Watch your loot boxes! – Recent developments and legal assessment in selected key jurisdictions from a gambling law perspective

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Abstract: So called loot boxes are one of the most important monetization methods for many companies in the video gaming, social gaming and social casino gaming industry. After the global skin betting scandal in 2016 and the 2017 loot-box uproar, loot boxes are now under investigation or even subject to legislative measures in several jurisdictions. Since then, numerous regulatory authorities, politicians and other stake holders have issued statements on the matter. From a legal perspective, loot boxes can touch gambling, youth protection, consumer and even financial laws. Characteristic of the 2017 loot-box debate was a black or white view and people taking extreme positions. In particular, gamers and people not familiar with the subject tend to condemn loot boxes as gambling. However, taking a closer look at selected key jurisdictions shows that the application of gambling laws depends on the jurisdiction and on the exact set up of the loot box mechanism. Furthermore, some questions are not conclusively solved yet – not even in those jurisdictions which are regarded as loot-box safe havens. One of these questions is, for instance, the impact of secondary-market trading of loot-box-generated items. This article evaluates the legal situation of loot boxes from a gambling law perspective in selected jurisdictions.

Keywords: loot boxes, loot crates, gacha, gambling, gaming, video games, virtual casino games, social games, youth protection, prize, stake, game of chance, consideration, monetary value, real world value, money's worth, microtransactions, pay-2-win, secondary markets, skin betting

I. Introduction

Several 2017 releases of top-games have ignited a world-wide debate about so called 'loot boxes' and 'microtransactions' which has not yet ended and whose long-term consequences cannot be conclusively determined at the moment. During the height of the public uproar, media coverage and complaints from gamers reached a so far unprecedented level and ultimately triggered several statements, warnings, regulatory investigations and legislative initiatives by authorities, age-rating boards, politicians and other stakeholders all over the globe. Recently even one of the leading app store providers changed its terms of service and now requires gaming app developers to publicly disclose the odds for loot box mechanisms included in apps available on its store.¹ These and several other developments caused massive uncertainty, made

stock prices fall² (at least temporarily) and even had one of the top German game magazines title its 2017 retrospective 'The year of the loot box'.³

For game developers and people working in the industry the loot box controversy is surely something one can do without; not only because of its never-ending nature but also because it shifts away the focus from all the creative and innovative ideas which are the actual backbone of the industry. However, regardless how tiresome the matter might be it should not be ignored that loot boxes are currently under scrutiny and that at least an increased level of caution is advised. This article follows the purpose to provide game developers with some initial guidance on the matter from a multi-jurisdictional perspective. The first section describes microtransactions and loot box mechanisms and summarizes the recent

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1 Alex Osborn, 'Apple now requires games offering loot boxes to disclose odds', ign.com, December 21, 2017.

2 Stephany Nunneley, 'EA stock value takes a \$3.1 billion hit after Star Wars Battlefront 2 controversy', vg247.com, November 29, 2017; Tae Kim, 'Video game stocks drop as Wall Street debates industry future after EA's monetization "debacle"', cnbc.com, November 29, 2017.

3 Martin Deppe, 'Jahresrückblick 2017 – Das Jahr der Lootbox', Gamestar.de, December 30, 2017.

developments that led to the global uproar of video gamers. The second (and main) section provides an overview over the regulatory and political developments in key jurisdictions which were caused by the recent loot box debate followed by a legal assessment for each jurisdiction, including a corresponding risk assessment. The article reflects the advice given by the authors to several leading game developers and platform providers on the subject of loot boxes and gambling laws and partly includes the legal assessment provided by associated local counsel from the relevant jurisdictions.

II. Microtransactions and loot boxes

1. Microtransactions

The term Microtransaction commonly refers to a business model, where users can purchase virtual goods via micro-payments.⁴ The origin of microtransactions goes back to so called 'freemium games'. 'Freemium' is a combination of the words 'free' and 'premium' and refers to a business model that allows consumers to receive basic services for free, but requires them to pay for any service or content deemed to be premium.⁵ Any purchase of premium content is typically a form of microtransaction. Microtransactions (i.e. premium content) may include downloadable content such as story extensions (so called 'DLCs'), additional play time, levels, new maps, virtual currency, weapons, armor, characters or cosmetic items to customize the player's character or items. The player pays for microtransactions either directly with real world currency or with some form of fantasy virtual currency (e.g. gold). The latter is typically earned during gameplay or can (often alternatively) be purchased with real world money.

Microtransactions were initially used mainly in free-to-play online and mobile games to allow the developers to monetize their developing and publication efforts and to retain players with frequently released new content and a never-ending gameplay experience. Free-to-play (or 'freemium') games are therefore a specific form of software-as-a-service ('SaaS'), often referred to as games-as-a-service.

Normal video games, in contrast, were traditionally monetized by relying on the sale of the game itself. However, it didn't take long for major game developers to conclude that monetization strategies based on microtransactions did not only pay out for freemium games but could also significantly increase the revenue generated from regular priced games, in particular so

called AAA games. In the video game industry, AAA games (pronounced "Triple-A") is a classification term used for games with the highest development budgets and levels of promotion. An AAA game is consequently expected to be a high quality game or to be one of the year's bestsellers. Games which combine AAA production values and budgets with games-as-a-service principles known from freemium games in order to retain players for months or years⁶ and to generate additional revenue are referred to as AAA+ games. These games often generate high revenue from the selling of the game itself and from constant revenue streams based on microtransactions.

2. Loot boxes

For years now, loot boxes have been an intensively growing sub-category of microtransactions. The term 'loot box', also known as 'loot crate' or 'prize crate' and other names, typically refers to a consumable virtual item which can be redeemed to receive a randomized selection of further virtual items, ranging from simple customization options for a player's game character, to game-changing equipment such as weapons, armor, virtual currency, additional skills and even completely new or exclusive characters.⁷ Loot box systems are often designed to drop certain items less frequently than other items. In fact, extremely rare items (in many games referred to as 'legendary' items) are dropped significantly less often than more common items. This way, players are induced to purchase additional loot boxes to obtain the desired item. Some loot box systems go a step further and provide a multi-level system by granting the player a special (even rarer) prize only if he/she obtains a complete set of specific items which must first be drawn from normal loot boxes (e.g. item A+B+C+D grants rare item E). Thus, the more items the player has for the required complete set, the smaller are the chances to obtain an item he/she does not already have. These combination-style loot boxes are often referred to as 'complete gacha' or 'kompu gacha'.

3. Two types of loot boxes

Loot boxes can be differentiated in two categories: Those dropping cosmetic items (the latter is often referred to as 'skins') and those generating items relevant for gameplay progress. Cosmetic items (or 'skins') serve the purpose of

4 Chin Osathanunkul, 'A classification of business models in video game industry' (2015) 17(1) International Journal of Management Cases 35, 41.

5 Chin Osathanunkul, see fn 4 above, p. 40.

6 Rob Fahey, 'Final Fantasy XV and The Last Guardian: The Last of their Kind', *gamesindustry.biz*, December 9, 2016.

7 Mark D. Griffiths, 'Loot Boxes in Video Games as form of Gambling or Gaming?' (2018) 22(1) Gaming Law Review 52–54, 52.

customizing the game, the player's character or an item (e.g. a weapon with a dragon texture). In simple words, cosmetic items mainly serve the purpose to make the game and the player look better, cooler and fancier. Rare cosmetic items are often more popular amongst gamers and serve as a form of status symbol or collector's item. In contrast, items relevant for gameplay provide not only a visual change but also game progress affecting upgrades (for instance entirely new and better weapons or stronger characters). Rare game progress affecting items are usually much stronger/useful than common game affecting items. Thus, these type of rare items do not only serve as a form of status symbol but also considerably support the player's gameplay progress or his/her ability to compete with other players.

4. 'Pay-to-win' criticism

The implementation of game-affecting loot box mechanisms can tie the player's ability to be successful or to compete with other players (in the case of multiplayer games) to the random generation system of the loot box mechanism and the player's will to spend further money on additional loot boxes until the desired or required item is drawn. Players who do not purchase loot boxes sometimes need to repetitively perform specific tasks for a significant amount of time to achieve similar progress as players who invest in loot boxes. Playing time spent on repetitive tasks within a game to unlock a particular item or to gather sufficient experience points or items (e.g. virtual currency) needed to progress through the game is usually referred to as 'grinding'.⁸ Loot boxes which grant game affecting items are often criticized as so called 'pay-to-win' systems,⁹ because players who purchase such loot boxes typically have an advantage in speed and strength over other players.

5. Standard loot boxes and tradeable loot boxes

Loot box mechanisms can further be differentiated in those allowing the player to trade the generated items and those which do not allow subsequent item trading. Loot boxes which grant virtual items that cannot be traded with other players, that is which can only and forever be used by the player him or herself without

him/her being able to trade or exchange the dropped items with other players are herein referred to as 'Standard Loot Boxes'. Loot boxes which grant virtual items that can be traded with other players, either within the game (e.g. by means of an in-game trading platform or by simply two game characters meeting within the game and 'handing over' the item as it is possible in many role play games) or outside the game environment (e.g. over secondary markets usually operated by third parties such as auction or betting platforms) are herein referred to as 'Tradeable Loot Boxes'.

6. Commercial relevance of microtransactions and loot boxes

Over recent years, microtransactions such as loot boxes have become an enormous commercial factor which can sometimes be the principal source of income for many companies, often far surpassing the income generated from game sales. Since 2012 revenue generated from microtransactions in PC free-to-play games alone has doubled from US\$11 billion to US\$22 billion in 2017.¹⁰ This does not include consoles or the significantly larger mobile games market. Several examples can be named which show the massive potential behind microtransactions: *Riot Games'* extremely popular *League of Legends* made US\$1.7 billion in microtransactions in 2016.¹¹ *Supercells* free-to-play games *Clash of Clans* and *Clash Royale* even generated US\$2.3 billion from microtransactions in 2016.¹² The so called *Ultimate Team* modus provided in *Electronic Art's* well-known soccer game *FIFA*, which allows players to buy loot boxes containing trading cards, now generates US\$800 million annually.¹³

III. Key developments that led to the current public and legal scrutiny of loot boxes

1. Early years of increased public awareness (2010–15)

The debate around the gambling law relevance and youth protection aspects of loot boxes and/or video games in general is not really a new discussion. In fact, it was preceded by several smaller and unrelated

⁸ <https://www.techopedia.com/definition/27527/grinding>.

⁹ Josh Bycer, 'Defining Pay to Win', game-wisdom.com, January 16, 2014.

¹⁰ Haydn Taylor, 'PC microtransaction revenue has doubled since 2012', gamesindustry.biz, November 24, 2017.

¹¹ Nick Statt, 'Overwatch's loot box system is Blizzard's true masterpiece', theverge.com, May 28, 2017.

¹² Dean Takahashi, 'Clash Royale, Clash of Clans push Supercell to \$2.3 billion in 2016 revenue', venturebeat.com, February 15, 2017.

¹³ Jared Newman, 'How Loot Boxes Led to Never-Ending Games (And Always-Paying Players)', rollingstone.com, November 14, 2017.

debates which, however, managed to gain greater public attention on local jurisdictional level without, of course, reaching the global scale of the 2016 and 2017 debates (see below). These early discussions were not about loot boxes – in fact the term was not even known by the public yet – but about social games, browser games, mobile games and social gambling. Social and browser games are typically smaller types of games which are free-to-play and are played as a pastime. Social gambling, on the other hand, refers to games which look and feel like traditional games of chance (e.g. roulette or poker) but which are not played with, or for, real money but instead with, or for, in-game currency, additional spins and so on which cannot be cashed out. Also social games exist that include social gambling opportunities (e.g. a fantasy role play game where the player's character can visit a casino). With the rise of the mobile market, social games and social gambling became more and more popular on mobile devices as well. Already in 2009 approximately US\$98 million were invested in social game companies.¹⁴ Because social games and social gambling are typical free-to-play games, the monetization model behind social games was always based on microtransactions, including what would later become known as 'loot boxes' (see above I(1) and (2)).¹⁵

All the aforementioned game types have in common that they often provide mechanisms which are based on chance and which allow the player to win virtual in-game items which can typically not be redeemed for money. In many cases, the player first needs to purchase some form of virtual currency for real-world money in order to subsequently use the purchased in-game currency to participate in the game of chance (e.g. by 'buying' a loot box or by using the virtual currency as bet within the social gambling app). This led to early discussions as to whether such mechanisms should be regulated under local gambling laws, as they would contribute to the normalization of gambling behaviour in children. At the centre of these discussions on local level was the question of whether virtual items could satisfy the requirement of a 'prize' as required under most local gambling laws.

One of the first countries to react was Japan, which started enforcement action against multi-level loot box mechanisms (see above I(2)) in 2012 after a major public

debate around the subject. Australia was another country where social games and social gambling was discussed on broader public scale leading, in 2013, to a legislative initiative to amend the local gambling act to make it applicable to games which provide only virtual items as prizes.¹⁶ Next was Singapore where the so called *Remote Gambling Act* was introduced in 2014. The intent of this bill is to protect Singaporeans, and in particular, younger tech-savvy Singaporeans, from the dangers of gambling, as well as to prevent gambling operations as a conduit to fund other illegal activities.¹⁷ The wording of the law applies to virtual items as well. In South Korea, the National Assembly proposed amendments to the existing gambling regulation already in 2015 to oblige the industry to disclose information on the type, composition ratio and acquisition probability of loot box-like mechanisms. Lastly, the USA must be mentioned where major case law on social games and social gambling apps which grant virtual items as prizes was introduced in 2015 and 2016 with proceedings having started before the debate went global in 2016 and 2017 (see the US section for details).

2. Skin Betting Scandal (2016)

The first year loot boxes were seriously discussed and named in relation to gambling laws on a global scale and over a significant period of time was 2016. However, the underlying matter – which soon became known as the 2016 Skin Betting Scandal¹⁸ – did not actually primarily concern loot boxes but was only indirectly connected to them.

