014, <https://www.wired.com/2014/03/bitcoin-exchange> [<https://perma.cc/MMA3-GBZT>].

150 *Id.*

151 *Id.* (stating, "[I]t's also a technology that was pushed forward by a community of people who were unprepared or unwilling to deal with even the basics of everyday business.").

152 *Id.*

153 See Jake Adelstein & Nathalie-Kyoko Stucky, *Behind the Biggest Bitcoin Heist in*

Online eXchange (Mt. GOX) could be more lucrative as a bitcoin exchange. As an exchange, it would solve the early problem associated with virtual currencies—being able to exchange virtual currencies for fiat currencies.¹⁵⁴ Mt. Gox would soon become the exchange of choice for the majority of bitcoin users, facilitating upwards of 70 percent of bitcoin's exchanges.¹⁵⁵

In February 2014, the Mt. Gox website was replaced with a note from Karpeles reassuring the website's customers that he had not fled Japan (the country where he resided) and was working on a solution but that no transactions would be facilitated for the foreseeable future.¹⁵⁶ The theft from Mt. Gox represented as much as 6 percent of the total number of circulating bitcoin.¹⁵⁷ In the aftermath of the collapse of the exchange, the total loss claimed by users around the world was roughly \$2.4 trillion.¹⁵⁸ The legitimacy of the majority of those claims is unknown. Most sources placed the value of bitcoin assets held by Mt. Gox at far below that figure—approximately \$500 million, of which Japanese authorities recovered \$91 million.¹⁵⁹ The claims associated with the Mt. Gox bankruptcy are largely fraudulent, as there is purportedly only \$7 billion worth of bitcoin currently circulating.¹⁶⁰ The downfall of Mt. Gox has raised concerns that there may have been an error in the cryptographic protocol, "which allows for a small window of time in which manipulation of the transaction details may be undertaken, either by human error or under fraudulent activity."¹⁶¹ The Mt. Gox theft remains one of the primary points of reference for those who oppose recognition of virtual currencies. The other frequently cited point of reference involves the Silk Road dark-web bazaar, discussed below.¹⁶²

History: Inside the Implosion of Mt. Gox, THE DAILY BEAST, May 19, 2016, <http://www.thedailybeast.com/articles/2016/05/19/behind-the-biggest-bitcoin-heist-in-history-inside-the-implosion-of-mt-gox.html> [<https://perma.cc/66DQ-AYBV>].

154 *Id.*

155 See Scott A. Wiseman, *Property or Currency? The Tax Dilemma Behind Bitcoin*, 2016 UT. L. REV. 417, 426 (2016).

156 Lawrence Trautman, *Virtual Currencies Bitcoin & What Now After Liberty Reserve, Silk Road, and Mt. Gox?*, 20 RICH. J.L. & TECH. 13, 100 (2014)

157 *Id.* at 101.

158 Nathaniel Popper, *Mt. Gox Creditors Seek Trillions Where There Are Only Millions*, N.Y. TIMES, May 25, 2016, <https://www.nytimes.com/2016/05/26/business/dealbook/mt-gox-creditors-seek-trillions-where-there-are-only-millions.html> [<https://perma.cc/BF85-VRL2>]. The total amount sought as noted by Popper was \$2,411,412,137,427, which "is in the same ballpark as the economic output of France." *Id.*

159 *Id.*

160 *Id.*

161 See Gareth W. Peters et al., *Opening Discussion on Banking Sector Risk Exposures and Vulnerabilities from Virtual Currencies: An Operational Risk Perspective*, 17 J. BANKING REGULATION 239, 258 (2016). Available from <https://arxiv.org/pdf/1409.1451.pdf> [<https://perma.cc/TB7D-AC8P>]. As Peters et al. note, there is not a consensus as to what led to or what shortcomings facilitated the theft from Mt. Gox. *Id.*

162 Potentially, raising more concerns for skeptics has been the decision by bitcoin exchange,

B. *The Silk Road*

Bitcoin itself is very innocuous, but because of its digital nature it allows for transfers that do not require an in-person exchange.¹⁶³ While online black markets exist in various outer reaches of the internet, none were as prominent as the Silk Road, a darknet market that operated between 2011 and 2013. The Silk Road facilitated transactions using a multistep process, which began with anonymizing a user's connection. The Silk Road would then anonymize the use of bitcoin by various third-party applications by combining payments with various other buyers and sellers to hide the initiator. Users could then purchase a cornucopia of illegal items, including drugs, guns, and banned animals.¹⁶⁴ The Silk Road was shut down in October 2013, when FBI agents arrested the "Silk Road's mastermind" at a San Francisco public library.¹⁶⁵

Bitfinex to cease accepting wire deposits. See Jasmine Solana, *Bitfinex Deposit Halt Stokes Fears of Mt. Gox-style Meltdown*, CALVIN AYRE (Apr. 18, 2017), <https://calvinayre.com/2017/04/18/business/bitfinex-deposit-halt-stokes-fears-mt-gox-style-meltdown> [<https://perma.cc/R38D-S8SA>] (Last Accessed Apr. 4 2018).

163 Tsukerman, *supra* note 138, at 1147.

164 *Id.* at 1148.

165 *Id.* at 1149. The arrest of Ross Ulbricht, was the result of Ulbricht's own real-world carelessness as opposed to a breakdown in the anonymity of the Silk Road. See Eric Engle, *Is Bitcoin Rat Poison? Cryptocurrency, Crime, and Counterfeiting (CCC)*, 16 J. HIGH TECH. L. 341 (2016). Available from: <https://cpb-us-east-1-juc1ugur1qwqqo4.stackpathdns.com/sites.suffolk.edu/dist/5/1153/files/2016/05/Is-Bitcoin-Rat-Poison-Cryptocurrency-Crime-and-Counterfeiting-CCC-1.pdf> [<https://perma.cc/ZDB9-XEE2>]. The scene of Ulbricht's arrest was recounted as follows:

Behind Ulbricht in the library, a man and woman started a loud argument. Ulbricht turned to look at this couple having a domestic dispute in awkward proximity to him, but when he did so, the man reached over and pushed Ulbricht's open laptop across the table. The woman grabbed it and handed it off to FBI Special Agent Thomas Kiernan, who was standing nearby.

Ulbricht was arrested, placed in handcuffs, and taken downstairs. Kiernan took photos of the open laptop, occasionally pressing a button to keep it active. Later, he would testify that if the computer had gone to sleep, or if Ulbricht had time to close the lid, the encryption would have been unbreakable. "It would have turned into a brick, basically," he said.

Joe Mullin, *Sunk: How Ross Ulbricht Ended Up In Prison for Life*, ARS TECHNICA, <https://arstechnica.com/tech-policy/2015/05/sunk-how-ross-ulbricht-ended-up-in-prison-for-life> [<https://perma.cc/679K-6ZXK>] (Last accessed Apr. 4, 2018). The Silk Road was in fact brought down by a Homeland Security Investigations agent who spent two years undercover gaining the trust of Ulbricht, even collecting a salary as an employee. *Id.* Later versions of the Silk Road have emerged since Ulbricht's incarceration, and despite continued efforts by authorities to shutter these sites on the darknet there have been at least two subsequent Silk Road's following the seizure of the original site. See Hope Reese, *How the Founder of the Silk Road Made Millions on his Illegal Startup on the Dark Web*, TECH REPUBLIC (May 10, 2017 2:44 PM), <https://www.techrepublic.com/article/how-online-marketplace-silk-road-became-the-craigslist-for-illegal-drugs> [<https://perma.cc/9EQH-LLD9>] (Last accessed Apr. 4 2018).

Ross Ulbricht was charged with a variety of counts, including participating in a narcotics trafficking conspiracy, a computer hacking conspiracy, a continuing criminal enterprise, and a money laundering conspiracy.¹⁶⁶ The court identified several questions arising from the structure of the Silk Road, noting that the Silk Road differed from legitimate online businesses and distinguishing Ulbricht from web designers who were typically not held to account for illegal activity that is transacted on their sites.¹⁶⁷ The Southern District of New York opinion described Ulbricht's defenses to the first three counts as "the kitchen sink arguments," because the defenses raised ranged from calling the statutes void for vagueness to claiming immunity under protections for internet service providers.¹⁶⁸ The court articulated that:

Ulbricht's alleged conduct is not analogous to an individual who merely steers buyers to sellers; rather, he has provided the marketing mechanism, the procedures for the sale, and facilities for the actual exchange. He is alleged to know that his facilities would be used for illicit purposes and, in fact, that he designed and operated them for that purpose. In this regard, he is alleged to have "intentionally and knowingly" "combine[d], conspire[d], confederate[d], and agree[d]" with others to violate United States criminal law. Ulbricht's alleged conduct is more akin to a builder who designs a house complete with secret entrances and exits and specially designed traps to stash drugs and money; this is not an ordinary dwelling, but a drug dealer's "dream house."¹⁶⁹

Ulbricht's motion to dismiss the charges was denied, paving the way for his trial and eventual conviction.¹⁷⁰ Ulbricht was convicted of all charges after roughly three-and-a-half hours of jury deliberations,¹⁷¹ sentenced to life in

166 United States v. Ulbricht, 31 F. Supp. 3d 540, 546 (S.D. N.Y. 2014).

167 *Id.* at 547. The concerns regarding the liability associated with operating a website or forum that is then used by third-parties for illicit activities has lingered for some time. See *Crime and Craigslist*, BOSTON GLOBE Apr. 23, 2009, http://archive.boston.com/bostonglobe/editorial_opinion/editorials/articles/2009/04/23/crime_and_craigslist [<https://perma.cc/HY62-G83G>] (Last accessed Apr. 4 2018). In 2016 litigation, Backpage.com, a website that posts links to a variety of services of varying levels of legality was successful in avoiding liability against victims of sex trafficking who sued alleging that the website was "tailored . . . to make sex trafficking easier." Jane Doe No. 1 v. Backpage.com, LLC, 817 F.3d 12, 29 (1st Cir. 2016).

168 *Ulbricht*, 31 F. Supp. 3d at 548.

169 *Id.* at 561.

170 *Id.* at 570.

171 Andy Greenberg, *Silk Road Mastermind Ross Ulbricht Convicted of All 7 Charges*, WIRED, Feb. 4, 2015, <https://www.wired.com/2015/02/silk-road-ross-ulbricht-verdict> [<https://perma.cc/3PQZ-DPAR>] (Last Accessed Apr. 4 2018). In an odd twist at Ulbricht's trial, it was alleged that one of Homeland Security's alternative suspects was Mark Karpeles of Mt. Gox. *Id.* Indeed, the revelations that Homeland Security once considered Karpeles a suspect were later declared inadmissible on the basis that they were based on the testifying agent's beliefs versus "competent evidence." See Andy Greenberg, *Silk Road Judge 'Eviscerates' Defense's Evidence that Mt. Gox CEO was*

prison without the possibility of parole, and forced to pay more than \$180 million in restitution.¹⁷² In a further twist to the Ulbricht saga, it was later revealed that federal agents involved in the investigation had stolen millions of dollars' worth of bitcoin from the Silk Road.¹⁷³ The conduct of the agents and its exclusion from the trial formed a partial basis for Ulbricht's appeal.¹⁷⁴ While the stories of Karpeles and Ulbricht are frequently cited by those fearful of the change brought about by disruptive virtual currencies such as bitcoin, these currencies continue to persist and the application of antiquated statutes have led to a variety of disparate decisions in different jurisdictions.

