



Bitcoin

Is Virtual Currency Real?

By Barth F. Aaron

Created in 2008², Bitcoin is the first or at least the most notable form of virtual currency. Conceptually, Bitcoin is a free market item of value, not regulated or controlled by any established regulatory body. It was intended to bypass the constraints of governmental regulation and inherent fluctuations in values caused by politics. Mechanically, Bitcoin is a sequence of software code with its foundation string and references to each transaction of the Bitcoin, as a security device allowing all with access to determine its history and validity. Access is through a public key and a private key, supposing only authorized access and control over the code. Bitcoin is given value by the market in which it is used. It is created by being “mined” or using algorithms to discern a proper foundation string of code. The “miner” is paid for his, her or their efforts, thus creating a form of value.³ As Bitcoin is not backed or regulated by any government, there is no established value. Rather the value of each Bitcoin is established by the market. The result is that Bitcoin value has been highly volatile rising and falling by hundreds of dollars in a day at times.⁴ The intent of Bitcoin is to be a mode of trade, with each vendor and customer trading Bitcoin value for some good or service and then using the traded Bitcoin for the next transaction. However, there are exchanges where Bitcoins can be exchanged for a government-supported currency, such as US dollars or Euros.⁵

In October 2008, Satoshi Nakamoto issued a paper titled “Bitcoin: A Peer-to-Peer Electronic Cash System”, describing Bitcoin as allowing payment transactions to go from one person to another without the intervention of a financial institution.⁶ A described benefit of using Bitcoin is the lack of a fee, as imposed by banks and processors for the use of credit or debit cards or other cash alternatives. However, there is a fee imposed by the exchanges, which is smaller than those of financial institutions, still allowing a financial benefit from the use of Bitcoin.

Bitcoin is a shared public ledger of software code, comprising a block chain consisting of the entire history of Bitcoin and each of its transactions. The code is “mined” by powerful computers computing an algorithm to establish a valid sequence. The entire block chain must be correct to add to it, thus ensuring validity to the code sequence. The longer the block chain, the more robust the computing power that is needed to compute the current algorithm and create new Bitcoin. This is an additional security feature to ensure validity. There is a limit to the amount of Bitcoin that can be created, established at 21 million Bitcoin (BTC). It is anticipated that the last block in the chain will be computed in 2140, so the amount of useable Bitcoin will increase but be limited.⁷

Users of Bitcoin can acquire BTCs by mining Bitcoin themselves, which takes considerable computing power and currently is attempted only by links of robust scientific computer systems, by buying them from exchanges, which operate similarly to financial institutions in being outlets for trading Bitcoins or by accepting BTCs in exchange for the sale of goods or services.

In practice, one needs a Bitcoin wallet as an application on a computer, to store and validate the person’s supply of Bitcoin. Like any wallet, it should be secured, which is done by having a private key, or encryption code, known only to the owner. When one trades or uses Bitcoin, the transfer is made by sending an amount of BTC to the receiver’s wallet and providing a secure code to access the bitcoin by the receiver. Once transmitted, the transaction is complete and irreversible. The history of the transaction is added to the block of code, adding a level of security to code.⁸

With the currency crisis that has taken place especially in some European countries in the past several years, Bitcoin has been more positively received and is beginning to attain some recognized status as a viable currency. Numerous online enterprises have accepted Bitcoin as payment and more and more “bricks and mortar” locations are amenable to Bitcoin technology.⁹ Unfortunately, the uncovering of Silk Road as an online criminal enterprise caused a major setback in the acceptance of Bitcoin. Silk Road accepted only Bitcoin as a means of payment, but was shut down by the FBI on October 2, 2013, when the person identified as its principal was arrested on charges of drug trafficking, soliciting murder and money laundering. The original Silk Road website was considered the “Amazon.com of the drug world” where people could buy and sell illicit drugs anonymously as well as transact other criminal business seemingly without detection. Subsequently, what has been denominated “Silk Road 2.0” has been established and was operating until December 2013, when others affiliated with the site were arrested.¹⁰

In addition to the taint of criminality associated with Bitcoin by it being the sole currency accepted by the Silk Road web site, other events have made for unusual volatility in the value of Bitcoin. For example, there have been several incidents involving Mt. Gox, a Bitcoin exchange. On June 19, 2011, the website was hacked causing the value of a bitcoin to temporarily drop to one cent. Then on April 11, 2013, Mt. Gox suspended trading in Bitcoin and the value dropped to \$55.59 before stabilizing at around \$100.¹¹ In mid-December 2013, the value of a

bitcoin fell from over \$1,000 to \$530 in one day, causing BTC China, the largest Bitcoin exchange to cease accepting conversions in renminbi, a Chinese currency.¹² There have been other similar huge fluctuations in value from over \$1,000 to fewer than one hundred dollars and back. On January 20, 2014, it was announced that Finland deemed Bitcoin to be a commodity and not a form of currency.¹³ Then, on February 6, 2014, the Russian Prosecutor General's Office banned the use of Bitcoin in that country.¹⁴