Over some time, secondary market places had existed which allowed players to trade, buy or sell in-game items and skins for real-world money, digital currency or other in-game items. Most of the traded in-game items were previously generated by loot boxes. As some loot box items are drawn significantly less than others, these items rapidly grew in value. Extremely rare skins are worth more than US\$4,200.¹⁹ However, some items even managed to gain a value of up to US\$100,000.²⁰ Soon, third-party websites opened, which not only allowed the trading of skins but also betting and gambling with them. Some of these websites even added the possibility to bet on the results of professional eSport matches. By 2015 an estimated US\$2.3 billion in skins

14 Sande Chen, 'The Social Network Game Boom', gamasutra.com, April 29, 2009.

15 Jared Newman, see fn 13 above.

16 Parliament of Australia, Interactive Gambling Amendment (Virtual Credits) Bill 2013: https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd1213a/13bd157.

17 Gameskinny.com, 'New Bill in Singapore Could Spell Trouble for F2P Games', October 5, 2014.

18 Will Green, 'Skin Betting Scandal Gets Deeper, As Gambler Said He Kept \$91,000 From Site He Exposed', esportsbettingreport.com, June 20, 2016.

19 Joseph Knoop, 'The most expensive CS:GO skins of 2017', pcgamer.com.

20 <http://csgopedia.com/most-expensive-cs-go-skins>.

were used to bet on eSports.²¹ For 2016, insiders estimated that US\$5 billion in skins were used for skin gambling of which US\$2 billion were used on eSports betting and the remaining US\$3 billion on traditional games-of-chance (e.g. virtual roulette or poker).²²

Without exception, all secondary market places and skin gambling platforms were operated by third-party providers, completely unrelated to the video gaming industry. Furthermore, in almost all cases the trading and gambling with in-game items outside of the video game environment violated the terms of use of the relevant game operator or gaming platform. In one case, which also became the most popular one, numerous third party gambling platforms managed to interface the video game distribution platform *Steam* – under violation of several of the operator's rights and service terms – to illegally exploit it for skin gambling purposes.

With skins worth up to US\$5 billion per year used for gambling purposes, one can imagine that it did not take long until the first negative headlines to hit the press. Already in 2015 seven professional eSport players were banned from further eSport events after it became public that they had manipulated the outcome of a 2014 eSport match to win skins worth more than US\$10,000.²³ In summer 2016, a similar incident gained major attention when it became known that a popular video game live streamer and former professional eSport player was provided with the outcomes of virtual dice rolls by its sponsor, a skin gambling operator, to ensure the player would have winning results when promoting the betting platform on its live stream channel.²⁴ However, the case which gained the most public attention was the revelation that two popular YouTube 'influencers' regularly promoted a skin gambling platform to their subscribers which was actually owned by themselves without disclosing this relationship.²⁵ This incident even sparked the interest of the US Federal Trade Commission ('FTC') which started investigating the case and ultimately required both parties to

disclose their business ties to anything they endorse on their channels in future.²⁶ Afterwards, the FTC also updated their product endorsement guidelines for social media.²⁷

Along with frequent news relating to manipulative behaviour, numerous press articles reported that children were being introduced to gambling on illegal skin betting web sites²⁸ and losing large amounts of money.²⁹ This again sparked the interest of regulators and politicians. The UK Gambling Commission started investigating and prosecuting two men who operated a skin gambling website based in the UK. Both men were ultimately convicted and ordered to pay £174,000 and £91,000 respectively. The District Judge concluded that children had been gambling on the site and that having been shown footage of a 12-year old boy gambling was 'horrific'.³⁰

Although the Skin Betting Scandal was primarily about illegal third-party gambling providers which had no connection to the video gaming industry, it was nevertheless the reason why for the first time public attention shifted towards the practices of the video gaming industry. The argument was made that game operators would indirectly profit from illegal skin gambling activities as players who lost all their skins on third party gambling sites needed to resupply themselves with new skins directly at the source – the video game. Here, players would purchase new loot boxes in the hope to obtain particular rare and valuable items. Gambling would thus be 'encouraged both within games and on third-party websites'.³¹ Various reactions followed. In Australia, Senator Nick Xenophon announced his plans to introduce legislation to make it illegal for games to seek payment for items of varying value according to chance.³² The British territory Isle of Man issued a regulation which explicitly defines in-game items as money's worth.³³ In the USA, several law suits based on alleged gambling charges were brought against *Steam*'s operator *Valve*.³⁴ Although none of

21 Joshua Brustein and Eben Novy-Williams, 'Virtual Weapons are Turning Teen Gamers into Serious Gamblers', Bloomberg.com, April 20, 2016.

22 Shaun Assael, 'Skin in the Game', espn.com, January 1, 2017.

23 Andy Chalk, 'New evidence of Counter-Strike: Global Offensive match fixing', pcgamer.com, January 19, 2015.

24 Will Green, 'Skin Gambling Site CSGO Diamonds: We Told Sponsored Player In Advance When He Would Win', esportsbettingreport.com, June 13, 2016.

25 Allegra Frank, 'Counter-Strike YouTubers revealed as owners of gambling site they promoted', polygon.com, July 4, 2016.

26 Allegra Frank, 'Counter-Strike gambling scandal comes to an end with FTC settlement', polygon.com, September 7, 2017.

27 FTC, 'CSGO Lotto Owners Settle FTC's First-Ever Complaint Against Individual Social Media Influencers', ftc.gov, September 7, 2017.

28 Joshua Brustein and Eben Novy-Williams, see fn. 21 above; Samuel Osborne, 'Rogue Gaming Sites let Children Gamble Hundreds of Millions', independent.co.uk, August 21, 2016; Abe Hawken, 'Rogue

sites let children bet millions of pounds on online matches played by professional gamers in virtual wagers', dailymail.co.uk, August 20, 2016.

29 Elle Hunt, 'Nick Xenophon calls for first-person shooter video games to be defined as gambling', theguardian.com, July 31, 2016.

30 Gambling Commission, 'Two men convicted after offering illegal gambling parasitic upon popular FIFA computer game', gamblingcommission.gov.uk, February 6, 2017.

31 Catherine Armitage, 'Nick Xenophon calls for curbs on teen gambling in eSports video games', *The Sydney Morning Herald*, smh.com.au, July 31, 2016.

32 Catherine Armitage, see fn 31 above.

33 Online Gambling (Amendments) Regulations 2016, regulation 11.

34 Michael McWhertor, 'Counter-Strike player files suit against Valve over "illegal gambling" surrounding CSGO', Polygon.com, June 23, 2016; Jacob Wolf, 'Second class-action lawsuit filed against Valve', espn.com, July 7, 2016; Matt Day, 'Valve faces suit by parents who say kids wagered on its games', seattletimes.com, December 23, 2016.

these cases turned out to be justified,³⁵ Valve eventually reacted with sending a total of 43 cease and desist letters to third-party gambling providers giving them ten days to discontinue the exploitation of the *Steam* platform which violated several of Valve's rights and terms of service.³⁶ Following this, several of the targeted websites went offline.³⁷

3. Loot box uproar (2017)

The 2016 Skin Betting Scandal paled in comparison to what would happen in 2017. Following the events from 2016, the image of loot boxes was already tainted in many gamer's minds. In addition and for some time, gamers increasingly opposed the inclusion of micro-transactions in full-prize games in general, arguing that game developers would become more and more greedy, in particular in cases where they implement game progress affecting loot boxes (see 'pay-to-win' criticism above II(4)). Only few industry insiders pointed out that the development costs for video games had sky rocketed over recent years and that game developers needed to find new monetization models to remain profitable in light of the fact that the average purchase price for video games had not increased.³⁸

All things considered, 2017 was not the best year to release video games which included loot box mechanisms. However, with the significant development times modern video games take nowadays, numerous such games were already on the way or in their final development phase. Numerous reports followed revealing that several long-awaited top-games would rely on loot box mechanisms. This concerned almost every popular video game genre: Sport and racing fans were complaining that they were forced to 'grind' in *Forza Motorsport 7*,³⁹ *NBA 2k18*⁴⁰ and *Need for Speed: Payback*⁴¹ unless they paid money on loot

boxes to build up their characters. Adventure fans criticized *Assassin's Creed Origins* for including loot boxes that contained game-progress-affecting items and not just cosmetic ones.⁴² RPG and fantasy fans had similar concerns regarding the highly-anticipated *Lord of the Rings: Shadow of War*⁴³ and also stated that reaching a bonus ending would require significant more time without the player spending real money on loot boxes.⁴⁴ Action and shooter fans claimed that loot boxes which could be opened in the Normandy setting of *Call of Duty: WWII* would be disrespectful towards the allied troops who 'gave their lives to save the world from fascism and tyranny'.⁴⁵ Science-fiction and shooter fans were outraged about several game events and gameplay adjustments for *Destiny 2* which were allegedly undertaken to boost the sale of loot boxes⁴⁶ and ultimately even demanded the removal of the game's entire in-game shop.⁴⁷ There was no game that did not get its share of criticism even though loot boxes were already introduced in many these game's predecessors.

By far and without any doubt the most negative attention, however, was caused by the highly anticipated new *Star Wars* game *Battlefront II*. Even before its release, during a limited trial phase, gamers and *Star Wars* fans around the globe massively criticized the game for a loot box system that rewarded players with gameplay advantages through loot boxes purchased with real money.⁴⁸ Although these loot boxes could technically also be purchased with in-game currency earned by gameplay, soon numbers were reported that players would on average have to 'grind' for approximately 40 hours to unlock a single particular strong character (e.g. *Darth Vader*).⁴⁹ Subsequently, the global debate around the *Star Wars: Battlefront II* loot box mechanism took on a life of its own with various records being broken, amongst others the most

35 Alex Wawro, 'Court dismisses class action lawsuit against Valve over CS:GO gambling', Gamasutra.com, October 5, 2016; Darren Heitner, 'Illegal Gambling Case Concerning CS:GO Is Kicked Out Of Court', forbes.com, April 4, 2017.

36 Alex Wawro, 'Valve calls on 23 Counter-Strike gambling hubs to cease & desist', gamasutra.com, July 20, 2016; Owen S. Good, 'Valve widens Counter-Strike gambling crackdown, tells another 20 sites to close', Polygon.com, July 30, 2016.

37 Allegra Frank, 'CSGO betting sites close in the wake of Valve's crackdown', Polygon.com, July 14, 2016.

38 Erik Kain, 'Video Games Should Be More Expensive', forbes.com, April 24, 2015.

39 Sam Machkovech, 'Loot boxes have reached a new low with Forza 7's "pay to earn" option', arstechnica.com, September 29, 2017.

40 Caty McCarthy, 'Those Hoping Star Wars Battlefront 2 Will Flop Amid Loot Box Controversy Should Look to NBA 2k18', usgamer.net, November 15, 2017.

41 Hayden Dingman, 'Need for Speed: Payback review: Pouring loot boxes on a tire fire', pcworld.com, November 10, 2017.

42 Tom Philips, 'Here's the deal with Assassin's Creed Origins in-game loot chests', eurogamer.net, October 9, 2017.

43 Paul Tassi, 'How Shadow Of War's Loot Boxes Cripple The Game, Even If You Can "Ignore" Them', forbes.com, October 14, 2017; Rob Keyes, 'Middle-earth: Shadow of War Microtransactions Make Game Look Bad', screenrant.com, September 8, 2017.

44 Allegra Frank, 'OpenCritic joins the loot box backlash', polygon.com, October 9, 2017.

45 Erik Kain, 'Call Of Duty: World War 2's Loot Boxes Are A Disrespectful Cash Grab', forbes.com, November 2, 2017.

46 Chandler Wood, 'Destiny 2 Fans Flood Bungie's Forums with Demands to Remove Eververse, Destiny 2's Loot Box Storefront', playstationlifestyle.net.

47 Chandler Wood, see fn 46 above.

48 Robert Purchase, 'The price and state of Star Wars Battlefront 2 loot crates at launch', eurogamer.net, September 11, 2017.

49 Owen S. Good, 'Star Wars Battlefront 2 heroes come at a substantial cost', polygon.com, November 11, 2017.

downvoted thread in the history of *Reddit*, receiving over 436,000 downvotes in 24 hours.⁵⁰ As a reaction to the heavy criticism the amount of credits needed to unlock top characters like *Darth Vader* or *Luke Skywalker* was reduced by 75 percent to enable players to obtain these characters faster through gameplay.⁵¹ The criticism continued nevertheless. Finally, only one day before the official release of the game, the emergency brake was hit and all microtransactions removed entirely.⁵²

All appeasement attempts by the industry did not help. In particular during the last months of 2017, gamers all around the globe had lodged thousands of complaints with local gambling and youth protection regulators as well as politicians to take action against loot boxes. The sheer amount of complaints together with the omnipresent coverage by the mass media and the corresponding global internet uproar ultimately made several authorities, age-rating boards, politicians and other stakeholders take a closer look at the matter. Many of them subsequently issued statements, warnings or even started legislative initiatives or investigations on loot boxes. Several of these initiatives are still ongoing.