C. State v. Espinoza

On July 22, 2016, Judge Teresa Pooler of the Circuit Court of Florida's Eleventh Judicial Circuit issued a ruling that drew little fanfare but has had large implications.¹⁷⁵ The case involved a joint investigation into the website localbitcoins.com undertaken by the Miami Beach Police Department and the United States Secret Service's Miami Electronic Crimes Task Force. Detective Arias of the Miami Beach Police and Special Agent Ponzi of the Secret Service responded to an online advertisement looking to purchase bitcoin.¹⁷⁶ The post from the defendant informed them that in order to transfer the bitcoin, the buyer would need to meet the defendant at a Miami Starbucks with cash, a cell phone, and the address of where to deposit the bitcoin.¹⁷⁷ Following an initial purchase, the law enforcement officials arranged for a second purchase of bitcoin in exchange for \$1000.¹⁷⁸ Detective Arias, operating in an undercover capacity, informed the defendant that he was using the bitcoin to purchase stolen credit card information and would be interested in knowing if the defendant would accept stolen credit card information as payment. The defendant responded that he would think about it.¹⁷⁹ Following a final proposed exchange totaling \$30,000 worth of bitcoin, the defendant was arrested and charged with

a Suspect, WIRED, Jan. 20, 2015, <https://www.wired.com/2015/01/silk-road-judge-eviscerates-mt-gox-ceo-karpeles-defense> [<https://perma.cc/X3L3-PFR2>] (Last accessed Apr. 4, 2018).

172 Andy Greenberg, *Silk Road Creator Ross Ulbricht Sentenced to Life in Prison*, WIRED, May 29, 2015, <https://www.wired.com/2015/05/silk-road-creator-ross-ulbricht-sentenced-life-prison> [<https://perma.cc/MX5H-3G9F>] (Last Accessed Apr. 4, 2018).

173 *Id.*

174 See Andy Greenberg, *Judges Question Ross Ulbricht's Life Sentence in Silk Road Appeal*, WIRED, Oct. 6, 2016, <https://www.wired.com/2016/10/judges-question-ulbrichts-life-sentence-silk-road-appeal> [<https://perma.cc/X3L3-PFR2>].

175 Order Granting Defendant's Motion to Dismiss the Information, *State v. Espinoza*, F14-2923 (Fl. 11th Cir Ct. Jul. 22, 2016).

176 *Id.* at 2.

177 *Id.*

178 *Id.*

179 *Id.*

operating an unlawful money services business as a money transmitter and two counts of money laundering.¹⁸⁰

In response to the defendant's motion to dismiss, the court examined the Florida statute which requires money services businesses to be licensed and concluded that the defendant's activities did not violate the statute because the defendant was a seller—not a middleman—in a transaction for the transfer of money from one person to another.¹⁸¹ Additionally, the court found that bitcoin does not meet the Florida statutory definition for “payment instrument” and noted that the IRS has classified bitcoin as a form of property.¹⁸² In regards to the money laundering counts, the court concluded that bitcoin is not a monetary instrument.¹⁸³ In concluding that bitcoin was property, as opposed to currency, Judge Pooler suggested that the Florida statute requires a modernization and at present the statute was inapplicable to virtual currencies, including bitcoin.¹⁸⁴

The state has filed an appeal in the *Espinoza* case,¹⁸⁵ but several other state legislatures have taken it upon themselves to update their money services and money transmitter statutes to incorporate decentralized currencies such as bitcoin.¹⁸⁶ Both Texas and Kansas have revamped their state statutes. Texas

180 *Id.* at 3.

181 *Id.* at 4. The relevant Florida statutory section is §560.125 (1), (5)(a) and (5)(b) and states the following:

A person may not engage in the business of a money services business or deferred presentment provider in this state unless the person is licensed or exempted from licensure under this chapter. A deferred presentment transaction conducted by a person not authorized to conduct such transaction under this chapter is void, and the unauthorized person has no right to collect, receive, or retain any principal, interest, or charges relating to such transaction.

(5) A person who violates this section, if the violation involves:

(a) Currency or payment instruments exceeding \$300 but less than \$20,000 in any 12-month period, commits a felony of the third degree, punishable as provided in s. 775.082, s. 775.083, or s. 775.084.

(b) Currency or payment instruments totaling or exceeding \$20,000 but less than \$100,000 in any 12-month period, commits a felony of the second degree, punishable as provided in s. 775.082, s. 775.083, or s. 775.084.

See *Espinoza*, F14-2923 at 3–4.

182 *Id.* at 5.

183 *Id.* at 6. The Florida statute defines as “a coin or currency of the United States or any other country, travelers’ checks, personal checks, bank checks, money orders, investment securities in bearer form or otherwise in such form that title thereto passes upon delivery, and negotiable instruments in bearer form or otherwise such form that title thereto passes upon delivery.” *Id.* (quoting Fla. Stat. §896.101 (2)(e)).

184 *Id.* at 7–8.

185 See Stan Higgins, *Florida Files Appeal After Charges Against Bitcoin Seller Dismissed*, COINDESK, Aug. 22, 2016, <http://www.coindesk.com/florida-files-appeal-charges-bitcoin-seller-dismissed> [https://perma.cc/A2VE-SCLA] (Last Accessed Apr. 4, 2018).

186 See Allison Caffarone & Meg Holzer, ‘Ev’ry American Experiment Sets a Precedent’: Why One Florida State Court’s Bitcoin Opinion is Everyone’s Business, 16 J. INT’L BUS.

specifies that “‘money’ or ‘monetary value’ means currency or a claim that can be converted into currency through a financial institution, electronic payments network, or other formal or informal payment system.”¹⁸⁷ In contrast, “Kansas defines monetary value as ‘a medium of exchange, whether or not redeemable in money.’”¹⁸⁸ Professors Caffarone and Holzer have critiqued Pooler’s decision in *Espinoza*, articulating that the decision—which relied on Black’s Law Dictionary—was read incorrectly, noting that there is no known definition of a “middleman requirement.”¹⁸⁹ Further, Caffarone and Holzer observe that the *Espinoza* defendant may have met the FinCEN definition of money services business by virtue of the premium which he charged for the transfer of bitcoin.¹⁹⁰ The current status of bitcoin, the most prominent virtual currency, remains unclear, and the status of other virtual currencies is even less clear.¹⁹¹

D. *FIFA Coins*

On August 16, 2016, the United States filed a sealed indictment against Anthony Clark alleging one count of conspiracy to commit wire fraud.¹⁹² The indictment specified that “[t]he defendant, Anthony Clark, . . . devised and intended to devise a scheme and artifice to defraud EA [Electronic Arts] by obtaining ‘FIFA Coins’ by means of materially false and fraudulent pretenses and representation.”¹⁹³ Effectively, the indictment stated that the defendant conspired to fraudulently obtain virtual currency from a soccer video game. FIFA Soccer is a video game produced annually by the Electronic Arts (EA) company.¹⁹⁴ In 2009, EA released an in-game feature called FIFA Ultimate Team (FUT), which allowed users to create and customize their own players. The feature became a popular part of future versions of the game.¹⁹⁵ Indeed, the FUT feature was so popular that users purchased FIFA coins—an in-game currency purchased using conventional payment methods—to purchase FUT

L. 34 (2017).

187 *Id.* at 40.

188 *Id.* Caffarone and Holzer observed that a variety of other states have taken varying approaches to regulating virtual currencies including New York, New Hampshire, and North Carolina. *Id.*

189 *Id.* at 45.

190 *Id.* at 47.

191 The problem with determining bitcoins’ status is not isolated to individual states, nor is it even isolated to the United States, as a Dutch court previously determined that bitcoin did not meet the relevant definition of legal tender in the country. *See* Jamie Redman, *Florida Appeals Espinoza Decision, Bitcoin’s Status at Stake*, BITCOIN.COM (Aug. 28, 2016), <https://news.bitcoin.com/florida-appeals-espinoza-decision> [<https://perma.cc/V5DS-EGJQ>] (Last Accessed Apr. 4, 2018).

192 Indictment, United States v. Clark, No. 4:16-cr-00205-O (N.D. Tex. Aug. 16, 2016).

193 *Id.* at 6.

194 *Id.* at 3.

195 *Id.*

card packs.¹⁹⁶ The FIFA card packs contain attributes that assist the user in building the user's FUT team, including increases in player skill ratings for passing, shooting, and defense.¹⁹⁷ But attributes may be redundant or useless to a particular user. In those cases the user may attempt to sell the attributes through an in-game marketplace for FIFA coins.¹⁹⁸ The prices for items on the market fluctuate based on the number of FIFA coins that have been produced by the game since its inception.¹⁹⁹ The FIFA coins are a bonus feature for EA. They generate millions of dollars annually in additional revenue for EA as users attempt to supplement the FIFA coins they earn through game-play achievements with those they purchase with conventional currencies.²⁰⁰

On December 11, 2016, following a jury trial and conviction on the lone charge, Clark moved for a new trial. He alleged that the government had failed to prove its case that FIFA coins constituted money or property, and that they were obtainable items.²⁰¹ In response to the government's alleged failure to show that FIFA coins were money or property, the defendant argued that the government raised two theories: that the EA lost revenue as a result of Clark's conduct and that FIFA coins are the intellectual property of EA.²⁰² Clark argued that the first theory was deficient because it was not contained in the indictment and that the second theory failed because the government failed to produce "credible evidence that FIFA coins were a trade secret or subject to copyright, trademark, or patent."²⁰³ The defendant relied on EA's own terms of service for the FIFA game, which stated that FIFA coins have "no monetary value and do . . . not constitute currency or property of any type."²⁰⁴ The defendant further argued that the government could not establish a central element of wire fraud—obtainability—because the coins are simply record numbers on a ledger that remains in the possession of EA at all times.²⁰⁵

In their response to Clark's motion for a judgment of acquittal, the government argued that the theory advanced at trial was consistent with the

196 *Id.* at 3–4.

197 Rodrigo Lopes, *FIFA 17 Players Cards Guide-Cards Colours and Categories*, FIFAU-TEAM (Sep. 4, 2016), <https://www.fifauteam.com/fifa-17-players-cards-guide-colours> [<https://perma.cc/4E32-QCME>].

198 *Id.* at 4–5.

199 *Id.* at 5.

200 *Id.*

201 Mot. for a J. of Acquittal or, Alternatively, Mot. for a New Trial, *United States v. Clark*, No. 4:16-cr-00205-O (N.D. Tex. Dec. 11, 2016).

202 *Id.* at 3.

203 *Id.*

204 *Id.* at 8.