Another blow to the effectiveness of Bitcoin was the March 18, 2013, interpretive memorandum from FinCEN identifying Bitcoin exchanges and administrators, as defined in the memorandum, as a money service business, requiring registration with the Department of Treasury and subject to certain recordkeeping and reporting obligations. While FinCEN exempted users of Bitcoin, those in the business of creating and exchanging bitcoins for recognized currency were made subject to these regulations.¹⁵

The result of the extreme volatility in Bitcoin value and the imposition of some government regulation on the Bitcoin system strikes at the core premise of Bitcoin, that it is free of government intrusion and is a peer to peer system.

What is the future of Bitcoin in the gaming industry? While the December 2011 DoJ opinion limiting the application of the Wire Act¹⁶ was seen as a boon to Internet and other interstate gaming, the reality may be quite different. UIGEA¹⁷ is still on the books and being enforced. More directly, however, are the announcements by several major banks that they are refusing to accept credit card transactions for Internet gambling transactions from licensed operators in Nevada, New Jersey and Delaware even though MasterCard and Visa have authorized the transactions and the transactions are fully authorized under state law. Thus, business interests have placed an impediment to funding legal Internet transactions even though they are quite legal. The alternative is that players must fund their accounts through other means, usually by wire transfer, in person at the sponsoring bricks and mortar casino, by check or other means. One such other means could very well be by using Bitcoin. Of course, one must agree to accept a currency as payment. Just because the customer wants to pay in gold bullion or ancient Roman coins does not mean the vendor must accept such types of payment. Since Bitcoin, by definition, is not supported by any government, there is no requirement that a casino, physical or online, must accept it as a form of payment.

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There may also be regulatory concerns. For example, gaming regulations require all casinos to maintain sufficient cash or cash equivalents to meet the expected jackpot payouts and operating requirement, known as the casino's bankroll. Cash equivalent is not defined, but there is a standard definition from accounting regulation.

Cash equivalents are short-term, highly liquid investments

that are both:

- a. Readily convertible to known amounts of cash
- b. So near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

Generally, only investments with original maturities of three months or less qualify under that definition.

Examples of items commonly considered to be cash equivalents are Treasury bills, commercial paper, money market funds, and federal funds sold (for an enterprise with banking operations). Cash purchases and sales of those investments generally are part of the enterprise's cash management activities rather than part of its operating, investing, and financing activities, and details of those transactions need not be reported in a statement of cash flows.¹⁸

It appears that Bitcoin, being secure, with irreversible transfer, which can be converted to a government-backed security within hours, should meet the definition of a cash equivalent.

The next question is the value volatility of Bitcoin. Is the gaming operator required to maintain the deposit of Bitcoin in a player's account in that form? For example, gaming regulation requires so-called front money deposits to be held and secured in the form of the deposit. The casino operator must return any unused deposit to the player in the same form (currency and denomination) in which the deposit was made. That is not a requirement of interactive gaming operations, but they are all account wagering systems, where the player must open and fund an account, playing only from funds on deposit in that account. What if the value of the bitcoins on deposit fluctuates? Who bears the loss?

Is Bitcoin subject to Bank Secrecy Act record-keeping and reporting? Casinos are deemed financial institutions for purposes of the BSA and must comply with the Cash Transaction and Suspicious Activities Reporting obligations of the Anti-Money Laundering Treasury regulations. Is Bitcoin cash or a currency which must be reported?

These are only a few of the legal and regulatory issues surrounding the use of Bitcoin in the

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A TIE THAT BINDS

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resubmit for approval all the technical information specified in Regulation 14.030. Additionally, treating each multi-jurisdictional progressive prize system as a new inter-casino linked system triggers several other procedural steps that the Nevada Board considers important. These steps include the applicability of minimum system standards in Regulation 14.045, the field trial requirements of Regulation 14.080, and compliance certification mandates of Regulation 14.090.

This approach by the regulatory agency means that each system will be fully vetted in public hearings before the Nevada Board and Nevada Commission. Following these procedures also will mean operators face an application approval process that will take at least four to six months based on typical processing history.

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highly regulated gaming industry. As attractive as virtual currency may be in avoiding the pitfalls inherent in monetary transfers to fund or withdraw from gaming players' accounts, there are substantial compliance issues, which only time will resolve.