IV. Loot boxes in different jurisdictions

1. United Kingdom

a. Overall risk assessment

- Standard Loot Boxes: Legal Risk:⁵³ Very low; Enforcement Risk:⁵⁴ Very low.
- Tradeable Loot Boxes: Legal Risk: Medium; Enforcement Risk: Low.
- Outlook: Caution advised due to ongoing scrutiny by the regulator and lawmakers.

b. Executive summary

So far, no case law on loot boxes or similar game mechanisms exists in the UK. Two papers released by the UK Gambling Commission provide the most useful guidance for practitioners. However, while these papers provide valuable insight, they are also contradictory

and vague with regard to several key questions. Applying a strict interpretation of these papers would mean that Tradable Loot Boxes require a license under UK gambling laws. However, with generous interpretation, loot boxes do not pose an issue at all. This uncertainty gives rise to some legal risk (i.e. legal risk assessment: medium). The Commission's papers need to be interpreted by taking into account additional (but unofficial) public statements and interviews of the Gambling Commission which imply a currently low enforcement risk in relation to loot boxes (see the political and regulatory environment section below) and the fact that no enforcement action has taken place so far. Because this climate could change due to continuous public or political pressure, in particular in case of another *Battlefront II*-like uproar, caution is generally advised.

c. Political and regulatory environment

aa. UK Gambling Commission position papers

In the wake of the 2016 Skin Betting Scandal the UK's Gambling Commission published two papers entitled *Virtual currencies, eSports and social casino gaming*.⁵⁵ While these papers were written in light of the 2016 Skin Betting Scandal and therefore mainly addressed the activities of third party skin gambling providers, many of the statements which can be found therein also applied to loot boxes. These papers will be discussed in detail in the legal environment section. However, in summary, the key questions that arise from the papers are: (1) whether in-game items generated by loot boxes attain a real-world value and must therefore be considered as 'money's worth' within the meaning of UK gambling laws if they can also be traded outside of the game environment via secondary market places (e.g. eBay or skin betting platforms); and (2) if the outcome would be different where the game operator prohibits the trading outside of the game by means of his terms of service. These key questions are not unambiguously answered by the UK Gambling Commission. Several of the Gambling Commission's statements imply that the answer would need to be 'yes' while other statements are unclear. This lack of clarity generally speaks in favour of an increased legal risk (see above: medium).

50 Jason Parker, 'EA lowers Star Wars Battlefront II costs after Reddit outcry', cnet.com, November 13, 2017.

51 'Star Wars Battlefront 2's Loot Box Controversy Explained', Gamespot.com, November 22, 2017.

52 Eddi Makuch, 'Shortly Before Star Wars: Battlefront 2's Release, EA Removes Microtransactions For Now', gamespot.com, November 20, 2017.

53 'Legal Risk' within the meaning of this article refers to the risk that applicable gambling laws apply to loot boxes.

54 'Enforcement Risk' within the meaning of this article refers to the risk that applicable gambling laws are actually enforced by the competent regulator.

55 Gambling Commission, 'Virtual currencies, eSports and social casino gaming – discussion paper', gamblingcommission.gov.uk, August 2016; Gambling Commission, 'Virtual currencies, eSports and social casino gaming – position paper', gamblingcommission.gov.uk, March 2017.

bb. UK Gambling Commission statements and stakeholder interviews

However, the UK Gambling Commission and several of its stakeholders have also given statements and interviews on the matter which make pretty clear that the Gambling Commission does not seem to consider loot boxes to be gambling (i.e. regardless of several statements from its official papers implying otherwise). In November 2017, the executive director of UK's Gambling Commission stated that the Commission had also investigated loot box mechanisms in video games and suggested self-regulation by the games industry for games which include loot box mechanisms.⁵⁶ In an official statement on its website, the UK Gambling Commission shortly after stated:

Our starting point in deciding our position with any product is to look closely at whether or not it falls under UK gambling law. The definition of what is legally classed as gambling is set by Parliament rather than by us. Our role is to apply that definition to activities that we see and any changes to that definition need to be made by Parliament. The law sets a line between what is and is not gambling. [...] A key factor in deciding if that line has been crossed is whether in-game items acquired 'via a game of chance' can be considered money or money's worth. In practical terms this means that where in-game items obtained via loot boxes are confined for use within the game and cannot be cashed out it is unlikely to be caught as a licensable gambling activity. In those cases our legal powers would not allow us to step in.

In other words, it seems more than unlikely that the UK Gambling Commission will engage in any enforcement action in relation to loot boxes in the near future (i.e. enforcement risk: low, see above). In an interview for eurogamer.net, the Gambling Commission's executive directive was even more clear stating that 'In relation to loot boxes specifically, the key thing here is the loot boxes we've seen, none of them contain a facility to be able to cash-out within the game itself, and that's really the key thing which is preventing them from crossing that line into becoming gambling.' However, the Commission also added that they would focus on raising awareness of the issues with loot boxes.

cc. Reactions by politicians and other regulators (including PEGI)

On October 6, 2017, Daniel Zeichner, a member of the British Parliament submitted two written questions to

ask the Secretary of State for Digital, Culture, Media and Sport, what plans she has to protect vulnerable adults and children from illegal gambling, in-game gambling and loot boxes within computer games and what assessment the Government has made of the effectiveness of the Isle of Man's enhanced protections against illegal and in-game gambling and loot boxes; and what discussions she has had with Cabinet colleagues on adopting such protections in the UK.⁵⁷ However, the government's response did not offer anything new and instead referred to the Gambling Commission's position paper.⁵⁸

Separately more than 10,000 UK citizens signed a petition demanding that the government change the UK's gambling law to include gambling activities in computer games which include loot box mechanisms.⁵⁹ The Government responded, inter alia, that the Video Standards Council ('VSC'), which is the designated body for classifying video games and responsible for applying the Europe-wide PEGI age-ratings to video games supplied in the UK, is in ongoing discussions with PEGI Council and its Experts Group to to determine whether any changes to the PEGI criteria need to be made.⁶⁰ However, operations director Dirk Bosmans of the PEGI had already given a statement on October 12, 2017 explaining that the PEGI, as well as other rating agencies 'cannot define what constitutes gambling, since that is the responsibility of a national gambling commission'.⁶¹ Bosmans also referred to the PEGI criteria by stating that the PEGI gambling content descriptor is currently given only 'to games that simulate or teach gambling as it's done in real life in casinos, racetracks, etc.' and that only if a gambling commission would state that loot boxes are a form of gambling, the PEGI would have to adjust its criteria to that.

d. Legal environment

Providing facilities for gambling without a license, or an exemption applying, is a criminal offence under the UK Gambling Act 2005. Gambling is defined as betting, gaming or participating in a lottery. Gaming is defined in Sec. 6 Gambling Act 2005 as playing a game of chance for a prize. Part of the legal test under the UK gambling legislation is – like in many other jurisdictions – that the 'prize' which the player receives at random is viewed as money or money's worth.

⁵⁶ Tim Miller, 'Black Friday, prices, Catios, Loot boxes', BBC Radio, bbc.co.uk, November 17, 2017.

⁵⁷ Vic Hood, 'Online petition forces government response to loot boxes', eurogamer.net, October 16, 2017.

⁵⁸ Tracey Crouch, Parliamentary Under-Secretary for the Department for Digital, Culture, Media and Sport, www.parliament.uk, question 106043, October 16, 2017.

⁵⁹ See fn 51.

⁶⁰ UK Government and Parliament, https://petition.parliament.uk/petitions/201300?reveal_response=yes#response-threshold.

⁶¹ Alessio Palumbo, 'PEGI on Loot Boxes: We Can't Define What's Gambling, Only A Gambling Commission Can', wccftch.com, October 12, 2017.

aa. Standard loot boxes

Standard Loot Boxes do not fall under the UK gambling legislation because they do not satisfy the prize requirement. Virtual items generated by Standard Loot Boxes can neither be traded nor cashed out and therefore do not have a real world value which would be required to constitute at least as ‘money’s worth’.

bb. Tradeable loot boxes

An increased risk, at least from a mere legal perspective, currently exists under UK gambling laws in case loot-box-generated items can be traded with other players – may it be within or outside the game environment. In the wake of the Skin Betting Scandal, the UK Gambling Commission issued two papers which provide valuable information on the Commission’s view in terms of loot boxes but which are also somehow contradictory and therefore cause some legal uncertainty.

(1) The Gambling Commission’s discussion paper

In August 2016 the Commission first released a discussion paper titled *Virtual currencies, eSports and social gaming*.⁶² According to the paper, the ‘Commission is focussing on virtual currencies, eSports and social gaming products, in particular, as they create issues for regulation and player protection for a number of reasons, because:

- the lines between some social gaming products and gambling are blurring;
- technological developments and the expansion of digital or virtual currencies mean that operators of some social gaming products may be offering facilities for gambling;
- the growth in the market for gambling on eSports raises new issues.⁶³

(a) Tradability of in-games items leads to the acquisition of a real world value

In its discussion paper the Commission particularly addresses the phenomenon of so called skin betting and makes some far-reaching statements. According to the Commission it considers skins to be ‘in-game items that provide aesthetic upgrades to a player’s game play where those in-game items can also be traded as commodities on a marketplace within a platform

operated by the game’s developer or distributor.’⁶⁴ The Commission then summarizes that ‘[i]n some cases, the inventory of the player’s account can be connected to websites where the user can use the “skins” they have bought or won to bet or stake in casino style games’.⁶⁵ The next statement made video game developers prick up their ears: ‘These types of “skins” have a monetary value derived from the current market price and can be converted into money.’⁶⁶ The Commission concludes with stating that a license is required ‘[w] here “skins” are traded or are tradeable and can therefore act as a de facto currency and facilities for gambling with those items are being offered’.⁶⁷

The Commission later confirms its position under the social gaming section of the discussion paper in relation to gambling style games which look and feel like traditional gambling:

In general terms we remain of the view that winning additional spins or credits or tokens, even if they can be acquired by the payment of real money, will not in and of itself make an activity licensable. If, however, we discover that items are being traded or are tradeable or are being used as a de facto virtual currency then our view would be different.⁶⁸

(b) Consequences of the Commission’s statements

While the Commission’s discussion paper was written in light of the Skin Betting Scandal and therefore primarily aims at third party skin betting providers and secondary markets, it does not take much to see that the Commission’s statements can also be applied to loot boxes in general. If items generated by loot boxes and traded (or betted) on third party platforms in any case attain a monetary value derived from the current market price and thus constitute money’s worth and consequently a ‘prize’, the underlying loot box mechanism would almost inevitably need to be considered as gambling as well. Otherwise it would be difficult to explain why one and the same skin can have a monetary value on a third party platform but not within the game where it is generated by a chance-based loot box. The legal test under the UK gambling legislation only requires that the ‘prize’ which the player receives at random is viewed as money or money’s worth.

Even more so, consequently thought through, the Commission’s position as outlined in the discussion paper would also mean that games with loot box

62 Gambling Commission, ‘Virtual currencies, eSports and social casino gaming – discussion paper’, gamblingcommission.gov.uk, August 2016.

63 Gambling Commission, see fn 62 above, para 1.4.

64 Gambling Commission, see fn 62 above, para 3.5.

65 Gambling Commission, see fn 62 above, para 3.5.

66 Gambling Commission, see fn 62 above, para 3.5.

67 Gambling Commission, see fn 62 above, para 3.6.

68 Gambling Commission, see fn 62 above, para 5.6.

mechanisms, which technically allow the trading of the generated items within the game only (but not directly via third party platforms by means of technical restriction), would need to be considered as gambling as well: There is always a secondary market (such as eBay or a common internet discussion board) where players can sell virtual items and agree to hand them over within the game.⁶⁹ Thus, strictly speaking, the mere technical possibility to trade items within a video game leads to the acquisition of a 'monetary value derived from the current market prize'. This is an inevitable consequence of the rules of market economy and the existence of supply and demand. Many games allow items to be handed over simply by one character meeting another to exchange the item (e.g. role play games).⁷⁰ Selling virtual items on platforms like eBay has occurred since the early days of *World of Warcraft*, where armies of so called gold farmers harvested virtual gold to sell it for real money.⁷¹ Thus, by applying the discussion paper's market economy approach, loot box mechanisms would always need to be considered gambling as soon as the underlying game allows the subsequent in-game trading of the generated items. Only Standard Loot Boxes which do not allow the trading of the generated item would be legally on the safe side.

(2) The Gambling Commission's position paper

Soon after the release of the discussion paper, the Gambling Commission released a position paper in March 2017 also titled *Virtual currencies, eSports and social casino gaming*.⁷² According to the Commission the paper 'seeks to balance an interpretation of the legal framework governing remote gambling in Great Britain with an assessment of where interactive entertainment has crossed, or is in danger of crossing boundaries into licensable gambling activities'.⁷³ However, the paper lacks clarity and overall remains vague in relation to several key questions, in particular those raised by the discussion paper.

(a) Unclear requirement of trading 'outside a video game'

A key conclusion the Commission presents is that '[w]here 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'.⁷⁴ While this statement at first seems to be clear and in line with the discussion paper, it brings up some confusion when taking a closer look. What does 'outside a video game' mean? This requirement was not mentioned in the earlier discussion paper.

Like the discussion paper, the position paper was mainly written in light of the Skin Betting Scandal and therefore primarily aims at third party gambling providers and secondary markets which allow using in-game items as wager and which (often illegally) exploit the internal trading mechanisms of existing video games or game distribution platforms (see the Skin Betting Scandal section above). Hence, there is little doubt that these practices take place 'outside a video game'. However, this does not answer the key question on the effects of such 'outside a video game' trading on the monetary value of the (same) item within a game. Does 'outside a video game' mean that the attained monetary value 'stops' at the border of the video game where the item is generated by chance-based loot boxes in the first place? At least in light of the discussion paper's more general market economy approach such a platform-specific monetary value approach does not sound very convincing and would have required further reasoning.

Unfortunately, the rest of the paper is vague in this regard as well: At one point, the Commission uses a broader wording when it states that the mere 'ability to convert in-game items into cash, or to trade them (for other items of value), means they attain a real world value and become articles of money or money's worth'.⁷⁵ This seems to somehow contradict the first statement and is more in line with the market economy approach of the earlier discussion paper. Strictly speaking the mere possibility to use a secondary market (even a common one like eBay) already constitutes an 'ability to convert in-game items into cash, or to trade them'. Such 'ability', however, exists once a game allows the item to be traded – even if it is just within the game (see above).