205 *Id.* at 11–12. Clark argued that obtaining property requires "not only the deprivation but also the acquisition of property," and because there was no actual transfer of the coins the element was not satisfied. *Id.* citing *Sekhar v. United States*, 570 U.S. 729 (2013), 133 S. Ct. 2720, 2725 (2013).

language of the indictment.²⁰⁶ In its response, the government stated that the scheme implicated FIFA coins because it “*involved*, but was not necessarily *limited to*, FIFA coins.”²⁰⁷ To counter the defense’s assertion that FIFA coins did not constitute property, the government referenced the testimony of Ahsan Nanji, EA’s director of product management. Nanji testified that to his knowledge the FIFA coins are the intellectual property of EA.²⁰⁸ The government also referenced testimony from EA’s attorney, who had testified as to the scope of EA’s terms of service limiting the transferability of EA’s intellectual property.²⁰⁹ The day before sentencing the 27-year-old Clark was found dead at his home in Whittier, California.²¹⁰ Clark’s death preceded any ruling from the Northern District of Texas District Court on his pending motions and the matter was dismissed on March 17, 2017.²¹¹

Clark’s death leaves many questions as to the legal status of virtual currencies more similar to FIFA coins than bitcoin unresolved. These secondary-level virtual currencies, which are seemingly restricted to in-game use and possess no stated value, may pose regulatory problems for lawmakers seeking to use antiquated laws to crack down on use. Indeed, just as the *Espinoza* court struggled to apply state money services laws to bitcoin transactions, lawmakers and other courts will likely struggle to apply existing law to virtual

206 Gov’t’s Response to the Def.’s Mot. for a J. of Acquittal or, Alternatively, Mot. for a New Trial, United States v. Clark, No. 4:16-cr-00205-O (N.D. Tex. Jan. 5, 2017).

207 *Id.* at 3.

208 *Id.* at 7.

209 *Id.* at 9–10. Shortly after the government’s response, the defense filed their response, asserting that the indictment was constructively amended to advance the theory that EA lost revenue as a result of the defendant’s activities. Def.’s Reply Br. in Support of His Mot. for a J. of Acquittal or, Alternatively, Mot. for a New Trial, United States v. Clark, No. 4:16-cr-00205-O (N.D. Tex. Jan. 11, 2017). The next day the defendant filed a new motion to dismiss, alleging prosecutorial misconduct. Mot. to Dismiss the Indictment Because of Prosecutorial Misconduct, United States v. Clark, No. 4:16-cr-205-O (N.D. Tex. Jan. 20, 2017). The motion alleged that the defendant had been denied adequate notice of the charges and evidence as a result of the “lost FIFA point revenue theory at trial.” *Id.* at 1. The defendant argued that the prosecution had concealed evidence regarding the loss of revenue associated with FIFA points by EA and that its introduction in a rebuttal to the defendant’s closing argument prevented him from rebutting the assertion. *Id.* at 2. The government response was filed on February 3, 2017, and asserted that Clark’s allegations were baseless. *Id.* Clark’s attorneys filed a motion to delay sentencing, as a result of a broken leg suffered by one of the defendant’s attorneys and preventing them from being able to adequately coordinate in preparation with Clark’s other attorney. Second Unopposed Mot. to Continue Sentencing, United States v. Clark, No. 4:16-cr-00205-O (N.D. Tex. Feb. 14, 2017).

210 Brian Day, *Whittier Man Found Dead While Awaiting Sentencing in \$16 Million ‘FIFA coin’ Fraud Case*, WHITTIER DAILY NEWS (Mar. 22, 2017), <http://www.whittierdailynews.com/general-news/20170322/whittier-man-found-dead-while-awaiting-sentencing-in-16-million-fifa-coin-fraud-case> [https://perma.cc/6NQG-F245].

211 See Mot. to Dismiss as to Anthony Clark, No. 4:16-cr-00205-O (N.D. Tex. Mar. 16, 2017).

currency transactions. Moreover, as will be discussed in the following sections, the argument advanced by the defendant in *Clark* is not without merit under existing precedent. In fact, terms of service agreements like EA's—stating that coins, tokens, or chips have no cash value—may have unintentionally created a loophole that could enable companies to offer sports betting with immunity from relevant federal and state laws.

IV. ILLEGAL GAMBLING

Gambling regulations in the United States have been historically viewed as an issue controlled by the states; however, the federal government relies on several statutes to supplement the authority of the states.²¹² The online wagering market in the United States has been primarily confined by four federal statutes: the Wire Act, the Illegal Gambling Business Act (IGBA), the Professional and Amateur Sports Protection Act (PASPA), and the Unlawful Internet Gambling Enforcement Act (UIGEA).²¹³ Despite the web of state and federal laws restricting online gambling, Americans have no shortage of accessible options to gamble online, with some companies advertising to U.S. customers that by virtue of using virtual currencies the activity is legal.²¹⁴ The four primary statutes used to enforce federal online gambling law provide a patchwork of illegality driven in part by the fact that only UIGEA was passed after most Americans had home access to the internet.

A. *The Wire Act*

Early attempts by the federal government to combat online gambling relied on the use of the Kennedy-era Wire Act.²¹⁵ The Wire Act was designed to allow the federal government to target organized crime's use of interstate wire services to transmit sports scores and animal race results, enabling them to operate illegal bookmaking enterprises.²¹⁶ The Wire Act states

212 See Bruce P. Keller, *The Game's the Same: Why Gambling in Cyberspace Violates Federal Law*, 108 YALE L.J. 1159, 1576 (1999) ("Gambling legislation is largely a matter of state law and, as a result, varies considerably, running from prohibition to regulation to taxation to the even more remunerative scheme of outright cooption, most notably in the form of state-run lotteries.").

213 See Jerry Brito et al., *Bitcoin Financial Regulation: Securities, Derivatives, Prediction Markets, and Gambling*, 16 COLUM. SCI. & TECH. L. REV. 144, 199 (2014). While Brito et al., do not identify PASPA as a relevant statute for regulating online gambling, PASPA plays an important role in confining full-scale sports betting to the state of Nevada. See Ryan M. Rodenberg & Anastasios Kaburakis, *Legal and Corruption Issues in Sports Gambling*, 23 J. LEGAL ASPECTS OF SPORT 8 (2013).

214 Brito et al., *supra* note 213, at 199 (stating "[f]or example, coinbet.cc offers poker, casino games, and sports betting to U.S. customers and claims that by using bitcoin, its offering is legal.").

215 See Gerd Alexander, *The U.S. On Tilt: Why the Unlawful Internet Gambling Enforcement Act is a Bad Bet*, 5 DUKE L. & TECH. REV. 1 (2008).

216 See generally DAVID G. SCHWARTZ, CUTTING THE WIRE: GAMING PROHIBITION AND THE

Whoever being engaged in the business of betting or wagering knowingly uses a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event or contest, or for the transmission of a wire communication which entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers, shall be fined under this title or imprisoned not more than two years, or both.²¹⁷

The statutory language contains several important limiting factors. First, the statute only applies to those “in the business of betting or wagering.” Indeed, the bill’s architect, Attorney General Robert F. Kennedy, specifically stated in a letter to then President John F. Kennedy,²¹⁸ that the Wire Act was not intended to apply to casual bettors. The second element of the Wire Act further limits the scope of the statute to “any sporting event or contest.”²¹⁹ Facially, the statute clearly and specifically references application to sporting events or contests, seemingly excluding other forms of gambling activity. This factor has been the subject of much debate within the internet era.²²⁰

The argument that the Wire Act was intended to apply to gambling beyond the “sporting events or contest” language of the statute—as some prominent elected representatives have articulated—is not supported by the legislative history of the Wire Act. In defining the contours of the Wire Act, Former Assistant Attorney General Herbert Miller had the following exchange with Senator Estes Kefauver in 1961:

Mr. Miller. . . . Oh, you mean gambling on other than a sporting event or contest?
 Senator Kefauver. Yes.

INTERNET (2005).

217 Transmission of Wagering Information, 18 U.S.C. § 1084 (1961).

218 Letter from Robert F. Kennedy, Attorney General of the United States, to John F. Kennedy, President of the United States (December 28, 1961) (on file with author). Robert F. Kennedy also testified in support of the Wire Act stating “is not interested in the casual dissemination of information with respect to football, baseball or other sporting events between acquaintances.” See *The Attorney General’s Program to Curb Organized Crime Hearings on S. 1653, S. 1654, S. 1955, S. 1656, S. 1657, S. 1658 & S. 1665 Before the S. Comm. on the Judiciary*, 87th Cong. 1 (1961). It has been observed that some members of Congress voiced displeasure that the Wire Act did not encapsulate the act of casual betting. See Ben J. Hayes & Matthew J. Conigliaro, “*The Business of Betting of Wagering*”: A Unifying View of Federal Gaming Law, 57 *DRAKE L. REV.* 445, 452–454 (2009).

219 18 U.S.C. § 1084(a) (1961).

220 Several have speculated that efforts to expand the scope of the Wire Act beyond mere application to “sporting event[s] or contest[s]” is being driven by land-based casino magnate Sheldon Adelson. See Chris Grove, *Federal Online Gambling Ban is Job-Killing, Tax-Raising Cronyism and a Waste of Everyone’s Time*, *HUFFINGTON POST* (Apr. 17, 2017, 9:30 AM), http://www.huffingtonpost.com/entry/federal-online-gambling-ban-is-job-killing-tax-raising_us_58f3b057e4b04cae050dc87c [<https://perma.cc/X96E-FSHN>].

Mr. Miller. This Bill, of course, would not cover that because it is limited to sporting events or contests.²²¹

In 2002, the U.S. Court of Appeals for the Fifth Circuit reached the same conclusion—that the Wire Act only “concerns gambling on sporting events or contests”—in finding that the plaintiffs in litigation could not avoid gambling debts by raising defenses of illegality, because their cited gambling failed to allege sports gambling.²²² This opinion was supplemented by the Office of Legal Counsel in a 2011 memorandum issued by Assistant Attorney General Virginia Seitz. The memorandum articulated the Department of Justice’s position that the statute only applies to sporting events and contests and does not prohibit the use of out of state providers for intra-state lottery sales.²²³ Despite the Wire Act’s apparent limitations in application to only sporting events and contests, the statute is one of the most powerful tools in the Department of Justice’s arsenal, given the size of the online sports gambling industry.²²⁴

B. *The Illegal Gambling Business Act*

The IGBA is a federal statute that is likely relevant to some online gambling ventures that operate using virtual currencies. The IGBA, which was passed in 1970, makes it a federal crime if a business that employs more than five individuals violates an existing state gambling regulation, and is in operation for thirty days or more or sees gross revenue in excess of \$2000 in a single day.²²⁵ The IGBA, like the Wire Act, was not passed with the intention of criminalizing gambling between friends; instead the IGBA was tasked with stopping organized crime’s lucrative gambling operations.²²⁶ The scope of the IGBA is exceptionally broad, as it functions to criminalize virtually any state-level gambling offense that applies to more than five people.²²⁷ The passage of the IGBA was, in part, driven by the federal government’s concern that state law enforcement officials were not effectively enforcing local gambling laws.²²⁸ The

221 *The Attorney General’s Program to Curb Organized Crime Hearings on S. 1653, S. 1654, S. 1955, S. 1656, S. 1657, S. 1658 & S. 1665 Before the S. Comm. on the Judiciary*, 87th Cong. 278 (1961).

222 *In re MasterCard Int’l, Inc.*, 313 F.3d 257, 262–63 (5th Cir. 2002).

223 *See* Whether Proposals by Illinois and New York to Use the Internet and Out-of-State Transaction Processors to Sell Lottery Tickets to In-State Adults Violate the Wire Act, 35 Op. O.L.C. 1 (Sep. 20, 2011).

224 *See generally* NAT’L GAMBLING IMPACT STUDY COMM’N, GAMBLING IN THE UNITED STATES *supra* note 14 and accompanying text. In addition to the various gambling specific statutory tools prosecutors may be able to prosecute certain acts by relying on broad statutes such as the federal wire fraud statute. *See* 18 U.S.C. § 1343.

225 *See* Prohibition of Illegal Gambling Businesses, 18 U.S.C. § 1955 (1970).