As with most modern technology, events are moving faster than the reporting. On January 28, 2014, it was reported that two Las Vegas hotels, the D Las Vegas Casino Hotel and the Golden Gate Hotel & Casino would begin accepting Bitcoin at the hotel registration desk, the D's Gift Shop and two food and beverage outlets. The announcement specifically advised that virtual currency would not be accepted for gaming purposes.¹⁹ On February 7, 2014, a major Bitcoin Exchange, Mt. Gox, announced that it had suspended acting on withdrawal requests.²⁰ The effect was that Bitcoin owners could not exchange their holdings for government-backed currencies. According to Reuters, the impact was that the price of Bitcoin fell 27%. In a follow-up announcement, Mt. Gox revealed that it had found technology issues with the Bitcoin code that could allow Bitcoin transactions to be falsified where the records would reflect no transaction when one had actually occurred.²¹ Needless to say, this finding strikes at the very foundation of Bitcoin as a secure, verifiable source of payment.

Impact on the industry and gaming public

Authorizing these systems was viewed by Nevada's regulators as important to maintaining global leadership in gaming entertainment technology development and deployment. This step also is consistent with Nevada's support of multi-jurisdictional interactive gaming like poker, where state collaboration in forming liquidity through common wagering pools mutually benefits the participating jurisdictions.

Practically, the systems are a technology product facilitating increased play of wide area progressive slot machines. That play, in turn, drives taxable gross gaming revenue, machine unit production and patron traffic at casinos.

These marketplace attributes are important in each of the jurisdictions. The systems will become yet another tie that binds the private and public participants in the evolution of global gaming competition. ♣

Bitcoin may be the currency of the future for the techno-savvy. Only time will tell if Bitcoin is the currency of the future for gaming. ♣

² See "An Abridged History of Bitcoin", New York Times, November 19, 2013

³ For the details of what Bitcoin is, how it is created, traded and used, go to the website, <https://bitcoin.org/en/faq#general>, and see <http://www.wired.com/wiredenterprise/2013/11/bitcoin-survival-guide/all/>. For an excellent review of how Bitcoins are "mined", see "Into the Bitcoin Mines", New York Times, December 21, 2013.

⁴ "Cash 2.0: Bitcoin and Regulating Digital Currency", Corporate Counsel, October 24, 2013.

⁵ <https://bitcoin.org>, *supra*

⁶ <http://bitcoin.org/bitcoin.pdf>

⁷ Note 5, *supra*

⁸ "The Past and Future of Bitcoins in Worldwide Commerce", Business Law Today, November 2013

⁹ *Id.*, "Bitcoin Pursues the Mainstream", New York Times, October 30, 2013;

¹⁰ "Arrest in U.S. Shuts Down a Black Market for Narcotics", New York Times, October 2, 2012; "An Abridged History of Bitcoin", *supra*;

¹¹ Note 8, *supra*.

¹² "Setback in China", New York Times, December 6, 2013; "Bitcoin, Nationless Currency, Still Feels Governments' Pinch", New York Times, December 18, 2013.

¹³ "Bitcoin Judged Commodity in Finland After Failing Money Test", Bloomberg, January 20, 2014

¹⁴ "Russian authorities say Bitcoin illegal", Reuters, February 9, 2014.

¹⁵ Department of the Treasury, Financial Crimes Enforcement Network, Guidance #FIN-2013-G001, March 18, 2013

¹⁶ Memorandum Opinion For the Assistant Attorney General, Criminal Division, September 20, 2011

¹⁷ 31 U.S.C. §§ 5361-5367

¹⁸ Statement of Financial Accounting Standards 95, issued by the Financial Accounting Standards Board.

¹⁹ "Las Vegas casinos adopt new form of currency: Bitcoins", USA Today, January 28, 2014.

²⁰ https://www.mtgox.com/press_release_20140207.html

²¹ https://www.mtgox.com/press_release_20140210.html



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The views expressed in this article are those of Mr. Reaser and Ms. Hoffman, and should not be attributed to any client of Lionel Sawyer & Collins.

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opens the door for intrastate Internet gaming, also has potential opportunities for land-based gaming. A new development in Nevada is featured in an article which discusses the use of multi-jurisdictional progressive prize systems, an expansion linking slot machines among casinos beyond the Nevada state lines.

Another new development in Internet gaming in the United States focuses on interactive and interstate gaming. An article discusses another area where the 2011 Wire Act memorandum creates a potential minefield of legal issues. The article analyzes the conflicts found when client-server based gaming crosses jurisdictions with different laws and varied interpretations of the laws.

This issue also contains an excellent article on conflicts of law in transnational contracts with a recommendation of how gaming attorneys can avoid potential problems with conflicting laws in diverse jurisdictions.

Next, a discussion of ethics in the gaming industry emphasizes four industry segments that face various ethical issues: manufacturers, promoters, compliance committee members and regulators.

Finally, the spring issue of *Casino Lawyer* includes a thorough explanation of Bitcoin with a discussion of legal and regulatory issues related to this "most notable form of virtual currency."

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