(b) The Commission on loot boxes – unclear requirement of 'readily accessible opportunities to cash in or exchange'

In 2017 the public centre of attention shifted away from third-party skin gambling providers to loot boxes in general. Nevertheless, in March 2017 when the position

69 Julian Dibbel, 'The Life of the Chinese Gold Farmer', nytimes.com, June 17, 2017.

70 Julian Dibbel, see fn 69 above.

71 Julian Dibbel, see fn 69 above.

72 Gambling Commission, 'Virtual currencies, eSports and social casino gaming – position paper', gamblingcommission.gov.uk, March 2017.

73 Gambling Commission, see fn 72 above, para 1.4.

74 Gambling Commission, see fn 72 above, para 1.4.

75 Gambling Commission, see fn 72 above, para 3.8 (emphasis added).

paper was released, the loot box controversy had not yet reached its climax and the intensity the discussion was about to take was not predictable then. Still, the level of public attention at this time was enough for the Commission to use the chance to address loot boxes and the implications of secondary markets with some additional comments:

Away from the third party websites which are overtly gambling (offering betting, casino games and lottery products) the ability to exchange in-game items for cash or trade on secondary markets also risks drawing elements within games themselves into gambling definitions. By way of example, one commonly used method for players to acquire in-game items is through the purchase of keys from the games publisher to unlock ‘crates’, ‘cases’ or ‘bundles’ which contain an unknown quantity and value of in-game items as a prize. The payment of a stake (key) for the opportunity to win a prize (in-game items) determined (or presented as determined) at random bears a close resemblance, for instance, to the playing of a gaming machine. Where there are readily accessible opportunities to cash in or exchange those awarded in-game items for money or money’s worth those elements of the game are likely to be considered licensable gambling activities.⁷⁶

Similar to the ‘outside a video game’ condition the requirement of ‘readily accessible opportunities to cash in or exchange’ brings up confusion. Three possibilities can be named on how this requirement can be interpreted, all with significantly different consequences:

- (i) The Commission only considers possibilities to cash out or exchange in-game items *via the game itself* as ‘readily accessible opportunities’. Applying this platform-specific interpretation, video game developers would not have much to worry as almost no game allows cashing out loot box items.
- (ii) The Commission could also be referring to *third party providers* which use/interface/exploit the existing in-game economy to enable players to trade or bet their in-game items on third party platforms. Consequently, once these exist, the in-game items attain a real world value. Thus whether loot boxes would need to be considered as gambling depends on the game’s technical infrastructure and whether third party providers are able to use/interface/exploit the game to enable outside trading. The consequence would be that game developers need to ensure that their in-game economy cannot be used/interfaced/exploited by third parties. This interpretation is more in line with the discussion paper’s market economy approach and the fact that both papers were written mainly in light of the Skin Betting Scandal which was primarily about third party gambling providers.

- (iii) Finally, the Commission could be referring to common secondary markets such as eBay. Strictly speaking such secondary markets also constitute ‘readily accessible opportunities to cash in or exchange’ in-game items (again, think of gold farmers). This would also be in line with the market economy approach of the discussion paper. Furthermore, the Commission explicitly names secondary markets in the cited section. With this interpretation only Standard Loot Boxes would be on the safe side and game developers would need to technically prevent even the in-game trading of all loot-box-generated items.

(c) The Commission on loot boxes – unclear requirement of ‘successfully restricted for the use solely within the game’

The uncertainty described in the previous section is not remedied by the Commission’s next statement: ‘Where prizes are successfully restricted for use solely within the game, such in-game features would not be licensable gambling, notwithstanding the elements of expenditure and chance’.⁷⁷ This brings up the question when exactly a prize is supposed to be ‘successfully restricted for the use solely within the game’. Again, *three interpretations* come into question, which are similar to those presented in the last section:

- (i) First, loot-box-generated items could be ‘successfully restricted to use solely within the game’ where the game developer prohibits the external trading of in-game items by means of the game’s *terms of use*. Since this is already market practice, most video game developers would not have much to worry about. Whether the contractual prohibition of item trading outside the video game is relevant under applicable gambling law is a key question. On the one hand it seems excessive to burden the game developer with a license requirement for the unwanted actions of third parties (players or third-party platforms) who trade or enable trading of items on secondary markets and by doing so violate the EULA or IP. On the other hand it is difficult to explain how the mere contractual prohibition to trade should have any influence on the establishment of a real market value which is driven by external factors such as the general technical possibility to trade as well as supply and demand.
- (ii) One could also argue that it is (additionally) required to technically *exclude the possibility that third party providers* use/interface/exploit the in-game economy of the game to enable item trading outside of the game. Again, this would require that video game developers technically exclude such practices (see (ii) in the section above already).

76 Gambling Commission, see fn 72 above, para 3.17.

77 Gambling Commission, see fn 72 above, para 3.18.

- (iii) finally, it can be said that loot-box-generated items are only ‘successfully restricted to use solely within the game’ if they cannot be traded at all, i.e. not even within the game. Otherwise it cannot be excluded that the items are used to sell or trade them on common *secondary markets* such as eBay (see (iii) in the section above already).

2. USA

a. Overall risk assessment

- Standard Loot Boxes: Legal Risk: Very low; Enforcement Risk: Very low.
- Tradeable Loot Boxes: Legal Risk: Low; Enforcement Risk: Low.
- Loot boxes including purchasable in-game currency: Legal Risk: Medium; Enforcement Risk: Medium.
- Outlook: Some caution advised due to legislative initiatives from lawmakers on state level.

b. Executive summary

Both, Standard and Tradable Loot boxes are currently relatively safe in the US. Based on recent case law they might not even satisfy the requirement of a game of chance if they are incorporated in an overall skill-based video game. There is also a clear tendency in US case law that virtual items which cannot be cashed out do not have a real world value. Thus, loot boxes do not constitute gambling as they are not awarding a ‘prize’ within the meaning of most US gambling laws. Despite some legal uncertainty in this regard, this might even apply if the game (from a mere technical perspective) allows the trading of its virtual items on secondary markets; at least in case the game operator prohibits such activities via the game’s terms of use. It is therefore crucial that game operators use clear and unambiguous language to prohibit outside video game trading of loot-box-generated items. Due to recent case law, a possible exemption and an increased risk exists in relation to loot boxes that include in-game currency which the player can also purchase for real money and which can subsequently be used to purchase additional loot boxes. The same applies to loot boxes which might include additional loot boxes.

c. Political and regulatory environment

The loot box controversy triggered several reactions by different stakeholders in the USA.

aa. ESRB developments in light of political pressure

(1) Early ESRB statements

One of the first reactions was a statement by the Electronic Software Rating Board (‘ESRB’) released in October 2017 after the ESRB received numerous complaints on the matter. The ESRB declared that it does not consider loot boxes to be gambling: ‘While there’s an element of chance in these mechanics, the player is always guaranteed to receive in-game content (even if the player unfortunately receives something they don’t want)’. However, the ESRB also stated that any game which provides ‘Real Gambling’ would receive an Adults Only (‘AO’) rating. According to the ESRB, ‘Real Gambling’ requires that the player ‘can actually gamble, including betting or wagering real cash or currency’.

(2) Letter by New Hampshire’s Senator to the ESRB

On February 14, 2018 it became known that New Hampshire’s Senator, Maggie Hassan, had sent a letter⁷⁸ to the ESRB asking the board to re-consider the rating process in light of loot boxes and requesting that ‘[a]t minimum, the rating system should denote when loot boxes are utilized in physical copies of electronic games’. Furthermore, the Senator asked the ESRB to ‘examine whether the design and marketing approach to loot boxes in games geared toward children is being conducted in an ethical and transparent way that adequately protects the developing minds of young children from predatory practices’ and ‘to consider working with the relevant stakeholders – including parents – to collect and publish data on how developers are using loot boxes, how widespread their use is, and how much money players spend on them’.

(3) Hearing of the Senate Commerce, Science and Transportation Committee

On the same day Senator Maggie Hassan sent her letter to the ESRB (see above) she asked four FTC nominees in a public hearing of the Senate Commerce, Science and Transportation Committee about their feeling towards loot boxes and if they would be willing to take action against such practices. The exact words used by the Senator left room for interpretation as to whether they were meant as a threat against the ESRB.⁷⁹ The statement and questions by Senator Maggie Hassan read as follows:⁸⁰

78 Brian Crecente, ‘U.S. Senator Calls on ESRB to Review Ratings Process in Light of Loot Boxes’, *rollingstone.com*, February 14, 2018.

79 Brian Crecente, see fn 78 above.

80 Video of the hearing available under fn 78 above.

In the past the FTC has looked at video games issuing a report on the marketing of violent video games to children in 2009 and in 2013. It also studied the Entertainment Software Rating Board - or ESRB - finding it one of the most effective voluntary enforcement boards. That's why I am confident that the ESRB will take this issue seriously. So today I am sending a letter to the ESRB outlining my concerns with microtransactions which may take the form of loot boxes – that's what they are called – and allow in-game purchases for surprise winnings and in many cases these are being marketed to and used by children who are obviously particularly susceptible to being addicted to them. Last month, the World Health Organization recognized gaming disorder as diagnosable disorder. We should be doing all we can to protect our children and to inform parents about their options when it comes to these types of games. So, the questions for you are: Do you agree that children being addicted to gaming and activities like loot boxes that might make them more susceptible to addiction is a problem that merits our attention and depending on how the ESRB responds to my inquiry would the FTC be willing to look at loot boxes as an issue independently.

All four nominees agreed with both counts and assured that they will look into the matter if they would be confirmed.

(4) Initiatives by the ESRB

As a reaction to the ongoing loot box debate, the ESRB announced on February 27, 2018 its plan to introduce a new label for 'In-Game Purchases'. The label is supposed to stand outside the normal rating box and content descriptors, similar to the 'Online Interactions Not Rated by the ESRB' notification.⁸¹ The explanation of the label as provided on the ESRB's website reads as follows:

In-Game Purchases – In-game offers to purchase digital goods or premiums with real world currency, including but not limited to bonus levels, skins, surprise items (such as item packs, loot boxes, mystery awards), music, virtual coins and other forms of in-game currency, subscriptions, season passes and upgrades (e.g., to disable ads).

The label will be applied to any title with in-game opportunities to spend real-world currency. Hence, the new label does not particularly concern loot boxes but instead all forms of microtransactions, including the direct purchase of virtual items or even DLCs. During a roundtable with journalists, ESRB president Patricia Vance explained why the new label does not particularly address loot boxes:⁸²

I'm sure you're all asking why we aren't doing something more specific to loot boxes, and I'll tell you we've done a lot of

research over the past several weeks and months, particularly among parents. What we learned is that a large majority of parents don't know what a loot box is, and even those who claim they do don't really understand what a loot box is. So it's very important for us to not harp on loot boxes per se, but to make sure we're capturing loot boxes but also other in-game transactions.

Parents need simple information, we can't overwhelm them with a lot of detail. We need to be clear, concise, and make it easy for them. We have not found that parents are differentiating between a lot of these different mechanics. They just know there might be something in the game they can spend money on.

This is a couple of steps forward. We'll continue to work with the industry to ensure there are effective disclosures about in-game purchases in general, and more specifically loot boxes. So if there's more that we can do, we will.

However, Vance explicitly stated that the ESRB would not take action in terms of obliging publishers to disclose the drop rates for loot-box-generated-items.⁸³ Vance also responded to Senator Maggie Hassan's letter, taking a rather opposing position:⁸⁴

While I appreciate your position and concerns, given the longevity of loot boxes as an in-game mechanic, there does not appear to be any concrete evidence of 'gaming disorders' stemming from loot boxes nor am I aware of any scientific evidence indicating that unlocking loot boxes has any psychological impact on children more specifically. Additionally, in investigating the claims set forth in your letter, we did not encounter any loot boxes that specifically target children. Regardless, we will continue to monitor the research in this field, as well as stay abreast of parental concerns, should they arise, about the potential impact loot boxes have on children and help guide parents accordingly.

Lastly, as an additional initiative the ESRB launched the website ParentalTools.org to help parents to set up parental controls on different entertainment devices by providing step-by-step instructions (e.g. on the type of games played by minors, how long they are played and how much money children are allowed to spend).

bb. Reaction by Hawaii lawmakers

(1) Reactions by Hawaiian state representatives Chris Lee and Sean Quinlan

In November 2017, Hawaiian state representative Chris Lee released a video where he classified loot boxes as 'predatory practices' and stated that he will seek legislative action that will prohibit sales of games to underage players that feature 'loot box' mechanics.⁸⁵ Shortly after,

81 Brendan Sinclair, 'ESRB responds to loot box controversy with in-game purchase label', *gamesindustry.biz*, February 27, 2018.

82 Brendan Sinclair, see fn 81 above.

83 Brendan Sinclair, see fn 81 above.

84 Brendan Sinclair, see fn 81 above.

85 Luke Plunkett, 'Hawaii Wants to Fight The "Predatory Behavior" Of Loot Boxes', *kotaku.com*, November 21, 2017.

Lee released a statement on reddit, where further explained that there have been discussions with 'a number of other states who are also considering how to address this issue'.⁸⁶ Furthermore, Lee encouraged others to step up as well and to call their state legislators.