226 Michael D. Schmitt, *Prohibition Reincarnated? The Uncertain Future of Online Gambling Following the Unlawful Internet Gambling Enforcement Act of 2006*, 17 U. So. CAL. INTERDISC. L.J. 381, 387 (2008).

227 *Id.*

228 *See* Kaitlyn Dunphy, *Following Suit With the Second Circuit: Defining the Illegal*

scope of the IGBA means that virtually any gambling activity that operates in violation of state law may be rendered similarly illegal under federal law.²²⁹

C. *The Professional and Amateur Sports Protection Act*

The third federal statute relevant to regulating virtual currencies and the online gambling industry is PASPA, a 1992 statute that affords injunctive relief to private sports leagues.²³⁰ PASPA makes it unlawful for a government or person to “sponsor, operate, advertise, or promote, pursuant to the law or compact of a governmental entity,” any of the following: “a lottery, sweepstakes, or other betting, gambling, or wagering scheme based, directly or indirectly [. . .] on one or more competitive games in which amateur or professional athletes participate, or are intended to participate, or on one or more performances of such athletes in such games.”²³¹ The statute acts as a bar to the expansion of the types of sports betting offered by states prior to the passage of the statute.²³² The statute further grants the enforcement authority to both professional or amateur sports leagues and the Attorney General of the United States.²³³ Despite several challenges to PASPA, the statute has passed constitutional muster on several occasions.²³⁴

Though PASPA has been criticized, the statute has endured, providing a sports betting monopoly to a select few grandfathered states.²³⁵ The statute’s

Gambling Business Act, 79 BROOKLYN L. REV. 1295, 1321–22 (2014);

229 See Anthony N. Cabot & Louis V. Csoka, *Fantasy Sports: One Form of Mainstream Wagering in the United States*, 40 J. MARSHALL L. REV. 1195, 1218 (2006). Cabot and Csoka further observe that the Travel Act (18 U.S.C. § 1952) which prohibits the use of the mail or cross state lines to commit some acts may also be relevant to understanding the scope of federal gambling law, though largely beyond the scope of the analysis *infra*.

230 See Professional and Amateur Sports Protection, 28 U.S.C. § 3701-04 (1992).

231 28 U.S.C. § 3702 (1992).

232 28 U.S.C. § 3704 (1992). Section 3704(a)(1) states that the statute does not apply to “a lottery, sweepstakes, or other betting, gambling, or wagering scheme in operation in a State or other governmental entity, to the extent that the scheme was conducted by that State or other governmental entity at any time during the period beginning January 1, 1976, and ending August 31, 1990.”

233 28 U.S.C. § 3703 (1992).

234 See Nat’l Collegiate Athletic Ass’n v. Gov. of NJ, 730 F.3d 208 (3d Cir. 2014), *cert. denied*, 134 S. Ct. 2866 (2014) (finding that the enactment of PASPA was within Congress’ commerce clause power and that PASPA does not unlawfully commandeer the state of New Jersey in violation of the Tenth Amendment). See also *Office Comm. Baseball v. Markell*, 579 F.3d 293 (3d Cir. 2009). Though *Markell* did not center on PASPA’s constitutionality the Third Circuit stated “Because we do not find PASPA ambiguous, we find unpersuasive Delaware’s argument that its sovereign status requires that it be permitted to implement its proposed betting scheme.” *Id.* at 303. See also Nat’l Collegiate Athletic Ass’n v. Gov. of NJ, 832 F.3d 389 (3d Cir. Aug. 9, 2016).

235 See generally John T. Holden et al., *Sports Gambling Regulation and Your Grandfather (Clause)*, 26 STAN. L. & POL’Y REV. ONLINE 1 (2014). See also Ryan M. Rodenberg & John T. Holden, *Sports Betting Has An Equal Sovereignty Problem*, 67 DUKE L.J. ONLINE 1 (2017).

lack of criminal penalties, in addition to the selectivity in filing suit by those with the power to enforce it, has prompted some to articulate that it may be time to repeal the statute.²³⁶ The commonly cited argument is that the prohibition against sports betting, rather than stopping the activity, has driven it into underground enterprises.²³⁷ The lack of enforcement against daily fantasy sports operators raises further questions about the willingness to enforce PASPA. However, in addition to a seeming lack of willingness to enforce the statute against some entities, there is a question as to whether PASPA would be applicable to certain types of virtual currencies.²³⁸ The Wire Act, the IGBA, and PASPA all pre-date widespread access to the internet, and as such they were not passed in contemplation of virtual currencies. UIGEA is the first federal statute specifically addressing illegal gambling on the internet.

D. *The Unlawful Internet Gambling Enforcement Act*

UIGEA was passed in 2006, on the last day that Congress was in Washington prior to midterm elections.²³⁹ Despite the reported midnight deals and attachment to an unrelated port security bill, the legislation had been debated in various forms for nearly a decade beforehand.²⁴⁰ UIGEA does not prohibit online gambling. Instead, the statute regulates certain transactions sent and received by financial services companies and those who receive those transactions.²⁴¹ UIGEA did not do anything to effectively alter the status quo. The statute's rule of construction stated, "No provision of this subchapter shall be construed as altering, limiting, or extending any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States."²⁴² By not preempting existing state or federal laws, UIGEA's application was essentially limited to otherwise unlawful gambling.²⁴³

236 See Dustin Gouker, *Law Enforcement Officials to Congress: Repeal Sports Betting Prohibition*, LEGAL SPORTS REPORT (Sep. 21, 2016, 11:32 PM), <http://www.legalsportsreport.com/11603/aga-sports-betting-report> [https://perma.cc/5S8H-AV5W].

237 *Id.*

238 Given that PASPA's application is limited to "lotteries, sweepstakes, or other betting, gambling, or wagering scheme . . ." it is possible that some virtual currency gambling transactions discussed *infra* may not implicate the statute. 28 U.S.C. § 3702 (1992).

239 See I. N. Rose & Rebecca Bolin, *Game On for Internet Gambling: With Federal Approval, States Line Up to Place Their Bets*, 45 CONN. L. REV. 655, 667 (2012) [hereinafter "Rose & Bolin *Game On*"].

240 *Id.* at 667, n. 90 (citing *Can Internet Gambling be Effectively Regulated to Protect Consumers and the Payments System?: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 12 (2007) (statement of Radley Balko, Senior Editor, Reason Magazine). For examples of the extensive number of hearings that predated passage of UIGEA, see, e.g., *Internet Crimes Affecting Consumers: Hearing Before the S. Comm on Judiciary*, 105th Cong. 1 (1997).

241 See Rose & Bolin *Game On*, *supra* note 239.

242 31 U.S.C. § 5361(b).

243 See Rose & Bolin *Game On*, *supra* note 239. Rose and Bolin argued that "UIGEA is

UIGEA's application to certain virtual currency transactions has further been questioned by some scholars as some online transactions lack an intermediary processor—the type that is typically executed by third-parties such as wire transfer companies like Western Union or Electronic Funds Transfer.²⁴⁴ However, UIGEA's definition of electronic fund transfer calls into question “whether a bitcoin transaction sent directly from the consumer to the gambling business, with no intermediary between them, qualifies as an ‘electronic fund transfer,’” given the necessary involvement of a financial institution.²⁴⁵

While the application of UIGEA to certain virtual currency transactions may be limited, there is a wide variety of federal statutes in a U.S. Attorney's arsenal to prosecute certain virtual currency transactions, including the Wire Fraud statute that was used in the prosecution of the *Clark* case.²⁴⁶

E. State Law

Despite the various federal statutes regulating gambling at the federal level, the power to regulate gambling has traditionally been vested in the states.²⁴⁷ State gambling classification schemes fall into four distinct categories, which determine the permissibility of an activity based on the level of skill involved.²⁴⁸ The most commonly used test to determine whether an activity is considered gambling is referred to as the Dominant Factor Test.²⁴⁹ The Dominant Factor Test requires to the court to ask “whether ‘player skill’ or ‘uncontrollable chance’ is the most likely factor that will influence the outcome of a contest.”²⁵⁰ The application of the dominant factor test is the subject of some controversy in games of mixed skill and chance.²⁵¹ While the distinction

riddled with loopholes that inadvertently open the door to many forms of online gaming . . . ” *Id.* at 668.

244 An Electronic Funds Transfer is sometimes referred to as consumer banking and is the process by which consumers are able to transfer funds amongst computerized banking networks, such as making an online credit card payment. *Consumer Information: Electronic Banking*, FEDERAL TRADE COMMISSION (Aug. 2012), <https://www.consumer.ftc.gov/articles/0218-electronic-banking> [<https://perma.cc/YEE2-8N53>].

245 Jerry Brito et al., *Bitcoin Financial Regulation: Securities, Derivatives, Prediction Markets, and Gambling*, 16 COLUM. SCI. & TECH. L. REV. 144, 202 (2014).

246 See Indictment, *United States v. Clark*, 4:16-cr-00205-O (N.D. Tex. Aug. 16, 2016). For a general overview of the breadth of the federal wire fraud statute, see generally Nirav Shah, *Mail and Wire Fraud*, 40 AM. CRIM. L. REV. 825 (2003).

247 See Keller, *supra* note 212. See also Interstate Horseracing Act of 1978, 15 U.S.C. §§ 3001–07 (2006).

248 Ryan Rodenberg, *Why Do States Define Gambling Differently?*, ESPN (Feb. 18, 2016), http://www.espn.com/chalk/story/_/id/14799507/daily-fantasy-why-do-states-define-gambling-differently [<https://perma.cc/949L-YMSG>].

249 See Cabot & Csoka, *supra* note 229, at 1204.

250 *Id.*

251 *Id.* For instance, the authors note that while roulette is an obvious game of chance, and conversely chess is a skill-game, activities such as poker are the subject of some debate. *Id.*

between games of clear skill and games of clear chance is often abundantly clear, the games that occupy a gray area of uncertainty represent the greatest challenge for courts. Despite decades of reliance on these classifications, few courts or legislatures have undertaken to clarify how exactly to determine what level of skill exists in the activity.²⁵²

The second most frequently used of the four tests for classifying activities as gambling is the Material Element Test. This test has been referred to as “subtly subjective and problematic” because of the lack of uniform acceptance for what level of chance can be sufficient to rise to a level of materiality.²⁵³ The judicial analysis of the Material Element Test is composed of two parts. The first, asking whether there is sufficient consideration, is often satisfied by the payment of money.²⁵⁴ The second portion of the test tasks the finder of fact with determining whether chance plays a material role in the outcome of a game, regardless of the amount of skill involved.²⁵⁵ If the contest possesses a material amount of chance and awards a prize, in some states that contest may be classified as a prohibited form of gambling. The third test is the “Any-Chance Test” and is applied by a small group of states. It classifies games that contain any degree of chance as prohibited gambling. This poses an immense barrier for gaming operators.²⁵⁶

252 Jon Boswell, *Fantasy Sports: A Game of Skill That Is Implicitly Legal Under State Law, and Now Explicitly Legal Under Federal Law*, 25 CARDOZO ARTS & ENT. L.J. 1257, 1264-1265 (2007). There has been a reliance on mathematical studies to show the level of skill involved in various gambling activities; for instance, in New York litigation involving daily fantasy sports company FanDuel, Anette Hosoi, of the Massachusetts Institute of Technology, was hired to submit an Affidavit attesting to the predominance of skill-factors in successful daily fantasy play. Affidavit of Anette (Peko) Hosoi, *Schneiderman v. FanDuel Inc.*, No. 453056/2015 (N.Y. Sup. Ct. Nov. 23, 2015). Hosoi even provided the New York Supreme Court with mathematical findings that indicate skill factors in daily fantasy success were more prominent than in poker, but success in football, baseball and hockey daily fantasy games on FanDuel required greater skill than was required to be successful in actual National Football League, Major League Baseball, or National Hockey League games. *Id.* Relatedly, Robert C. Hannum, filed an Amicus Curiae brief in a support of a petition for certiorari arguing that mathematical analysis could conclusively show that Texas Hold ‘em Poker was a game where skill predominates over chance. See Brief for Amicus Curiae Robert C. Hannum, PH.D., in Support of the Petitioner, *DiCristina v. United States*, cert denied, 134 S. Ct. 1281 (2014) (No. 13-564), 2013 WL 6493519.