Sean Quinlan another Hawaiian state representative took a critical position on loot boxes. However, Quinlan's reaction was slightly more reserved.⁸⁷ According to Quinlan the video gaming industry should self-regulate the matter: 'The fear when you introduce government legislation into private enterprise is that we are going to overreach. Ultimately, it's best for the industry to self-police'. Quinlan suggested either to exclude gambling-like systems in games sold to children or to have games rated 21-plus by the ESRB. However, Quinlan implied that he would consider legislation if the industry does not handle the matter on its own. Both, Lee and Quinlan, asked Hawaii State Attorney General Doug Chin for an official opinion about the legal issues surrounding loot boxes.⁸⁸

(2) Proposed bills to regulate loot boxes

On January 24, 2018 four bill proposals were introduced by Hawaiian lawmakers to regulate loot boxes. However, all bills failed to meet final deadlines since being introduced in January.⁸⁹ Nevertheless, the bills provide a good understanding of how potential loot box regulation in the USA could look like:

(a) House Bill 2686 and Senate Bill 3024

House Bill 2686⁹⁰ and Senate Bill 3024⁹¹ identically proposed to prohibit the sale of video games that contain a system of further purchasing a randomized reward or a virtual item that can be redeemed to directly or indirectly receive a randomized reward to consumers under 21 years of age. According to the Bills' introductory section 'video game publishers have begun to employ predatory mechanisms designed to exploit human psychology to compel players to keep spending money in the same way that casino games are so designed'. The introduction also addressed the key issue of secondary markets (see the UK section above for more details): 'There are even online marketplaces where players can buy and sell digital items won from loot boxes and

other gambling-like mechanisms in many games, enabling players to effectively cash out their winnings'. The Bills identified as a key issue that '[t]here is currently no age restriction on games which include loot boxes and other exploitive gambling-like mechanisms' and that '[i]n fact, games which include these mechanisms are often marketed to youth'. Furthermore there would currently be 'no disclosure required at time of purchase that video games contain predatory loot boxes and gambling-like mechanisms which may pose a harmful risk for some people, particularly youth and young adults'. In concrete, House Bill 2686 and Senate Bill 3024 proposed to amend Chapter 481B Hawaii Revised Statutes by adding a new section to read as follows:

§481B Video games; restrictions

- (a) It shall be unlawful for any retailer to sell to any person under twenty-one years of age a video game that contains a system of further purchasing that includes:
 - (1) A randomized reward; or
 - (2) A virtual item that can be redeemed to directly or indirectly receive a randomized reward.
- (b) For purposes of this section:
 - 'Randomized reward' means a reward in a video game that is based on a variable ratio schedule, wherein a player receives a reward after a random number of actions.

'Retailer' means any person who offers video games for sale, including resale by the purchaser, through any means, including sales outlets, catalogs, or the Internet.

'Video game' means an object or device that stores recorded data or instructions, receives data or instructions generated by a person who uses it, and, by processing the data or instructions, creates an interactive game capable of being played, viewed, or experienced on or through a computer, gaming system, console, or other technology.

(b) House Bill 2727 and Senate Bill 3025

House Bill 2727⁹² and Senate Bill 3025⁹³ identically proposed to establish certain disclosure requirements for publishers of video games that contain a system to purchase a randomized reward or virtual item that can be redeemed and directly or indirectly converted to a randomized reward. The introductory section of both Bills is identical to Bill 2686 and Senate Bill 3024 (see above

⁸⁶ Chris Lee, https://www.reddit.com/r/gaming/comments/7elin7/the_state_of_hawaii_announces_action_to_address/dq62w5m/.

⁸⁷ Brian Crecente, 'State Rep to Video Game Industry: Regulate Loot Boxes Before We Are Forced to Legislate', *rollingstone.com*, November 27, 2017.

⁸⁸ Brian Crecente, see fn 87 above.

⁸⁹ Michael Brestovansky, 'Loot box' bills fail to advance, *hawaiiitribune-herald.com*, March 24, 2018.

⁹⁰ https://www.capitol.hawaii.gov/session2018/bills/HB2686_.HTM.

⁹¹ https://www.capitol.hawaii.gov/session2018/bills/SB3024_SD1_.HTM.

⁹² https://www.capitol.hawaii.gov/session2018/bills/HB2727_HD1_.HTM.

⁹³ https://www.capitol.hawaii.gov/session2018/bills/SB3025_.HTM.

already). In concrete, House Bill 2727 and Senate Bill 3025 proposed to amend Chapter 481B Hawaii Revised Statutes by adding two new sections to read as follows:

§481B-A Video games; probability rates; disclosure

- (a) Video game publishers that distribute video games that contain a system of further purchasing:
 - (1) A randomized reward or rewards; or
 - (2) A consumable virtual item that can be redeemed and directly or indirectly converted to a randomized reward or rewards,

shall prominently disclose and publish to the consumer the probability rates of receiving each type of randomized reward or rewards at the time of purchase and at the time any mechanism to receive a randomized reward or rewards is activated so as to meaningfully inform the consumer's decision prior to the purchase or activation of any mechanism to receive a randomized reward or rewards.

- (b) The department of commerce and consumer affairs, in consultation with the office of enterprise technology services, is authorized to audit the code of video games sold in this State and subject to this section to ensure that the probability rates for receiving each type of randomized reward or rewards are calculated correctly and working properly. The department may contract with a third party to provide additional assistance as needed. The department shall not publicly disclose proprietary information beyond that which is necessary to fulfill the intent of this section.

- (c) As used in this section:

'Video game' means an object or device that stores recorded data or instructions, receives data or instructions generated by a person who uses it, and, by processing the data or instructions, creates an interactive game capable of being played, viewed, or experienced on or through a computer, gaming system, console, or other technology.

'Video game publisher' means an entity that publishes video games that have either been created internally or through a separate entity.

§481B-B Video games; labelling; disclosure

- (a) Each video game subject to section 481B-A shall:
 - (1) Bear a prominent, easily legible, bright red label on its packaging which reads: 'Warning: contains in-game purchases and gambling-like mechanisms which may be harmful or addictive'; or
 - (2) If purchased digitally and downloaded through the Internet or an online application, prominently disclose to the consumer at the time of consumer purchase a bright red label that is easily legible and

which reads: 'Warning: contains in-game purchases and gambling-like mechanisms which may be harmful or addictive',

so as to meaningfully inform the consumer's decision prior to purchase.

- (b) No video game publisher shall at any time modify a game to contain or otherwise permit the inclusion of additional content for which the game was not appropriately labeled at the time of original sale.

cc. Bill by three Washington State Senators

On January 11, 2018, three Washington State Senators (Ranker, Carlyle, and Keiser) introduced a bill that if passed would charge the Washington State Gambling Commission to conduct a study of the use of loot boxes and similar types of mechanisms in online games or apps by no later than December 1, 2018.⁹⁴ According to Section 3 of the bill, the Washington state gambling commission must provide the appropriate committees of the legislature written findings and provide recommendations regarding how to best regulate the practice of including loot boxes and similar types of mechanisms in online games and apps, including options for the adoption and implementation of a regulatory and enforcement system, restrictions on the sale of games, containing these mechanisms, and any appropriate disclosures.

dd. Bill by Californian Assembly Member Dr. Bill Quirk

On February 12, 2018, Californian Assembly Member Dr. Bill Quirk introduced a bill (AB 2194)⁹⁵ which would require a manufacturer of a video game that is sold in California and includes the opportunity to engage in a microtransaction, as defined, within the video game to provide a clear disclosure that the video game includes the opportunity to engage in a microtransaction on the physical box the video game is sold in. Under the bill, a violation of this provision would be subject to a civil penalty of up to \$1,000 per violation. The legislative process is still ongoing. Quirk stated:

Gaming has become an essential part of California's entertainment economy. I am happy to join other legislators from across our nation in addressing this issue by making sure California does its part to protect consumers in creating a more transparent process in how information is shared by manufacturers regarding video-game microtransactions.

⁹⁴ Senate Bill 6266.

⁹⁵ https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB2194.

ee. Bill by Minnesota State Rep. Rick Hansen

On April 24, 2018 the Minnesota House of Representatives released a press release⁹⁶ stating that State Rep. Rick Hansen (DFL-South Saint Paul) introduced the bill H.F. 4460,⁹⁷ which ‘would regulate “loot box” gambling in video games’. The matter was discussed and both parties spoke in favor of the bill. However, the legislative process is still ongoing. According to Rep. Hansen ‘People are spending real money on random drawings in video games. Minnesota regulates gambling and when loot boxes meet the threshold to be considered gambling, then we need to treat it as such and regulate it too.’

The bill prohibits the sale of a ‘video game containing a system that permits the in-game purchase of (1) a randomized reward or rewards, or (2) a virtual item that can be redeemed to directly or indirectly receive a randomized reward or rewards to a person under 18 years of age’ [sic]. Additionally, no video game may be sold or provided unless accompanied by a warning stating: ‘Warning: This game contains a gambling-like mechanism that may promote the development of a gaming disorder that increases the risk of harmful mental or physical health effects, and may expose the user to significant financial risk.’ For games sold through electronic means, the warning must be acknowledged by the purchaser. Full text of the proposed law:

Section 1. [3251.07] VIDEO GAMES; PROHIBITIONS.**Subdivision 1. Definitions.**

- (a) For purposes of this section, the terms in paragraphs (b) and (c) have the meanings given.
- (b) ‘Retailer’ means a person who offers video games for sale, including resale by the purchaser, through any means including but not limited to sales outlets, catalogs, or by electronic means.
- (c) ‘Video game’ means an object or device that stores recorded data or instructions, receives data or instructions generated by a person who uses it, and, by processing the data or instructions, creates an interactive game capable of being played, viewed, or experienced on or through a computer, gaming system, console, or other technology.

Subd. 2. Loot boxes; prohibition; warning required.

- (a) No retailer may sell to a person under 18 years of age a video game containing a system that permits the in-game purchase of (1) a randomized reward or rewards,

or (2) a virtual item that can be redeemed to directly or indirectly receive a randomized reward or rewards.

- (b) No video game may be updated to include a system described in paragraph (a) unless the provider of the update verifies, using commercially reasonable technology, that the recipient of the update is not under 18 years of age.
- (c) No video game or update subject to the age restriction in paragraph (a) or (b) may be sold or provided unless accompanied by the warning described in this paragraph. The word ‘warning’ must be stated clearly in uppercase letters that measure at least one-half inch in size, or, in the case of a warning for an electronic purchase, in a 16-point font, centered over the body copy of the actual warning. The warning copy must be presented in letters that measure at least 3/32 of an inch in size, or, in the case of a warning for an electronic purchase, in a 12-point font. The text of the warning must have a color that strongly contrasts with the background. The warning must state the following: ‘Warning: This game contains a gambling-like mechanism that may promote the development of a gaming disorder that increases the risk of harmful mental or physical health effects, and may expose the user to significant financial risk.’ For games sold through electronic means, the warning must be acknowledged by the purchaser.

d. Legal environment

Considering that the USA is (together with China) the largest video gaming market and that most of the relevant gambling laws are state laws, the legal situation regarding loot boxes is – at least at the moment – relatively clear in the US. The USA is one of the few countries where actual case law on loot box mechanisms already exists, which provides a certain amount of legal certainty. In fact, such case law is also a rich source of debate which could potentially be applied to other jurisdictions, since the most US gambling laws provide basically the same requirements as many other regulation schemes. The majority of US gambling laws require staking something of value (consideration) for a chance to win something of value (a prize).⁹⁸ If these three requirements (consideration, chance, and prize) are met, the activity is likely to constitute gambling.⁹⁹ All three requirements have been subject to US court decisions which concerned loot boxes or loot box-like mechanisms. The findings of the US Courts can be summarized as follows:

96 <http://www.house.leg.state.mn.us/members/pressrelease.asp?pressid=19935&party=1&memid=12282>.

97 <https://www.revisor.mn.gov/bills/bill.php?b=House&f=HF4460&ssn=0&y=2017>.

98 James G. Gatto and Mark A. Patrick, ‘Are Loot Boxes An Illegal Gambling Mechanic?’, *natlawreview.com*, October 25, 2017.

99 James G. Gatto and Mark A. Patrick, see fn 98 above.

aa. Elements of a game of chance within a skill-based game do not constitute a game of chance

The first notable case is *Mason v. Machine Zone, Inc.*¹⁰⁰ which provides valuable insight on the interpretation of the requirement ‘game of chance’ within an overall skill-based game. The case concerned the free-to-play mobile game *Game of War: Fire Age* (‘GoW’). GoW is a strategy game played in real time; players construct a simulated empire comprising resource plots, buildings, troops, and a ‘hero’. The object is to coordinate with other players in strategic alliances so as, ultimately, to ‘conquer the world’.¹⁰¹ As in many games, the player can also purchase in-game currency with real money and subsequently use the in-game currency to buy in-game items. Aside from that, the player can also use the in-game currency to purchase virtual chips to wager on a virtual spinning wheel in an in-game casino. After each spin, players receive a virtual prize from an in-game resource such as wood or stone.

The court ruled that an in-game casino, while being a game of chance, does not make a predominantly game of skill such as GoW a game of chance: ‘The game at issue here is not “Casino”; the game is GoW’. According to the court, the plaintiff did not proffer any argument ‘that the Court may excise one particular aspect of an integrated strategy game and evaluate that aspect in isolation’. The plaintiff’s complaint that by this interpretation any game of chance normally violating the law can be transformed into a legal game by surrounding it with games of skill was countered by the court with the argument that by applying the plaintiff’s logic, one could excise the free replay and similar chance-based functions of any number of skill-based games and, viewing those aspects in isolation, find the games to violate applicable gambling laws.

The court’s arguments can be applied to nearly all video game loot box mechanisms. An in-game casino within a strategy game is not different from loot boxes incorporated in any other game of skill. Both situations concern a single element of chance in an overall skill based game.

bb. In-game currency and items do not have a real world value if they cannot be cashed out

(1) *Mason v. Machine Zone, Inc.*

In *Mason v. Machine Zone, Inc.* (see last section above) the plaintiff’s main objective was to recover the money spend on the in-game casino. It was therefore, amongst

others, a decisive factor whether the plaintiff actually suffered an ‘economic loss’. Because the player had to first purchase in-game currency and subsequently in-game casino chips, the court had to decide whether spending these in-game items amounts to an economic loss. For this question it was of relevance whether in-game items generally have an actual real world value. The court denied this mainly for the reason that the items could not be cashed out:

‘Plaintiff could spend her “gold” as she pleased within the bounds of Defendant’s ToS: she could acquire resources to “hasten [her] advancement in the game” ..., or she could exchange her “gold” for chips to spin the Casino wheel What she could not do is cash out of the game.’

The court held also that ‘none of the prizes on offer in the GoW Casino have any freestanding value apart from their contribution to gameplay’. This was later also stressed by the United States Court of Appeals:¹⁰²

... when Mason participated in the virtual casino, she used only virtual chips, which are not redeemable for money. Thus, when Mason ‘spun’ the virtual wheel, there was no money at stake. Rather, as a result of that action, she only could receive either virtual gold, which she concedes does not amount to money, or she could receive other virtual resources that likewise were not money or redeemable for money.

(2) *Soto v. Sky Union, LLC*

A similar ruling to *Mason v. Machine Zone, Inc.* can be found in *Soto v. Sky Union, LLC*.¹⁰³ which concerned the social game *Castle Clash*. The objective is to build up an army to battle against other players. Like in many modern games, the armies consist of ‘heroes’ who – by fighting each other – develop more skills and attributes (‘level-up’) that make them stronger and more capable of winning future battles. Heroes are sorted into different categories: *Sacrifice* (the weakest class), *Elite* and *Legendary* (the strongest classes). During the gameplay the player earns *Shards* – a virtual currency. With *Shards*, players can purchase heroes of the different classes in a ‘Hero Shop’. The price for stronger heroes is higher than for weaker heroes. The amount of *Shards* that players can collect via gameplay is limited. However, *Castle Clash* offers a second virtual currency called *Gems*. The latter can be purchased via an in-game shop for real money. With *Gems*, players can buy various in-game items and enhancements. They can also participate in two loot box mechanisms called *Hero Roll* and

¹⁰⁰ *Mason v. Machine Zone, Inc.*, United States District Court, D. Maryland, October 20, 2015, 2015 WL 6335771.

¹⁰¹ *Mason v. Machine Zone, Inc.*, see fn 100 above.

¹⁰² *Mason v. Machine Zone, Inc.*, United States Court of Appeals, Fourth Circuit, No. 15-2469, March 17, 2017 (note that the appeal mainly concerns

the legal question whether the virtual currency used as stake must legally be considered a ‘loss’).

¹⁰³ *Soto v. Sky Union, LLC*, United States District Court, N.D. Illinois, Eastern Division, January 29, 2016, 2016 WL 362379.

Talent Roll. *Hero Roll* grants the player a randomly selected hero. Strong hero classes are awarded significantly less frequently than weak hero classes. *Talent Roll* grants the player randomly selected talents which increase a hero's abilities in combat. Strong talents are awarded significantly less frequently than weak talents.

Again, the plaintiffs argued that the in-game mechanisms *Hero Roll* and *Talent Roll* would constitute illegal gambling in form of a 'slot machine or device'. The awarded heroes would meet the requirement of a 'thing of value' due to the amount of money a player must expend on *Gems* to guarantee winning each type of hero. The court clearly rejected this argument:

This method of valuation is fallacious and circular. By the same logic, a game's reward would be a "thing of value" any time a player pays to play a game of chance. This would render superfluous the statutory language imposing liability only on devices that award a prize.

Similarly, in *Kater v. Churchill Downs Incorporated* (see above), the plaintiffs also argued that because heroes and talents advance gameplay, winning them in a game of chance is like being awarded a free play. While the court agreed with the plaintiffs and the presented case law¹⁰⁴ that 'a reward of extended play by a video game for winning is a "thing of value" within the meaning of the Penal Code definition' it nevertheless rejected the argument:

This [the case law] makes sense because, as those courts have explained, additional gameplay ordinarily costs additional money – if a game costs twenty-five cents to play one round, and a player wins an extra round, he has been awarded something worth twenty-five cents. But plaintiffs do not allege that high quality Heroes and Talents extend gameplay. Instead, they allege that high quality Heroes and Talents *improve* gameplay. Added enjoyment simply does not have measurable worth, and it cannot be a 'thing of value'.

Again, similar to *Kater v. Churchill Downs Incorporated* the court then concludes that 'Heroes and Talents are not exchangeable for real money or other goods, either within the game or in the real world' and '[u]ltimately, players who use their purchased gems to play Rolls are not paying for the chance to win anything of measurable value'.

(3) Possible exemption for loot boxes including purchasable in-game currency: *Kater v. Churchill Downs Incorporated*

A possible exemption might apply to loot boxes that include in-game currency which the player can also

purchase for real money and which can subsequently be used to purchase additional loot boxes (e.g. 1000 in-game gold typically costs USD 5. A loot box costs USD 1. The loot box can include 5000 Gold). In this case an argument could be that the included items can be regarded as an extension of entertainment for which the player would have otherwise had to pay and therefore constitute things of value. The same applies to loot boxes which might include additional loot boxes (e.g. one loot box can generate three new loot boxes). This legal uncertainty arises from another case: *Kater v. Churchill Downs Incorporated* which was recently reversed by the United States Court of Appeals for the Ninth Circuit.¹⁰⁵

The defendant operated the game *Big Fish Casino*, a virtual game that allows users to play a variety of electronic casino games such as roulette and blackjack and which can be downloaded free of charge. Although users can play the games for free by using only the virtual casino chips awarded to them without charge, users have the option to purchase additional chips and a wide variety of other low-cost virtual items that enhance or extend gameplay.¹⁰⁶ Users receive additional chips as a reward when they win one of *Big Fish Casino*'s games. The plaintiff claimed that *Big Fish Casino*'s virtual casino chips are prizes constituting things of value because although the chips cannot be exchanged for cash or merchandise directly, they allow users to extend gameplay.

Initially, the court of first instance – the District Court for the Western District of Washington – had dismissed the plaintiff's argument and ruled that *Big Fish Casino*'s virtual chips do not satisfy the prize element required to establish that *Big Fish Casino* constitutes gambling. The first instance court unambiguously ruled that 'Big Fish Casino is free to play and there is never a possibility of receiving real cash or merchandise, no matter how many chips a user wins'.¹⁰⁷ The first instance court held that the fact that players can use the awarded chips to continue playing the game is not of relevance as 'extended gameplay cannot result in any gain to the user, pecuniary or otherwise, aside from the amusement that accompanies continuing to play a game that is already available to play for free'.

The United States Court of Appeals for the Ninth Circuit reversed this decision and held that *Big Fish Casino* falls within Washington's definition of an illegal gambling game:

The virtual chips, as alleged in the complaint, permit a user to play the casino games inside the virtual Big Fish Casino. They

104 *Score Family Fun Ctr., Inc. v. Cty. of San Diego*, 225 Cal. App.3d 1217, 1220–21, 275 Cal. Rptr. 358, 359–60 (1990).

105 *Kater v. Churchill Downs Incorporated*, United States Court of Appeals for the Ninth Circuit, March 28, 2018, D.C. No. 2:15-cv-00612-MJP.

106 *Kater v. Churchill Downs Incorporated*, see fn 95 above.

107 *Kater v. Churchill Downs Incorporated*, see fn 95 above.

are a credit that allows a user to place another wager or re-spin a slot machine. Without virtual chips, a user is unable to play Big Fish Casino's various games. Thus, if a user runs out of virtual chips and wants to continue playing Big Fish Casino, she must buy more chips to have 'the privilege of playing the game.' Id. Likewise, if a user wins chips, the user wins the privilege of playing Big Fish Casino without charge. In sum, these virtual chips extend the privilege of playing Big Fish Casino.

The Court of Appeals applied an older case – *Bullseye Distributing LLC v. State Gambling Commission* – which the former court did not hold to be applicable:

In *Bullseye Distributing LLC v. State Gambling Commission*, the Washington Court of Appeals held that an electronic vending machine designed to emulate a video slot machine was a gambling device. ... To use the machine, players utilized play points that they obtained by purchase, by redeeming a once-a-day promotional voucher, or by winning a game on the machine. ... In reviewing an administrative law judge's decision, the court concluded that the game's play points were 'things of value' because 'they extend[ed] the privilege of playing the game without charge,' even though they 'lack[ed] pecuniary value on their own.' ... Because the play points were a 'thing of value,' the machine fell within the definition of a gambling device, and therefore was subject to Gambling Commission regulation. ... Contrary to Churchill Downs' assertion, nothing in *Bullseye* conditioned the court's determination that the play points were 'thing[s] of value' on a user's ability to redeem those points for money or merchandise. Instead, *Bullseye's* reasoning was plain – 'these points fall within the definition of "thing of value" because they extend the privilege of playing the game without charge.' ... Based on the reasoning in *Bullseye*, we conclude that Big Fish Casino's virtual chips also fall within section 9.46.0285's definition of a "thing of value."

cc. Impact of the existence of secondary markets for in-game items

One of the central questions in relation to the determination of a real world value of in-game items and their qualification as a 'prize' is the impact of secondary markets where players have the option to sell or trade their in-game items (see the UK and Sweden section).

(a) *Mason v. Machine Zone, Inc.*

At least some clarity in this regard is provided also by *Mason v. Machine Zone, Inc.* (see above). The plaintiff argued that in-game currency and in-game chips would have an actual real world value because players can sell their gaming accounts on secondary markets. The court rejected the argument by stating that selling

or trading the entire gaming account does not mean that there is a secondary market for in-game items as well.¹⁰⁸

(b) *Soto v. Sky Union, LLC*

The question was also considered in *Soto v. Sky Union, LLC* (see above) with the court deciding it in precisely the same way:

By contrast, when Castle Clash players win Heroes or Talents, they do not turn to the secondary market to sell those Heroes and Talents; indeed, plaintiffs' complaint makes clear that the game is designed to make this impossible. Instead, players sell their entire accounts, which plaintiffs contend increase in value when plaintiffs are awarded rare and powerful Heroes. The amount a player can get for selling his account to another player says little about the values of the individual items (Heroes, Talents, etc.) contained within that account.

However, in both *Mason v. Machine Zone, Inc.* and *Soto v. Sky Union, LLC* the question is left open whether the possibility to separately sell or trade in-game items on secondary markets might entail the acquisition of a real world value. In *Mason v. Machine Zone, Inc.*, the District Court also mentioned several times that the selling of the GoW account would constitute a breach of the contract with the defendant. Still the court did not make a clear statement on the implications of such a breach on the determination of a real money value in relation to in-game items which are sold on secondary markets (refer to the UK section for more details on this question).

dd. Impact of a breach of the developer's terms of service

Fortunately both aforementioned questions, that is, the relevance of the possibility to separately sell or trade in-game items on secondary markets and the implications of a breach of the game developer's terms of use, are addressed to greater extent in *Kater v. Churchill Downs Incorporated* (see above). Here, the plaintiff (additionally) argued that *Big Fish Casino's* virtual casino chips are prizes constituting things of value because, although the chips cannot be exchanged for cash or merchandise directly, they can be sold to other users for actual money on a secondary market. The plaintiff also argued that the defendant would facilitate and profit from the sale on secondary markets because the game provides an in-game exchange mechanism, which allows players to transfer in-game chips to other players and the game operator receives a fee on each of these exchanges between players.

108 *Mason v. Machine Zone, Inc.*, see fnn 90 and 92 above.

The first instance court rejected the plaintiff's argument by extensively citing the game operator's terms of use which explicitly prohibit the trading of in-game items against cash or outside the game. According to the first instance court, 'any user exchanging Big Fish Casino chips for cash on a secondary market is expressly violating the game's Terms of Use, which users are required to agree to before they can access the game'. It would 'be contrary to basic principles of law and equity' if the plaintiff would be allowed 'to sue Defendant for damages based on their own breach of contract'.

Despite the ruling of the first instance court later being reversed by the United States Court of Appeals for the Ninth Circuit (see above) this particular reasoning was expressively upheld by the Courts of Appeal:

Kater makes a second argument, which we reject. She argues that the chips are a "thing of value" because users can sell them for money on the 'black market.' However, Big Fish Casino's Terms of Use prohibit the transfer or sale of virtual chips. As a result, the sale of virtual chips for cash on a secondary market violates the Terms of Use. The virtual chips cannot constitute a 'thing of value' based on this prohibited use. See *Mason v. Mach. Zone, Inc.*, 851 F.3d 315, 320 n.3 (4th Cir. 2017).

However, while *Kater v. Churchill Downs Incorporated* provides a comprehensive and satisfying ruling on contractual violations under illegal gambling recovery laws (i.e. where the plaintiff seeks compensation of his lost money), it still does not conclusively answer the question whether in-games items actually acquire a real world value if they can be sold individually on secondary markets and, if so, what impact a violation of the game operator's terms of use would have in this regard. The ruling only dismisses – in a very convincing way – an unlawful gambling recovery claim based on 'basic principles of law and equity'. However, this does not answer the question from a pure gambling-law perspective and brings up the question of what the court would have decided if the subject matter of the case had been, as a hypothetical example, a license requirement for operating a gambling device rather than a damage claim. In this case the court could not have ruled that no license requirement applies because it would be contrary to basic principles of law and equity.

ee. Using virtual money on loot boxes does not amount to an economic injury, loss or gain

Lastly, it was uniformly decided by several courts that players who first buy non-redeemable virtual currency with real money and afterwards use the purchased

virtual currency on an in-game event of chance do not suffer an economic injury and therefore legally do not qualify as 'loser' while at the same time the operator of the in-game event of chance legally does not qualify as 'winner'. This point is mainly interesting from a US-law perspective and does not transfer as well to other jurisdictions as do the other arguments outlined above.