253 See Erica Okerberg, *What’s In A Game? A Test Under Which We May Call a “VGT” A Gambling Game Is Not So Sweet: Why Courts Should Not Apply the Material Element Test to VGTS*, 5 UNLV GAMING L.J. 27, 28 (2014).

254 *Id.* at 29.

255 *Id.*

256 See Anthony N. Cabot et al., *Alex Rodriguez, A Monkey, and the Game of Scrabble: The Hazard of Using Illogic to Define the Legality of Games of Mixed Skill and Chance*, 57 DRAKE L. REV. 383, 393 (2009) (“For example, a multiple choice trivia question with five possible answers has a chance element because a completely unskilled person has a 20% chance of selecting the correct answer.”).

The final test is the Gambling Instinct Test.²⁵⁷ It is the most subjective, but is in many ways quite intuitive. The test asks whether an activity stimulates the participant's gambling instinct.²⁵⁸ As such, the Gambling Instinct Test is not contingent on whether an activity is based on skill or chance, rendering it the outlier of the four tests.²⁵⁹

The questionable application of laws that predated the internet to internet gambling was one of the primary reasons for enacting UIGEA. Nonetheless, since the passage of UIGEA, little in the way of federal legislation has come about to substantially reframe the applicability of existing statutes to new technologies. Indeed, many state regulations that address emerging gaming advances, such as daily fantasy sports, are narrowly tailored to exempt specific contests and to create consumer protection standards—all while largely leaving in place antiquated definitions of gambling.²⁶⁰ This reliance on statutes that largely predate the internet, mobile phones, and virtual currencies to enforce gambling laws has led to a number of seemingly absurd judicial results. Moreover, reliance on such statutes may have created a legislative void that is being filled by a multi-billion-dollar industry that is not clearly illegal.

V. THE RISE OF SOCIAL CASINOS AND THE DECLINE OF GOVERNMENT REGULATION

The changing nature of interest in gaming amongst so-called “millennials” has been noted by the gaming industry for some time.²⁶¹ With this knowledge, the gaming industry is being forced to change how it appeals to

257 *Id.* at 393-94.

258 *Id.* at 394.

259 *Id.* Cabot et al. cite *City of Milwaukee v. Burns* to illustrate the gambling instincts implicated by pinball machines:

The machine makes an appeal to the gambling instinct, because the player has constantly before him the chance that the next play will assure him of the right on the next succeeding play to secure from 2 to 20 checks. Were it not for this appeal to the gambling instinct, these machines, which attempt to adhere to the letter of the law while violating its spirit, would never have been placed upon the market.

Id. at 394, n. 69 (citing 274 N.W. 273, 275 (Wis. 1937)). The gambling instinct test may present a logical alternative to the present reliance on measures of chance because it essentially treats things that look like gambling as gambling, alleviating the need for mathematical studies that produce results which seemingly defy conventional logic.

260 For an overview of the background that led to the passage of UIGEA, see Michael D. Schmitt, *Prohibition Reincarnated? The Uncertain Future of Online Gambling Following the Unlawful Internet Gambling Enforcement Act of 2006*, 17 S. CAL. INTERDISC. L.J. 381 (2007). For an example of a law passed regulating daily fantasy sports, see Mass. Gen. L. Ch.219 §§135-137 (2016).

261 See I.N. Rose, *From Daily Fantasy Sports to Candy Crush for Cash: How Millennials Are Changing Legal Gaming*, 20 GAMING L. REV. & ECON. 136 (2016) [hereinafter Rose Candy Crush].

the millennial market segment, a group that has spent most of its time gaming online.²⁶² The shift to online gaming is transforming the gaming industry and making it challenging for brick and mortar casinos to compete.²⁶³ The move online is partially driven by players of “social casino games,” games that may be found on Facebook or in app-stores and are often free to play, but allow users to make in-game purchases for extras.²⁶⁴ These social casino games are leading a transformation away from gambling in stigmatized casinos to virtually any location with wireless internet or mobile reception.²⁶⁵ These social casino games have also formed the basis for the judicial dismantling of the assumed application of federal and state gambling laws to internet gaming.

A. *Sweepstakes Cases*

Prior to the social casino cases that have raised questions regarding the applicability of various gambling laws, a number of other cases centering on the lawfulness of sweepstakes challenged the applicability of state gaming laws. In *Telesweeps of Butler Valley v. Kelly*, a phone card company offered customers entry into a sweepstakes with each purchase.²⁶⁶ Entry into the sweepstakes did not require purchase, as anyone wishing to participate could receive 100 free credits per day. With each bet requiring 25 credits, the customers could enter a pin on a video machine and a slot machine-like interface would appear and randomly award winners. The Middle District of Pennsylvania held that because the video terminals awarded a prize, they violated laws prohibiting sweepstakes.²⁶⁷

In *United States v. Davis*, the defendants were charged with operating an illegal gambling business under a Texas statute criminalizing “gambling promotion, keeping a gambling place, and possessing a gambling device, equipment or paraphernalia.”²⁶⁸ The defendants operated an internet café that awarded customers entries into a sweepstakes that awarded cash prizes to certain randomly selected entries.²⁶⁹ The defendants were convicted but appealed, arguing that the trial court had incorrectly applied the Texas statutes.²⁷⁰ The court found that the defendants’ attempt to sell internet time “was an attempt to legitimize

262 See Hugo Martin, *Southern California Casinos are Going All in to Attract Millenials*, LA TIMES (Jan. 31, 2016, 3:00 AM), <http://www.latimes.com/business/la-fi-casino-expansions-20160131-story.html> [<https://perma.cc/3T8S-L2X5>].

263 See Rose Candy Crush, *supra* note 261, at 142.

264 *Id.*

265 *Id.*

266 No 3:12-CV-1374, 2012 WL 4839010 (M.D. Pa. 2012).

267 *Id.* The Middle District of Pennsylvania’s decision was upheld in a brief non-precedential opinion of the Third Circuit. See *Telesweeps of Butler Valley, Inc. v. Attorney General of the Commonwealth of Pennsylvania*, 537 Fed. Appx. 51 (3d Cir. 2013). It should be noted that many sweepstakes laws do not require consideration.

268 690 F.3d 330, 332 (5th Cir. 2012) (citing Tex Penal Code Ann. §§ 4703, 4704, 4706).

269 *Id.* at 333–34.

270 *Id.* at 337.

an illegal lottery.”²⁷¹ The court determined that “the consideration element in the Texas gambling statutes can be fulfilled without an explicit exchange of money for the opportunity to participate in a sweepstakes.”²⁷²

A similar scheme was challenged in *City of Cleveland v. Thorne*. Customers could receive sweepstakes points by purchasing time online at an internet café. They could then use their points to play casino-style games to win money.²⁷³ The Ohio Court of Appeals stated “[t]he system used by appellants constructs a thinly veneered facade constituting the flimsiest of walls separating the consideration paid from the opportunity for gain through chance.”²⁷⁴ In numerous sweepstakes cases involving internet cafes or the purchase of items like phone cards, courts across the country have found that the consideration paid for items of hollow value is no shield to state and federal gambling laws. This is in stark contrast to the emergence of social games that purportedly allow both free and paid purchases, but do not award prizes of value, which various courts have analyzed and found no basis for concluding that they constitute illegal gambling. The result of analyzing sweepstakes cases in conjunction with social casino cases is that it becomes quite clear that there are certain gaming structures that simplistically defeat the objectives of federal and state law.

B. *Northern District of Illinois Cases*

Led by the Chicago-based law firm Edelson PC, three separate social casino cases have been decided by the Federal Northern District Court of Illinois. The first such case was *Soto v. Sky Union LLC*, decided in January 2016.²⁷⁵ *Soto* centered on the mobile game Castle Clash. The plaintiffs contended that the game was a game of chance but the defendants had advertised it as a game of skill in violation of the laws of Illinois, Michigan, and California.²⁷⁶ The court noted that it could not “say exactly what the objective of Castle Clash is, but it appears to be a game of conquest in which players amass armies of ‘Heroes’ to do battle with one another.”²⁷⁷ In playing the game, the players are able to collect a type of virtual currency called ‘shards,’ which allow players to purchase new game characters.²⁷⁸ The game also offers ‘gems,’ which allow players to progress more quickly through the game. These gems can also be used to enter various random slot machine-like rolls to win character attributes or win new

271 *Id.* at 339.

272 *Id.* The importance of the Texas court’s decision here can be contrasted with the cases discussed *infra* because the consideration in these cases was being paid for the opportunity to win a prize of value, versus win tokens, skins, etc. of zero value in accordance with the terms of service.

273 2013 Ohio 1029 (Oh. Ct. App. 2013).

274 *Id.* at *35.

275 159 F. Supp. 3d 871 (N. D. Ill. 2016).

276 *Id.* at 874.

277 *Id.* at 875.

278 *Id.*

characters themselves.²⁷⁹ The plaintiffs contended that these slot machine-like rolls constituted a violation of various state gambling laws.²⁸⁰ The defendants filed a motion to dismiss, arguing that Castle Clash could not violate the various gambling laws because “players use virtual, valueless currency to participate in rolls and events with virtual, valueless prizes.”²⁸¹ The court noted that in order for there to be a violation of the implicated gambling laws, there must be the possibility of winning a thing of value or an additional chance to play or a token that can be converted for a thing of value.²⁸² The plaintiffs argued several theories as to why there was a thing of value at stake; first, the plaintiffs were willing to pay, thereby creating a thing of value. The court rejected this theory.²⁸³ Second, the plaintiffs argued that the attributes gained increased the value of accounts sold on a secondary market.²⁸⁴ The court distinguished the Castle Clash secondary market from a casino by noting that, unlike a casino that cashes out tokens or chips at the marker’s noted value, Sky Union offers nothing to those seeking to sell their accounts. The court also noted that the character attributes gained are not themselves transferable, as only the entire account can be transferred on a secondary market.²⁸⁵ The court distinguished a market with fixed values for tokens or chips and the case of Castle Clash users who essentially can only sell their entire account for what the market will support.²⁸⁶ In granting the motion to dismiss, the court made clear that the prize element of the gambling statutes cannot be satisfied by in-game items with no stated value.²⁸⁷

The second related decision from the Northern District of Illinois was *Phillips v. Double Down Interactive, LLC*.²⁸⁸ The plaintiff in *Phillips* alleged that the defendant’s online casino games were illegal gambling devices.²⁸⁹ The defendant is the operator of online and mobile casino games which can be downloaded for free.²⁹⁰ Players initially obtain one million virtual chips, with additional chips being granted to players each day that they log in to the game. In addition to the free chips, players can also purchase chips.²⁹¹ The chips can only be used in the games operated by Double Down and they cannot be cashed out at a physical casino. The defendant also prohibits the “transfer

279 *Id.*

280 *Id.* at 876–77.