(a) US recovery laws for unlawful gambling, unfair competition and similar activities

Under several US state laws private-party plaintiffs can recover lost money or other property from persons who engage in unlawful gambling, unfair competition or similar activities. Leaving aside the question whether or not loot boxes legally constitute gambling (for this question see the sections above), all these laws (additionally) require some form of loss or economic injury and sometimes a 'winner' on the other side of the table. The following laws can be named as examples:

- Sec. 17203 of the California Business and Professions Code provides that any person who engages, has engaged, or proposes to engage in unfair competition (i.e. unlawful, unfair or fraudulent business acts or practice) may be enjoined in any court of competent jurisdiction. The court may make such orders or judgments [...] as may be necessary to restore to any person in interest any money or property, real or personal, which may have been acquired by means of such unfair competition. Such a claim requires that a private-party plaintiff must
 - (1) establish a loss or deprivation of money or property sufficient to qualify as injury in fact, i.e., *economic injury*, and
 - (2) show that that economic injury was the result of, i.e. caused by, the unfair business practice that is the gravamen of the claim.¹⁰⁹ This means a plaintiff who has received the benefit of his bargain has no standing under the Californian unfair competition law.
- Sec. 12-110 Maryland Code Criminal Law provides that a person who 'loses money' at a prohibited 'gaming device' may 'recover the money as if it were a common debt'.
- The Illinois Loss Recover Act, 720 ILCS 5/28-8(a) provides that any person 'who by gambling shall lose to any other person any sum of money or property worth fifty dollars or more may sue "the winner" to recover the money or property lost'.
- The Illinois Prizes and Gifts Act, 815 ILCS 525/20(a) provides that no sponsor may require a person to pay the sponsor money as a condition of awarding the person a prize, or as a condition of allowing the person to receive, use, compete for, or obtain information

¹⁰⁹ *Kwikset Corp. v. Superior Court*, 51 Cal. 4th 310, 120 Cal. Rptr.3d 741, 246 P.3d 877, 885 (2011).

about a prize. Furthermore, 815 ILCS 525/40 provides a private right of action for any consumer ‘who suffers loss by reason of any intentional violation of this act’.

- The Michigan Loss Recovery Statute, 600.2939(1) provides that ‘the person losing any money or goods’ may bring suit ‘against the person receiving the same’ if the recipient took possession of the money ‘by gaming’.
- The Washington Recovery of Money Lost at Gambling Act RCW 4.24.070 provides that ‘[a]ll persons losing money or anything of value at or on any illegal gambling games shall have a cause of action to recover from the dealer or player winning, or from the proprietor for whose benefit such game was played or dealt, or such money or things of value won, the amount of the money or the value of the thing so lost’.

(b) *Mason v. Machine Zone, Inc.*

Again *Mason v. Machine Zone, Inc.* proves very insightful in relation to the interpretation of the above mentioned requirements in terms of loot boxes and virtual currency. The plaintiff argued that her economic loss arose from the initial purchase of virtual currency which was afterwards lost on the game of chance. According to the court, however, the plaintiff ‘was not wagering with dollars; she was playing with virtual gold’. The court then took an interesting view on the legal standing of virtual currency:

Plaintiff acquired that ‘gold’ in the ‘gold store’, where she exchanged her real-world currency for a nontransferable, revocable license to use virtual currency for entertainment purposes. ... At the moment of that antecedent transaction, Plaintiff’s ‘loss’, if any, was complete: then and there she had swapped something of value (real money) for something of whimsy (pretend ‘gold’). Plaintiff could spend her ‘gold’ as she pleased within the bounds of Defendant’s ToS: she could acquire resources to ‘hasten [her] advancement in the game’ ..., or she could exchange her ‘gold’ for chips to spin the Casino wheel In this respect, while *GoW*’s Casino function aesthetically resembles classic games of chance, the underlying transaction is more akin to purchasing cinema or amusement park tickets. Consumers of such services pay for the pleasure of entertainment *per se*, not for the prospect of economic gain.

(c) *Mason v. Machine Zone, Inc. – Appeal*

The United States Court of Appeals upheld the decision of the District Court. During the appeal the plaintiff argued that she had lost money in *GoW*’s virtual casino because, after paying money to ‘spin’ the virtual wheel, she ‘won’ prizes that were worth less than the amount of money she spent to spin the wheel. She therefore claimed that she is entitled to recover the difference between the amount of money she paid to spin the virtual wheel, and the monetary value of the virtual prizes she won. The United States Court of Appeals rejected the

claim but used slightly different arguments than the District Court before it did:

However, if Mason received in the virtual casino ‘resources’ of lesser ‘value’ than virtual gold, as she claims she did, Machine Zone did not win money as a result. Nor did Machine Zone lose money if Mason ‘spun’ the virtual wheel and received any particular prize. Indeed, Machine Zone retained the money that Mason paid to obtain virtual gold regardless of the outcome of Mason’s spin of the virtual wheel. Instead of losing money in the virtual casino, Mason paid money to obtain virtual gold, which she later used to accrue virtual chips, all while playing Game of War on her mobile device. Later, when Mason participated in the virtual casino, she used only virtual chips, which are not redeemable for money. Thus, when Mason ‘spun’ the virtual wheel, there was no money at stake. Rather, as a result of that action, she only could receive either virtual gold, which she concedes does not amount to money, or she could receive other virtual resources that likewise were not money or redeemable for money. Accordingly, based on the manner in which the Game of War casino operates, Mason could not have lost or won money as a result of her participation in that virtual activity.

(d) *Phillips v. Double Down Interactive, LLC*

The matter was similarly decided in *Phillips v. Double Down Interactive, LLC*, another valuable case which concerned the social casino game *Double Down Casino*. The facts are similar: The player must buy virtual casino chips to participate in a virtual casino game. The only prizes awarded are additional virtual casino chips. The court ruled:

The statutory language ..., as well as the case law, make clear that in order for a plaintiff to recover under the Act, there must be a ‘winner’. It is against the winner that a plaintiff is entitled to recover his or her gambling losses. Under the statute a winner is ‘a person whom a player had played with and lost to’... To be a winner, a person must have ‘a direct stake in the outcome of gambling’... Here, Double Down is not a ‘winner’. Double Down never directly participated in the games ..., nor did it have a direct stake in the outcome of any games. Because Double Down keeps the money a player pays to buy additional chips no matter whether that player wins or loses in the games, that money is never put at risk. Simply put, once the chips are paid for, there is no way for Double Down to lose that money.

(e) *Conclusion*

The logic applied by the courts is convincing (provided, of course, one takes the view that in-game items do not have a real world value): Because the defendants would have kept the real money which was initially paid by the plaintiffs for virtual currency in any case, i.e. regardless of the outcome of the in-game event of chance, the defendant is legally not a ‘winner’. The plaintiff on the

other side is not a 'loser', because (i) non-redeemable virtual currency has no monetary value and (ii) the player got what he paid for when purchasing the virtual currency (entertainment). The courts' argument shows that at least under US laws it provides a significant legal advantage to design loot box mechanisms in a way that means the player must first purchase virtual currency which is then used to purchase loot boxes. In other jurisdictions this is not as relevant because similar unfair competition or unlawful gambling money recovery laws typically do not exist.

3. Poland

a. Overall risk assessment

- Standard Loot Boxes: Legal Risk: High; Enforcement Risk: Low.
- Tradeable Loot Boxes: Legal Risk: High; Enforcement Risk: Low.
- Outlook: Caution advised. The overall risk depends on the regulator continuing not to apply applicable gambling laws.

b. Executive summary

There is a high risk that the Polish gambling legislation applies even to Standard Loot Boxes. However, so far, the Polish regulator has not made any move on the video gaming industry. Due to its effective state aid scheme, Poland nowadays benefits from a strong local video gaming industry. At the moment, it seems unlikely that Poland intends to stall this engine. Still, there is no guarantee that this might not change in future, in particular if the public pressure on loot boxes remains high. Because illegal online gambling services have to be blocked by Polish telecom providers, a change of the local enforcement practice could have a devastating impact.

c. Political and regulatory environment

Due to its strong state aid program, Poland is nowadays the home country of a number of well-known video game developers. Having such a strong video gaming industry it might come as a surprise that there were no noticeable political and regulatory developments or statements during the Skin Betting Scandal or the 2017 loot box uproar. Instead, Poland had its own gambling scandal which was, however, completely unrelated to loot boxes or skin gambling and occurred in 2009.

Back then it became was revealed that the (physical) slot machine gambling lobby had inappropriate contact to several important politicians, allegedly to water down a planned tax on slot machines. Several politicians lost their office over the scandal and the legislator ultimately adopted particular strict regulations on slot machines in order to show that the industry did not have any influence on the legislative process. These strict regulations apply to loot boxes as well.

d. Legal environment

Polish gambling regulations are considered to be among the most restrictive in Europe. The applicable law is the Gambling Act of November 19, 2009. For several years, online gambling was entirely prohibited in Poland (with the exception of betting and online promotional lotteries). However, an amendment to the Polish Gambling Act was adopted in 2016 and entered into force on April 1, 2017. The amended Gambling Act now allows all types of online gambling games. Still, with the exception of online betting and online promotional lotteries the gambling sector in Poland is subject to a state monopoly. Illegal gambling offers are added to a blacklist administered by the Ministry of Finance¹¹⁰ and must be blocked by Polish telecom operators.

Due to the 2009 slot machine gambling scandal, the Polish legislator adopted particular strict regulations on slot machines. This included the introduction of a very broad definition of slot machines. According to Section 2(3) Gambling Act, slot machines are:

... games played with the use of mechanical, electromechanical or electronic devices, computers included, as well as games that reflect the rules of slot machine games held via the internet network, for cash or in-kind prizes, where the game features an element of chance.

'In-kind prizes' also constitute additional play time as well as additional free games (Section 2(4) Gambling Act). A loot box is a game which reflects the rules of a slot machine game held via the internet network. This leaves the question whether the generated in-game items are 'in-kind prizes'. The fact that even additional play time and free games are considered 'in-kind prizes' shows that not only physical or real prizes can be 'in-kind prizes' and indicates there is broad interpretation of the term. Thus, there is already a risk that loot boxes fall under the basic definition of a slot machine and consequently constitute illegal gambling under Polish gambling law.

110 Ministerstwo Finansów, 'Rejestr Domen Służących do Oferowania Gier Hazardowych Niezgodnie z Ustawą', hazard.mf.gov.pl.

However, whether loot boxes fall under the basic definition of a slot machine is not decisive anyway as Section 2(5) Gambling Act additionally provides that it also constitutes a slot machine if the game is ‘organised for commercial purposes’ and is ‘of random nature’, even ‘if there is no possibility to win any cash and/or in-kind prizes’. In other words, the price requirement – one of the fundamental conditions in almost all gambling laws – is replaced with the requirement of commercial purposes. Since there is little doubt that almost all loot box mechanisms are organised for commercial purposes there is significant risk that even Standard Loot Boxes fall under the Polish Gambling Act and therefore constitute illegal gambling. Altogether, the legal risk in terms of loot boxes must be classified as high.

4. Sweden

a. Overall risk assessment

- Standard loot boxes: Legal Risk: Very low; Enforcement Risk: Very low.
- Tradeable loot boxes: Legal Risk: Medium; Enforcement Risk: Low – Medium.
- Outlook: Caution advised due to an ambiguous statement of the regulator making the situation difficult to predict.

b. Executive summary

Based on a statement issued by the Swedish gambling authority, there is a risk that Tradable Loot Boxes constitute gambling under Swedish gambling law. Nevertheless the Swedish regulator has not made a move on any local video game company so far. Thus the enforcement risk seems to be rather low. However, this might change in case the public pressure increases again. The Swedish gambling law applies only to companies located in Sweden. Still, companies who work together with Swedish game developers should also look into this requirement.

c. Political and regulatory environment

Sweden has one of strongest video gaming industries with several Swedish gaming companies belonging to the most well-known video game developers.

aa. Statement by the Swedish Gambling Authority on loot boxes

During the 2017 loot box uproar, the Swedish gambling authority (*Lotteriinspektionen*) issued a statement on its opinion about loot boxes which provides valuable insight on the legal environment but is also – like the two papers released by the UK Gambling Commission (see the UK section above) – somewhat vague. This statement will be discussed in detail in the legal environment section.

bb. Interview by the Swedish Minister of Civil Affairs and ‘Investigation’ on loot boxes

On February 7, 2018, the Swedish Minister of Civil Affairs, *Ardalan Shekarabi*, gave an interview¹¹¹ explaining that the Swedish government is working to ‘regain control of the gaming market as soon as possible and ensure that Swedish consumer protection rules apply to all actors involved in gaming’. The new gambling legislation is supposed to enter into force in January 2019. *Shekarabi* was also asked about loot boxes and responded: ‘I am ready to ask our authorities to take a closer look at the phenomenon of loot boxes in the next step and see if there is a need to change legislation in order to strengthen consumer protection’. In response to the question whether loot boxes could be classified as a lottery already in 2019, *Shekarabi* responded: ‘I do not want to exclude it. I would like to start by asking our authorities and experts to look at this. Obviously, there are many people stuck in a game abuse and also end up in this kind of gambling and lose money on it’. Despite these rather vague and non-committal statements, the interview was widely picked up by the global mass media reporting that Sweden is now investigating loot boxes and is considering classify them as gambling.¹¹²

Following the *Shekarabi* interview, *Per Strömbäck*, spokesman of the Swedish games industry saw gave a statement seeking to clarify that the current legislation review is not about loot boxes but has been brought about by the advent of online casinos and overseas gambling which has interfered with the state’s monopoly on lotteries.¹¹³ In reference to *Shekarabi*’s comment, *Strömbäck* said: ‘I think that’s a very defensive answer from a policy maker, it’s very non-committal and I think it’s a stretch’. *Strömbäck* additionally clarified that loot boxes would only be affected by the review in case the government would change the definition of lotteries.

111 Ardalan Shekarabi, ‘Ardalan Shekarabi: Lootlådor kan klassas som lotteri redan 2019’, *sverigesradio.se*, February 7, 2018 (Swedish language).