281 *Id.* at 877.

282 *Id.* at 879.

283 *Id.*

284 *Id.*

285 *Id.* at 879–80.

286 *Id.* at 880.

287 *Id.* at 882.

288 173 F. Supp.3d 731 (N.D. Ill. 2016).

289 *Id.* at 733–34.

290 *Id.* at 734.

291 *Id.* at 734–35.

of Virtual Currency [that is, virtual chips],” by the games’ terms of service.²⁹² The plaintiff contrasted the defendant’s argument by pointing to a secondary market that functions as a means of cashing out chips for players through the sale of their accounts.²⁹³ In arguing that its games are not gambling devices, the defendant noted that the chips are not things of value, an element necessary to transform a regular device to a gambling device.²⁹⁴ While disposing of the gambling loss recovery claim, the court articulated that the defendant was not a winner and the plaintiff was not a loser in the scope of the statute, as the plaintiff only paid for the opportunity to continue playing and not for the opportunity to win something of value.²⁹⁵ The *Phillips* case centered on defining gambling “winners” and “losers” without directly addressing whether the chips constituted “things of value.”²⁹⁶

The final case in the Northern District of Illinois trilogy was *Ristic v. Machine Zone*, which implicated both the Illinois Loss Recovery Act and the Illinois Deceptive Business Practices Act.²⁹⁷ Game of War, the game at the center of *Ristic*, is accessible free of charge on Apple and Android mobile platforms.²⁹⁸ A portion of Game of War is operated in conjunction with a casino; users are entitled to an initial free spin for a chance to win an in-game prize.²⁹⁹ The prizes available from the casino are of varying levels of usefulness towards in-game success. Should players wish to have additional spins to win additional prizes, users can buy additional spins with purchased virtual gold.³⁰⁰ Like the determination in *Phillips*, the court in *Ristic* found that the defendant was not a “winner” within the meaning of the statute because the defendant keeps the money the plaintiff spent, whether the plaintiff obtained the worst prize or the best prize available by spinning the wheel.³⁰¹ Even if the plaintiff chose never to purchase more gold for additional spins because the plaintiff obtained the best possible prize, this would not constitute a violation of the Illinois statute.³⁰²

The Northern District of Illinois in *Ristic*, like in *Phillips* and *Soto* granted the defendants motion to dismiss. The Northern District of Illinois is not the only venue addressing issues related to free-to-play virtual casinos; indeed,

292 *Id.* at 735.

293 *Id.* The court noted that the sale of chips is how Double Down’s parent company makes money stating, “In 2014, for example, Double Down (as reported in IGT’s annual SEC filings) reported over \$240 million in revenue.” *Id.*

294 *Id.* at 739. The defendants also contended that the implicated statute was inapplicable to internet games, a theory which the court rejected. *Id.*

295 *Id.* at 741.

296 *Id.* at 739.

297 No. 15-cv-8996, 2016 WL 4987943, at *1 (N.D. Ill. 2016).

298 *Id.*

299 *Id.*

300 *Id.*

301 *Id.* at *3.

302 *Id.*

courts across the country have been tasked with addressing cases involving the so-called freemium model of online gaming and social casinos.

C. *Dupee v. Playtika Santa Monica*

In *Dupee*, the plaintiff alleged that the defendants had “illegally profited through the operation of a virtual casino under the name of ‘Slotomania.’”³⁰³ Slotomania was described as a free game that was available as an app or through platforms like Facebook and Yahoo.³⁰⁴ Users of Slotomania receive an initial allotment of virtual coins, but can then purchase additional coins once they have depleted their reserves.³⁰⁵ Slotomania’s terms of service prohibit the purchasing, selling or exchanging of coins “outside the service.”³⁰⁶ The plaintiff’s claims were dismissed as a procedural matter without the court addressing the status of the virtual coins.³⁰⁷ While the *Dupee* matter was dismissed for a lack of personal jurisdiction, the case contributed to the discussion by an additional district court observing that the terms of service appear to have the power to limit the value of virtual coins.

D. *Mason v. Machine Zone*

The dismissal of *Dupee* provided little instruction as to the valuation assigned to the virtual coins in Slotomania and whether they may constitute a thing of value. However, perhaps the most advanced discussion of virtual coins in freemium games constituting a thing of value originated in the district of Maryland in *Mason v. Machine Zone*. The *Mason* case centered on Game of War: Fire Age, the same game at-issue in *Ristic*.³⁰⁸ Judge Bednar described the case as follows:

On the surface, Plaintiff charges that Defendant trampled real and important rights and interests of hers, wrongfully and unlawfully, in an alternative, virtual world created by an electronic game. But a careful probe beneath the surface reveals a hodgepodge of hollow claims lacking allegations of real-world harms or injuries. Perceived unfairness in the operation and outcome of a game, where there are no real-world losses, harms, or injuries, does not and cannot give rise to the award of a private monetary remedy by a real-world court.³⁰⁹

303 No. 1:15-cv-1021, 2016 WL 795857, at *1 (N.D. Ohio 2016).

304 *Id.* at *2.

305 *Id.*

306 *Id.*

307 *Id.* at *10.

308 140 F. Supp. 3d 457, 459 (D. Md. 2015). It should be noted that it appears as though the game at the center of *Mason* was a different rendition of the game that was the focus of *Ristic*.

309 *Id.*

The court in *Mason* described the “freemium” model of Game of War, noting that players could purchase virtual gold.³¹⁰ This virtual gold could then be used to hasten parts of the game or be used to purchase chips for spins on a virtual prize wheel, which provided in-game resources of varying value.³¹¹ The Maryland district court noted that the virtual items in the game may not be sold for real-world currency or other items of value and that users only acquire a revocable license to play the game and do not acquire an ownership right in any of the game’s features.³¹² By only receiving a license to play the game users are restricted to the terms imposed upon them by Machine Zone, and are not free to exceed those terms. In her pleadings, the plaintiff alleged that despite the terms of service established by Machine Zone, secondary markets do exist for users to buy or sell game of war accounts.³¹³ The court found that the casino in Game of War did not constitute a slot machine or device, additionally articulating that the plaintiff could not recover under the Maryland gambling loss recovery statute because “she did not lose money while playing in the Casino. Rather . . . any ‘loss’ that Plaintiff sustained occurred when she volitionally chose to spend real-world dollars in exchange for a nontransferable, revocable license to play with virtual currency in a virtual world.”³¹⁴ Judge Bredar concluded by stating: “the case ends up being more about the need to draw clear and distinct lines between real and virtual worlds, particularly when it comes to the serious business of going to court and litigating real claims and interests. Even in the Internet age, there is a crucial distinction between that which is pretend and that which is real and true.”³¹⁵

The Fourth Circuit Court of Appeals would further examine the *Mason* case, highlighting that the district court had found the plaintiff did not lose money when she spun the wheel in her virtual game.³¹⁶ The Fourth Circuit unanimously found that the plaintiff had not paid real money to play in the virtual casino. She had only paid real money to obtain virtual gold, which was later converted into virtual chips. Because the chips could not be converted back to real-world currency, there was no money being bet.³¹⁷ The Court of Appeals elaborated, noting that there was no basis “for applying the term ‘money’ to include virtual gold and other virtual resources” that the plain-

310 Freemium describes a business model whereby users can download and play a game for free, but accelerated advancement requires micropayments that provide an in-game advantage. See generally Elizabeth Evans, *The Economics of Free: Freemium Games, Branding and the Impatience Economy*, 22 CONVERGENCE 563 (2015).

311 *Id.* at 460.

312 *Id.*

313 *Id.*

314 *Id.* at 468.

315 *Id.* at 469. Bredar would further add, “The laws of California and Maryland do not trifle with play money, and so Plaintiff’s Complaint must be dismissed.” *Id.*

316 *Mason v. Machine Zone*, 851 F.3d 315, 319 (4th Cir. 2017).

317 *Id.*

tiff might acquire in the virtual casino.³¹⁸ Additionally, the court distinguished between the presence of the secondary market and the sale of accounts on secondary markets. The sale of accounts did not simultaneously create a value in the virtual gold and virtual chips so as to bring them within the scope of them being things of value.³¹⁹

E. *Kater v. Churchill Downs*

The final social casino case involves a plaintiff bringing suit pursuant to the Washington Recovery of Money Lost at Gambling Act and Consumer Protection Act.³²⁰ The plaintiff alleged that the defendant's virtual casino violated Washington's gambling laws.³²¹ Like the other social casino cases, Big Fish Casino was a free game that users could download.³²² Within the game, users could obtain chips either by waiting a certain period of time or purchasing chips with real-world currency.³²³ According to the terms of use, which users must agree to before virtually entering the casino, "the virtual chips have no cash value, and cannot be exchanged for cash or merchandise, either at the Big Fish Casino virtual store or with other users."³²⁴ Unlike the previous cases, the plaintiff in *Kater* alleged that the defendant operates a secondary market where users can exchange chips for real-world currency by charging a fee to transfer accounts from one user to another.³²⁵ The defendant argued that by not awarding cash or merchandise, the activities of Big Fish Casino do not constitute gambling under Washington law.³²⁶ The court found that the "prize" component of gambling to be lacking in because, unlike other cases where the opportunity to continue playing constituted a thing of value, Big Fish Casino is free and there is no possibility of winning cash or merchandise.³²⁷ By virtue of the game already being free to play, extending game play could not possibly become a thing of value, according to the district court.³²⁸ Additionally, Judge Pechman concluded that, because the terms of service prohibit transferring virtual items for commercial gain and because these have no value, the existence of a secondary market does not create value in the virtual coins.³²⁹

318 *Id.* at 320.

319 *Id.*

320 *Kater v. Churchill Downs, Inc.*, No. 2:15-cv-00612-MJP, 2015 WL 9839755, at *1 (W.D. Wash. 2015).

321 *Id.*

322 *Id.* at *2.

323 *Id.*

324 *Id.*

325 *Id.*

326 *Id.* at *3.

327 *Id.* at *7.

328 *Id.*

329 *Id.* at *8. The *Kater* case is presently under appeal at the Ninth Circuit Court of Appeals. See *Kater v. Churchill Downs*, No. 16-35010 (9th Cir. 2017).

While the social casino cases may seem trivial, a very important public policy consideration has developed regarding the extent to which terms of service agreements can establish that virtual currencies have no real-world value. This allows consumers to engage in gambling activities without any of the benefits or protections of a regulated gambling environment. This question may have already come to the forefront in the form of decorative weapon skins.

VI. GRAY IS THE NEW BLACK MARKET

On August 14, 2013, the aforementioned video game company Valve introduced the “Arms Deal Update,” to the popular video game Counter-Strike Global-Offensive (CS:GO), launching a billion-dollar gambling industry along with it.³³⁰ The Arms Deal Update allowed for the transfer of decorative weapon skins between any user who had the game and an account on the Valve-owned Steam platform.³³¹ The Arms Deal Update created a market for vibrant weapon designs, which could be acquired through one of four ways: randomly during game-play, as a promotional item, through trading with other players, or through purchase on primary markets or various secondary markets.³³² The secondary markets utilize Valve’s Steam platform; Valve receives a 15 percent share of every transaction made on Steam.³³³ The ease with which skins can be transferred, users’ ability to link their Steam accounts, and the emergence of weapons skins of varying rarity created a near immediate wind-fall for early movers willing to enter the market and operate gambling websites that transacted in weapons skins.³³⁴ The CS:GO lounge, which began taking bets on professional esports contests shortly after the Arms Deal Update, is

330 See John T. Holden et al., *Esports Corruption: Gambling, Doping and Global Governance*, 31 MD. J. INT’L L. (forthcoming 2017) [hereinafter Holden Esports Corruption]. The arms deal update was sub-headlined by the phrase: “Get Ready for A Whole New Deal.” The deal was touted with the following: “. . . the Arms Deal Update, which lets you experience all the illicit thrills of black market weapons trafficking without any of the hanging around in darkened warehouses getting knifed to death. The Arms Deal Update lets you collect, buy, sell and trade over 100 all-new decorated weapons that you can equip in-game.” 8/13—*Arms Deal Update*, COUNTER-STRIKE.NET (Aug. 14, 2013), <http://blog.counter-strike.net/index.php/2013/08/7425> [https://perma.cc/D6KF-Q28L]. See also Joshua Brustein & Eben Novy-Williams, *Virtual Weapons are Turning Teen Gamers Into Serious Gamblers*, BLOOMBERG, Apr. 20, 2016, <https://www.bloomberg.com/features/2016-virtual-guns-counterstrike-gambling>. [https://perma.cc/8QDW-4M8Y].

331 Holden Esports Corruption, *supra* note 330.

332 Chris Grove, *Understanding Skin Gambling*, NARUS ADVISORS (2016), available at: <https://www.slideshare.net/ChrisGrove3/understanding-skin-gambling-a-guide-to-the-leading-esports-betting-product> [https://perma.cc/KC6N-GLMN]. The weapon skins provided no competitive in-game advantage to players.

333 Nathan Grayson, *The Counter-Strike Gambling Scandal, Explained*, KOTAKU July 7, 2016, <http://steamed.kotaku.com/why-people-are-flipping-out-over-the-counter-strike-gam-1783369102> [https://perma.cc/5SEL-CBGZ].

334 *Id.*

widely regarded as the first skins betting marketplace.³³⁵ The popularity of CS:GO created a sufficiently liquid market for the variety of skins to be valued by rarity and market pricing.³³⁶ The popularity of CS:GO and the Arms Deal Update created another space for entrepreneurially minded individuals in the skins-exchange market.³³⁷ With the rise of a means to easily convert skins to real-world cash, a video game, known for being low on frills, created one of the world's most popular virtual currencies.³³⁸

The skins betting world came to the attention of mainstream America following a prominent article in Bloomberg chronicling the vast gambling industry tethered to a video-game.³³⁹ The authors vividly described the subculture surrounding bets using skins, arguing the subculture was helped explain why skins had evaded detection, despite a booming gambling industry ranging in offerings from bets on professional esports games to flips of a virtual coin.³⁴⁰ The piece also highlighted Judge Bredar's comment from the *Mason* case noting that "[t]he laws of California and Maryland do not trifle with play money."³⁴¹

While the laws of California, Maryland, Illinois, and a handful of other states may not "trifle with play money," the Washington State Gambling Commission took issue with Valve's seeming complicity in allowing the transfer of skins that facilitated the online gambling market.³⁴² In Valve's response to the Gambling Commission, it articulated that the company has no relationship with the gambling sites that rely on the transferability of skins through Valve's application program interface, and that the company does not allow users to cash out skins or trade skins for real money.³⁴³ Valve further responded incred-

335 Eric Yu, *The Start of It All: Skin Gambling*, UNIKRN (July 15, 2016), <https://unikrn.com/news/the-start-of-it-all> [https://perma.cc/6457-JKEE].

336 *Id.*

337 *Id.*

338 The total value of skins is not known though estimates have placed the value of the skins gambling market in 2016 at \$7.4 billion dollars. Lionel Iruk, *Legality of CS:GO Skins Gambling*, CALVINAYRE.COM, Feb. 23, 2017, <https://calvinayre.com/2017/02/23/business/legality-of-csgo-skin-gambling>. [https://perma.cc/9BVD-EAUN]. In contrast the total amount wagered on sports in Nevada in 2016 was approximately \$4.5 billion. See UNLV CENTER FOR GAMING RESEARCH, NEVADA SPORTS BETTING TOTALS 1984–2016 (Jan. 2017), available at http://gaming.unlv.edu/reports/NV_sportsbetting.pdf [https://perma.cc/2MW9-TKP9].

339 See Brusteian and Novy-Williams, *supra* note 330.

340 *Id.* See also Holden Esports Corruption, *supra* note 330.

341 *Id.* See also *Mason v. Machine Zone*, 140 F. Supp. 3d 459 (D. Md. 2015).

342 PRESS RELEASE—VALVE CORPORATION TOLD TO STOP FACILITATING GAMBLING, WA. STATE GAMBLING COMM'N (Oct. 5, 2016), available at <http://esports-marketing-blog.com/valve-corporation-told-stop-facilitating-gambling> [https://perma.cc/6PTA-BBYS]. See also John T. Holden et al., *The Future is Now: Esports Policy Considerations and Potential Litigation*, 27 J. LEGAL ASPECTS OF SPORT 46, n.148 (2017) [hereinafter Holden Esports Policy].

343 Valve Corporation Update—New Information: October 18, 2016, WA. STATE GAMBLING

ulously to the implication that they were in violation of any law by stating: “If there is a specific criminal statute or regulation you believe Valve is violating, please provide a citation. We are not aware of any such law that Steam or our games are violating.”³⁴⁴ Despite their assertion that they were not in violation of any laws, Valve ordered various skins gambling sites to cease accepting skins, arguing that it was a violation of the terms of service agreements to use skins for a commercial purpose.³⁴⁵ There is no indication that the Washington State Gambling Commission has taken any further steps against Valve, raising the possibility that in examining their laws, Valve may be compliant.

Specifically referencing the *Mason* case, one commentator has suggested that by virtue of the various social casino cases, it is possible that skin gambling is not illegal in most states because the skins do not constitute money or things of value.³⁴⁶ In fact, a variety of civil cases brought against Valve and various skins gambling sites have either been settled or dismissed, leaving the question unanswered.³⁴⁷ Unlike many of the social casino cases, which largely involved small amounts of money and adults, the skins betting industry is fueled by large amounts of spending by underage players. Despite this, the scandals appear to have largely faded after many (though, not all) skin gambling sites ceased operations.³⁴⁸ The rise of the skins gambling industry, in combination with judicial determinations in the examined social casino cases, at minimum, raises the question of whether or not gambling online using certain virtual currencies is illegal.

While skins gambling gained some initial attention and coverage from the media, including a feature on ESPN’s “Outside the Lines,”³⁴⁹ there has

COMM’N (Oct. 18, 2016).

344 *Id.* See also Holden Esports Policy, *supra* note 342, at 67, n. 148.

345 See Chris Grove, 23 *Skin Gambling Sites, Spanning Casino and Sports Betting, Targeted with Cease and Desist From Valve*, ESPORTS BETTING REPORT (July 19, 2016), <http://www.esportsbettingreport.com/valve-skin-betting-cease-desist> [https://perma.cc/R4E7-654K].

346 See Iruk, *supra* note 338.

347 See McLeod et al v. Valve Corporation, No. C16-1227-JCC, 2016 WL 5792695 (W.D. Wash. Oct. 4, 2016). See also Notice of Dismissal without Prejudice Pursuant to F.R.C.P. 41(a)(1)(A)(i), Reed v. Valve Corp. et al., No. 2:16- CV-04099-ES-JAD (D. N.J. Aug. 4, 2016); Final Order of Dismissal, C.B., v. Valve Corp et al., No. 0:16-cv-61561-BB (S.D. Fla. Aug. 5, 2016).

348 For a profile feature on various skins gamblers, see Colin Campbell, *The True Cost of Counter-Strike Skin Gambling*, POLYGON (July 18, 2016, 3:00PM), <https://www.polygon.com/features/2016/7/18/12203534/counter-strike-cs-go-skin-gambling> [https://perma.cc/HY4A-GYUW]; For an overview of companies that did not immediately cease offering skins wagering after the Valve cease and desist letter, see Will Green, *How One Esports Gambling Site Still Offers Skin Betting Despite Order to Stop*, ESPORTS BETTING REPORT (Aug. 29, 2016), <http://www.esportsbettingreport.com/csgofast-eludes-skin-betting-crackdown> [https://perma.cc/PKB3-52HC].

349 See Shaun Assael, *Skin in the Game*, ESPN (Jan. 20, 2017), http://www.espn.com/espn/feature/story/_id/18510975/how-counter-strike-turned-teenager-compulsive-gambler

been little public action from regulators to inquire into the legality of the practice. Whether skins gambling or social casino gambling violate the law turns on whether the activity qualifies as gambling, as determined by application of the three factor tests introduced above: some degree of chance, payment of consideration, and a prize of some value.³⁵⁰ The reliance on terms of service agreements that hollowly declare in-game items to be devoid of value seemingly results in a finding that such activities are not gambling because there is no “prize of some value.” The purported absence of value resulting from the winnings, and a potential issue regarding the adequacy of consideration,³⁵¹ creates a scenario where these activities do not violate most, if not all, state gambling laws. Yet, that existing secondary markets establish a value indirectly (as in the case of some social casino cases) or directly (as in the case of CS:GO skins) indicates that, in fact, these items may be of value.³⁵²

Additionally, if terms of service agreements can negate reasonable means of otherwise establishing value, it is likely that these activities would also be outside the scope of the primary federal gambling statutes. The Wire Act³⁵³ and the Illegal Gambling Business Act³⁵⁴ both require a predicate violation of state law, which is seemingly absent without a prize of value.

The question of whether PASPA may be a means of stopping the spread of no-value gambling is two-fold. As an initial matter, implicated activity must involve bets or wagers “on one or more competitive games in which amateur or professional athletes participate . . . ”³⁵⁵ If this threshold requirement is satisfied, then a supplementary analysis must be done to determine whether the

[<https://perma.cc/R4M4-XT4Y>].

350 See generally DAVID G. SCHWARTZ, *ROLL THE BONES: THE HISTORY OF GAMBLING* (2006).

351 If, for example, a token with a value of \$0.00 by terms of service agreement is exchanged for the opportunity to spin a wheel for a chance to win more of the same tokens, there is a likelihood that there is neither consideration nor a prize. In fact, a court may conclude that any money played is simply associated with the right to play a game generally, akin to an entrance fee.

352 For example, CS:GO Analyst provides various weapons skins for sale at market prices despite the fact that Valve has sought shelter behind their own position that they do not facilitate exchange of money back to users, conceivably making the argument that the money paid to purchase skins is only a means of continuing the enjoyment of the game, regardless of the existence of the billion dollar secondary market. See, e.g., CS:GO ANALYST (last visited May 20, 2017), <https://csgo.steamanalyst.com> [<https://perma.cc/6JFZ-QTCC>].

353 18 U.S.C. § 1084 (1961).

354 18 U.S.C. § 1955 (1970).