112 For instance: Andy Chalk, ‘Sweden could classify loot boxes as gambling by early 2019’, *pcgamer.com*, February 7, 2018; Tatiana Morris, ‘Swedish

authority pushing to classify loot boxes as gambling in 2019’, *gamezone.com*, February 7, 2018.

113 Per Strömbäck, interviewed by Haydn Taylor, ‘Update: Swedish gambling legislation review unlikely to impact loot boxes’, *gamesindustry.biz*, February 8, 2018.

d. Legal environment

Applicable law is the Swedish Lotteries Act (as amended).¹¹⁴ Sec. 3 defines lotteries as ‘an activity where one or more participants may, with or without a stake, obtain prizes of a higher value than that which each and every one of the other participants may obtain’. Thus, once again the decisive factor is whether loot boxes grant prizes of value. The Swedish Lotteries Act does not provide a definition or further explanations on the requirement of ‘prize’ with the exemption that prizes shall also refer to the continuation of the game (Sec. 3 Lotteries Act). The latter implies a rather extensive understanding of the term ‘prize’, however. A license is required to provide lotteries in Sweden (Section 9 Lotteries Act).

aa. Statement of the Swedish gambling authority on loot boxes

Like in several other jurisdictions, the Swedish gambling authority issued a statement on its opinion about loot boxes in the wake of the 2017 loot box uproar.¹¹⁵ The statement reads similarly to the key points set out in the papers released by the UK Gambling Commission and likewise it remains vague in terms of the central question of when exactly in-game items attain a real world value.

According to the Swedish gambling authority, the definition of a prize is met in case it is considered as money or money’s worth. This requires that the prize has a certain economic value in the real world. Gambling therefore requires that whoever ‘participates in a computer game in an event determined by chance must win something that, outside of the computer game’s virtual environment, can be bought and sold for money or money’s worth’. Following this abstract explanation, there seems to be a real risk that all loot box mechanisms which allow the trading of the generated items (within or outside the game) constitute gambling, as every in-game item could always be bought and sold on secondary markets such as eBay to be afterwards exchanged within the game (please refer to IV.1.d.bb.(1)(b) and (2). of the UK Section for more details in this regard).

However, the Swedish gambling authority concludes its statement with an example which is much more restrictive compared to the aforementioned abstract explanation:

Eva has a user account on the gaming game platform Gaming. Through the Gaming platform, she can play different computer games. The Gaming platform also includes the

possibility of exchanging real money into gaming coins that you can be used to purchase virtual items with different values in a computer game. In one of these computer games, Eva participates in an arrangement that is determined by chance, whereby she wins a virtual object. The virtual item she sells to another user on the Gaming platform in exchange for gaming coins. Gaming coins are then exchanged to real money by the Gaming platform by transferring the amount to her bank account.

According to the Swedish gambling authority the provided example constitutes gambling and requires a license. The example is much more restrictive than the aforementioned abstract explanation which only referred to winning ‘something that, outside of the computer game’s virtual environment, can be bought and sold for money or money’s worth’. In fact, the last sentence of the example almost completely takes out the practical relevance of it, as there is currently no video gaming company or platform which offers loot boxes and exchanges virtual currency (or in-game items) back to real money. There are, however, countless companies which allow the in-game trading of loot-box-generated-items which means that these items can also be ‘sold for money or money’s worth’ on secondary markets. There are also several companies whose in-game economy is (illegally) used/interfaced/exploited by third-party providers to enable outside game trading or betting with in-game items. It remains unclear whether the initial abstract statement or the more restrictive example sets the bar for these practices under Swedish gambling law. This uncertainty gives rise to some legal risk.

bb. Applicability only if the lottery is organized in Sweden

An important difference in comparison to many other Jurisdictions is that the Swedish Lotteries Act only applies if the lottery is organized in Sweden. This means the main business of the company which organizes the lottery must be conducted in Sweden. For this question it is of particular interest where the organization and management of the business takes place. However, with several internationally operating game developers headquartered in Sweden, this requirement is met in many cases. International video game companies not located in Sweden should also look into this requirement if they work together with Swedish video gaming companies (e.g. by having them develop games).

114 https://www.lotteriinspektionen.se/globalassets/dokument/engelsk/lotteries-act-1994-1000justerad_2017.pdf.

115 LotteriInspektionen, ‘Lotteriliknande moment i dataspel?’, lotteriinspektionen.se, November 21, 2017 (Swedish).

5. Canada

a. Overall risk assessment

- Standard Loot Boxes: Legal Risk: Very low; Enforcement Risk: Very low.
- Tradeable Loot Boxes: Legal Risk: Medium; Enforcement Risk: Low.
- Outlook: Stable.

b. Executive summary

The Canadian legal situation is similar to many Jurisdictions. There is a medium risk that the Canadian test for gambling is satisfied at least by Tradable Loot Boxes with the prize requirement being the one which is discussed the most. However, the enforcement risk is low and not even the 2016 Skin Betting Scandal and 2017 loot box uproar caused noteworthy reactions by politicians and regulators.

c. Political and regulatory environment

Other than the developments in relation to the ESRB (please refer to the US section under IV.2.c.aa in this regard) there have been no recent political and regulatory developments in Canada in relation to loot boxes. The general enforcement risk in terms of loot boxes must be considered as low. The Canadian online gambling laws are deemed to have failed¹¹⁶ and led to a huge unregulated grey market and a regulatory scheme which seems to have surrendered in light of countless illegal offers. In fact, there have only been two prosecutions ever in Canada in relation to internet gambling and both involved servers located in Canada. One was in 2001, the other in 2007.¹¹⁷ Nevertheless, the enforcement risk might increase in case loot boxes remain at the centre of the public attention. At the moment, however, nothing points in this direction.

d. Legal environment

Gambling is mainly regulated by criminal law in Canada and is generally considered an illegal activity. Because the legislative power to pass criminal laws lies with the Canadian Parliament, gambling law is essentially subject to federal law. Nevertheless, by means of Sec. 207 (1) Criminal Code the ability to conduct and manage games of chance lawfully is delegated to the provinces.

One of the most practically relevant provisions for the regulation of gambling in Canada is Sec. 206 Criminal

Code. Like in many jurisdictions, the (key) requirements of Sec. 206 Criminal Code can be reduced to (i) a game of chance, (ii) a payment by the player and (iii) a prize that needs to be awarded. If these three requirements are met, the mechanism in question will typically constitute some form of illegal gambling.

aa. Game of chance

Most provisions of Section 206 Criminal Code require a game of chance. When considered separately, there is no doubt that loot box mechanisms are based on chance and therefore satisfy the game of chance requirement under Canadian gambling laws. Even if not considered separately but instead as part of an overall skill-based video game (please refer to the US section under IV.2.d.aa in this regard), the chance requirement can be met: Section 206(1)(f) Criminal Code applies not only to games of chance but also to games of mixed skill and chance. The latter requirement differentiates Canadian gambling law from the gambling laws of many other jurisdictions as it does not necessarily require that the game in question is predominantly a game of chance. According to Canadian case law, any element of chance is already sufficient to constitute a game of mixed chance and skill.¹¹⁸ In fact, to constitute a pure game of skill, all elements of chance would need to be eliminated.¹¹⁹ Section 206(1)(e) Criminal Code even goes a step beyond this by omitting any reference to a game of chance at all. However, in terms of the latter the prize requirement (money or valuable security) is most likely not met in relation to loot boxes.

bb. Payment

Most provisions set out in Section 206 Criminal Code require the payment of either 'money', 'a sum of money' or another 'valuable consideration'. Where loot boxes are directly bought with real money, the payment requirement will typically be satisfied. However, many loot box mechanisms require that the player first buys virtual currency with real money and subsequently uses such currency to buy loot boxes. Nevertheless, legal experts argue that either the initial purchase price for the game or the price for additional in-game items (e.g. in case of 'freemium' games) is likely to be sufficient to qualify as a 'sum of money'¹²⁰ or that virtual currency generally does not prevent the Canadian test for

116 Sandra Rubin, 'Gaming the System', *Lexpert Magazine*, May 2016, p. 44; Peter Czegledy, 'Social Network Gaming – A Canadian Perspective', *Canadian Gaming Lawyer Magazine*, June 2013, pp. 4, 5 ('ill-equipped').

117 Sandra Rubin, see fn 116 above, p. 46.

118 *R. v. Ross* (1968), 70 D.L.R. (2d) 606 (S.C.C.) at 617.

119 *R. v. Gardiner* (1971), 2 C.C.C. (2d) 463 (Alta. C.A.).

120 Peter Czegledy, see fn 116 above, pp. 4, 5; Michael D. Lipton and Jack Tadman, 'One Cup of Coffee - Gambling, Social Games and Virtual Currency in Canadian Law', *Casino Lawyer*, Fall 2012, pp. 24, 26 et seq.

gambling to be satisfied.¹²¹ Even if that is not the case, virtual currency might at least be seen as a 'valuable consideration' within the meaning of Section 206(1)(f) Criminal Code. Consequently, there is also risk that the payment requirement is fulfilled under Canadian gambling law.

cc. Prize

As in many jurisdictions, the key question under Canadian gambling law is whether loot boxes satisfy the requirement of awarding a 'prize'. The prevailing view with respect to (social) gaming which involves games of chance or games of mixed chance and skill is that as long as the prizes to be obtained are virtual, players are not able to win money or money's worth.¹²² However, the central question, whether in-game items which can be traded within the game and therefore also on secondary markets such as eBay obtain a real world value and thus constitute 'money's worth', is not solved under Canadian law either. The question is currently being debated amongst legal experts who point out that the interaction between virtual currency and social gaming has blurred the lines between gaming and gambling.¹²³ Based on the assumption that the value of a good refers to the worth of that item as determined by the market, virtual currency can obtain real cash value¹²⁴ and consequently social gaming which involves a game of chance and uses virtual currency as consideration and as a prize can satisfy the Canadian test for gambling.¹²⁵ Thus, where secondary markets exist and virtual items become subject to real world commerce, there is also an increased risk that virtual items may more readily be found to constitute money or 'money's worth' for purposes of the prize element of Section 206 Criminal Code.¹²⁶ This uncertainty under Canadian gambling laws, in particular with regard to the requirement of 'prize', gives rise to some legal risks.

V. Other related areas of law

Gambling laws are not the only area of law relevant for loot box mechanisms. Game operators should also keep an eye on youth protection laws, financial license requirements and money laundering laws as well as ecommerce and contract laws.

1. Youth protection laws

During the 2017 loot box uproar, it was intensively discussed whether games which incorporate loot boxes also need to be reconsidered under applicable youth protection laws, in order to allow or force, for instance, higher age-ratings. The argument is that loot box mechanisms might lead to a habituation effect and contribute to the normalization of gambling behaviour in children, increasing the prevalence of problem gambling behaviour in later life. In the most jurisdictions, loot box mechanisms currently do not fall under applicable youth protection and age-rating laws. For this reason some officials have suggested changing the relevant laws to better address the matter or to cooperate with the competent youth protection regulator.¹²⁷ In Germany, the Commission for the Protection of Minors in the Media ('KJM') is currently evaluating whether loot boxes in games which particularly appeal to children fall under the prohibition of advertising containing direct appeals to buy or rent goods or services directed at children or adolescents exploiting their inexperience and credulity. Youth protection laws should therefore remain on the radar of game operators which currently make use of loot box mechanisms.

2. Financial license requirements and money laundering laws

Potential license requirements under local finance and banking laws are another important regulatory area game developers should be aware of. In some jurisdictions the issuing of (fantasy) virtual currency might trigger license requirements which typically apply only to payment service providers (one example would be Japan). Closely connected to this subject are potential money laundering regulations which often apply in relation to the issuing of (virtual) currencies and/or gambling-like activities. Game operators should ensure that none of these typically strictly regulated areas apply to the intended game service.

3. E-commerce and contract laws

Game operators should also look into local e-commerce and contract laws. In several jurisdictions, the purchasing of virtual goods (including virtual currency, items and loot boxes) is often subject to online consumer

121 Michael D. Lipton and Jack Tadman, see fn 120 above.

122 Michael D. Lipton and Jack Tadman, see fn 120 above, p. 24.

123 Michael D. Lipton and Jack Tadman, see fn 120 above, p. 25 et seq., Peter Czegledy, see fn 116 above, p. 7.

124 Michael D. Lipton and Jack Tadman, see fn 120 above, p. 24.

125 Michael D. Lipton and Jack Tadman, see fn 120 above, p. 26.

126 Peter Czegledy, see fn 116 above, p. 7.

127 Australia, for instance, see: Alex Walker, 'Victoria's Gambling Regulator: Loot Boxes "Constitute Gambling"', *kotaku.com.au*, November 22, 2017; also see the UK Section under IV.1.c.cc.

laws such as withdrawal rights. These rights cause uncertainty on the part of the game operator but can often be excluded, provided the correct language is used and accurately displayed when the item is purchased. Furthermore, where minors buy virtual items, local contract laws might render the underlying purchase contract invalid. Thus, game operators should also look into ways to mitigate this risk.

VI. Summary

The article shows that loot boxes are subject to scrutiny in several jurisdictions. While the legal risk in some jurisdictions is clearly lower (USA), applicable gambling

laws in other jurisdictions most likely already cover loot boxes (e.g. Poland). These jurisdictions currently benefit from a low enforcement risk, which is, however, dependent on the regulator and might change in case the public pressure remains high. Several other jurisdictions have initiated investigations and legislative initiatives in relation to loot boxes in the past and should therefore be carefully assessed from a local law perspective by any game developer targeting these jurisdictions. As an example Japan, China, Singapore, Belgium, the Netherlands, Germany, South Korea, and Australia can be named. In some of these jurisdictions, loot boxes are not only subject to an increased legal risk but also to a significant enforcement risk.