355 See 28 U.S.C. § 3702(2) (1992). PASPA might be particularly relevant to skins gambling in both the context of betting on traditional sporting events, but also esports betting given the direct connection to CS:GO. If esports are a sport under PASPA then it may necessitate analyzing whether skins betting falls into one of PASPA's prohibited schemes, though if skins do not constitute a thing of value the question is likely moot. For greater discussion of the legal analysis of whether esports are a sport see Holden et al. Esports Policy *supra* note 342.

activity constitutes the sponsorship, operation, advertising, or promotion of a lottery, sweepstakes, or other betting or wagering scheme.³⁵⁶ It is unlikely that there is a sweepstakes, betting or wagering scheme in violation of federal law because the transactions involve items with a declared value of zero and therefore do not implicate existing law. Similarly, most of the so-called social casino games are likely not considered unlawful lotteries; however, depending on jurisdiction-specific lottery definitions, certain gambling sites that hold lotteries for giving away skins may be in violation because lotteries use the language “distributing property” versus “awarding money” or “awarding a prize.”³⁵⁷ PASPA’s usefulness as a means of shutting down social casinos and skins gambling is limited because of the statute’s scope being limited to gambling involving professional and amateur sporting events.³⁵⁸

Relatedly, UIGEA is unlikely to be implicated. The statute does prohibit the transfer of funds to those participating in the undefined “unlawful internet gambling”; however, given the previous discussion, it is unlikely that there is gambling in certain circumstances where prizes are deemed to be of no-value, as limited by the terms of service.³⁵⁹

Gambling laws seem like the most obvious tools in a federal prosecutor’s tool belt to combat activities that mimic illegal gambling activities but escape criminality by virtue of transparent semantics in the terms of service. Other options may be applicable for stopping the spread of activities that exist in the realm of social casino gaming and skins betting, though their use is likely to be more fact-specific and less broadly applicable than gambling specific statutes. The federal mail and wire fraud statutes offer prosecutors broad power to punish illicit activity. However, wire or mail fraud would likely require some level of deception relating to social casino and skins activities.³⁶⁰ Additionally, the scheme implicates some type of property under both the federal mail and wire fraud statutes.³⁶¹ It may also be possible to argue that the parties involved

356 See 28 U.S.C. § 3702(2) (1992).

357 Black’s Law Dictionary defines Lottery as: “1. A system of deciding who will get something by choosing people’s names by chance. 2. A method of raising revenues, esp. state-government revenues, by selling tickets and giving prizes (usu. cash prizes) to those who hold tickets with winning numbers that are drawn at random.” *Lottery*, BLACK’S LAW DICTIONARY (10th ed. 1910). Black’s had previously defined Lottery as: “A lottery is any scheme for the disposal or distribution of property by chance among persons who have paid.” *Lottery*, BLACK’S LAW DICTIONARY (2nd ed. 1910). The latter definition is still in use by some states, including California. See CAL. PENAL ch. 9, § 319.

358 28 U.S.C. § 3702(2) (1992).

359 See 31 U.S.C. § 5363 (2006).

360 18 U.S.C. § 1341 (2008); see also 18 U.S.C. § 1343 (2008). For an overview of the depth of the federal wire fraud statute, see John T. Holden et al., *Daily Fantasy, Tipping, and Wire Fraud*, 21 GAMING L. REV. & ECON. 8 (2017).

361 See 18 U.S.C. § 1341 (2008). See also 18 U.S.C. § 1343 (2008). In the *Clark* case, the defendant was charged with violating 18 U.S.C. § 1343, but because of the defendant’s death there remain several questions unanswered about the extent to which no traditional

in social casino activities may be violating FinCEN's regulations, though the application of FinCEN's regulations is limited given that game operators (including Valve) allow for money to only enter the games; extraction of player funds is limited to non-affiliated third-parties.³⁶²

CONCLUSION

Standing in contrast to a gap-filled US regime that has allowed a multi-billion-dollar industry to flourish, not all countries have taken the same approach to interpreting the status of social casinos and skins based gambling. The United Kingdom's Gambling Commission issued a position paper in March 2017 which specifically addressed "[g]ambling with in-game items and virtual currencies."³⁶³ The Gambling Commission recommended addressing the articulated gap by treating in-game items that can be exchanged for money outside of a video game as items that thereby acquire a value and are akin to money.³⁶⁴ While the Commission's position paper is clearly directed at skins, it is likely relevant, if not applicable, to social casino transfers as well. The ability of multibillion dollar companies to offer games that are indistinguishable from other forms of illegal gambling, except by including in unread terms of service agreements statements that the in-game currencies have no real-world value, despite lucrative and flourishing secondary markets, is concerning.³⁶⁵ Indeed, one of

virtual currencies constitute property. Indictment, United States v. Clark, *supra* note 192. For instance, in *Clark* the defendant arguably fraudulently obtained the intellectual property of EA; however, situations related to obtaining FIFA Coins from a third-party may also implicate the statute, given EA's retention of rights by terms of service. *Id.*

362 For instance, there is a possibility that a website like OPSkins Exchange may be operating as a money transmitting business and be required to follow federal regulations. See OPSKINS EXCHANGE (last visited May 20, 2017), <https://opskins.com>. [<https://perma.cc/L6A2-QC5P>]. However, it is unlikely the peer-to-peer marketplaces, such as Craigslist or message board, that operate for the sale of social casino accounts would implicate the statute barring someone operating and selling a social casino account commercially. The commercial farming of in-game resources for sale has been documented in other video games such as World of Warcraft. See Rebecca Campbell, *Trump Advisor Steve Bannon Spent \$60 Million on World of Warcraft Virtual Currency*, CRYPTO COINS NEWS (Feb. 13, 2017), <https://www.cryptocoinsnews.com/trump-advisor-steve-bannon-60million-warcraft> [<https://perma.cc/GSY3-NQ7V>].

363 UNITED KINGDOM GAMBLING COMMISSION, VIRTUAL CURRENCIES, ESPORTS AND SOCIAL CASINO GAMING—POSITION PAPER (Mar. 2017), available at: <http://www.gamblingcommission.gov.uk/PDF/Virtual-currencies-eSports-and-social-casino-gaming.pdf> [<https://perma.cc/DVE7-QS9K>].

364 *Id.* at 5 ("Where in-game items can be traded or exchanged for money or money's worth outside a video game, they acquire a monetary value and are themselves considered money or money's worth.").

365 Machine Zone, who makes *Game of War*, was estimated to be worth \$6 billion in 2015. See Leslie Picker, *Machine Zone Said in Talks at \$6 Billion Value After Upton Ads*, BLOOMBERG (July 14, 2015, 3:26PM), <https://www.bloomberg.com/news/articles/2015-07-14/machine-zone-said-in-talks-at-6-billion-value-after-upton-ads> [<https://>

the concerns that should be addressed by the industry is the negative externalities associated with social casino games; these games feature all the same formalities of casino gambling, often adding in other game play components with none of the reward.

The reliance on terms of service agreements that feature certain components including: non-redeemability of in-game items, non-transferability of coins to third-parties, and the revocability of license to access the account have formed the basis for the avoidance of gambling laws by social casino operators.³⁶⁶ The current interpretations raise questions about the boundary between social activity and prohibited gambling. The conglomeration of social casino decisions creates a framework that would allow for virtually any gambling activity, including the widely restricted offering of single-game sports betting, by creating a social game that uses tokens with a declared value of zero, regardless of the operation of a secondary market.³⁶⁷ It is potentially a logical leap to envision a “social” game that offers sports betting where users can simply trade off their account to any new user looking to place the next wager in the social sportsbook in exchange for whatever rate the market sets for the number of valueless tokens the previous user had. We have now entered the post-cyberspace era of gambling, as entrepreneurs have sought ways to bring back consumers who were previously restricted to gambling in casinos or illegally off-shore. With the emergence of activities like daily fantasy sports, social

perma.cc/R76P-5YXY]. Churchill Downs Inc., who also runs various real-world casinos and racetracks had \$279.5 million in revenue during the first three months of 2017. See *Churchill Downs Inc. (NASDAQ: CHDN)*, GOOGLE FINANCE (last visited May 20, 2017), <https://www.google.com/finance?q=NASDAQ%3ACHDN&fstype=ii&ei=halg-WYH3AoqxjAHRgZDwBA> [https://perma.cc/NY6P-EP23].

366 See Behnam Dayanim, *Social Casino Gaming: Legal (R)evolution*, Presentation at the 16th International Conference on Gambling and Risk-Taking (Jun. 9, 2016), available at http://digitalscholarship.unlv.edu/cgi/viewcontent.cgi?article=1404&context=gaming_institute [https://perma.cc/8Z49-JRSE].

367 One Washington state-based esports sportsbook, which accepts real money wagers in some foreign jurisdictions, announced the launch of a two-tiered blockchain enabled virtual currency for users in jurisdictions where the company is not licensed to offer real-money wagering, as well as a virtual currency for those in licensed gambling jurisdictions. However, with the launch of the company’s new gold-tier virtual currency (accepted in jurisdictions with licensed gambling) it is reported that users will be able to exchange the currency for other virtual currencies or even fiat currency on various exchanges. The forthcoming launch of Unikoin Gold, whose parent company, Unikrn, has received venture capital funding from high-profile investors including National Basketball Association team owner Mark Cuban and actor Ashton Kutcher. Whereas, in unlicensed jurisdictions the company will allow users to wager using Unikoin-silver, which will reportedly not be exchanged for fiat currencies, but can be exchanged for entries in raffles, potentially raising meaningful questions about not only virtual currencies, but the application of sweepstakes laws to virtual currencies. UNIKOIN GOLD CRYPTOCURRENCY COIN MODEL (June 2017), available at <https://s3.amazonaws.com/stat-ic.unikoingold.com/whitepaper.pdf> [https://perma.cc/64WJ-JBKF].

casinos, and skins gambling, the line between legal and illegal gambling is seemingly irrelevant.³⁶⁸

The emergence and popularity of bitcoin and other virtual currencies have captured the attention of the public with huge swings in value.³⁶⁹ The growth of virtual currencies has become such that bitcoin, and other currencies are losing their stigma that they are primarily used by the fringes of society and do not have any real usefulness. While the current infatuation with bitcoin has centered on its usefulness as an investment asset, there remains a possibility that as bitcoin remains in the public vernacular it may be more widely accepted as a means of payment. The widespread acceptance of bitcoin, however, is likely dependent on the implementation of federal standards and revisions of state laws to afford virtual currencies a more certain status under the law. The lack of regulatory clarity surrounding virtual currencies has created a void that has allowed a multi-billion-dollar gaming industry to exist. Moving forward, lawmakers face a choice of whether to continue trying to justify a gambling prohibition that resembles a piece of Swiss cheese with little rationality separating lawful from unlawful gambling or proposing legislation that would treat activities that act like gambling as gambling activities and providing common-sense regulation and consumer protections. The same approach should be taken with respect to the regulation of virtual currencies imposing rules that make practical sense and protect consumers.

368 I. Nelson Rose coined the various waves of gambling regulation with his most recent wave being the online gaming era, which was characterized by widespread access to the internet and the emergence of online gaming. See I. N. Rose & Rebecca Bolin, *Game On for Internet Gambling: With Federal Approval, States Line Up to Place Their Bets*, 45 CONN. L. REV. 653 (2012).

369 See Adam Samson & Philip Stafford, *Bitcoin Swings Wildly After Its Biggest Reverse of 2017*, FINANCIAL TIMES (Dec. 24, 2017), <https://www.ft.com/content/a72a61dc-e6f2-11e7-8b99-0191e45377ec> [<https://perma.cc/3WQ5-K76Z>].