



# VIRTUAL CURRENCIES

## Blockchain and Bitcoin - Impact on iGaming Enforcement

By Mark Balestra

**E**leven years have passed since President Bush signed into law the Unlawful Internet Gambling Enforcement Act (UIGEA), and for the most part it has been an effective policy. The so-called Blockchain gambling phenomenon, however, could threaten the status quo.

For years one of the most cumbersome hurdles for passing a ban in Congress was convincing potential supporters that prohibition was enforceable. Dating back to the mid nineties both chambers repeatedly rejected precursory legislative proposals that sought to penalize Internet Service Providers (ISP) as well as versions that would have imposed criminal liability on the casual bettor. But in 2002, US Representatives. James Leach and John LaFalce introduced a game-changer with a ban to be enforced through regulations imposed on those entities that facilitate the transfer of funds between online gambling sites and their customers. From that point on, proposals to prohibit online gambling consistently focused on funding mechanisms, and the

breakthrough came in 2006 when Representative Bill Frist piggybacked UIGEA onto an anti-terrorism bill that was jammed through Congress in the dead of night.

UIGEA's enforcement mechanisms were relatively palatable solutions because banking institutions were already accustomed to stringent regulation. For an industry reliant on its ability to monitor the movement of funds and identify the parties to transactions, cutting off the flow of money to and from online gambling sites wasn't too much to ask. In fact, credit card issuers and merchants—repulsed by iGaming's extraordinarily high charge-back rates and under the threat of legal action by the Department of Justice—were already voluntarily flagging and blocking iGaming transactions by the time UIGEA finally passed.

Financial institutions can block funding for iGaming in large part because the transactions are funneled through necessary third parties and are consequently traceable. But what if you were to decentralize the flow of money in the iGaming space? What if you decentralized the movement of data in general?

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Enter the Blockchain. The concept can be as complicated or as simple as you want to make it, but essentially a Blockchain is a distributed database that functions as a continuously growing set of records (aka “blocks”). The technology enables the secure transfer of data throughout peer-to-peer networks with verification executed through smart contracts.

With Blockchain-based virtual currency (“cryptocurrency”), both parties to a financial transaction can verify it without needing a trusted authority or central server. Instead of all funds being funneled through third parties that enable financial transactions, money flows directly from the payor to the recipient, who has immediate access to the funds. This presents a major problem for UIGEA enforcement because the regulations apply primarily to the third-party facilitators that no longer exist.

Blockchain technology materialized in 2009 with the arrival of Bitcoin, which remains a standard among cryptocurrencies. But even though Bitcoin is now accepted worldwide by businesses of all types and sizes (including brick-and-mortar merchants), its adoption in the tightly regulated gambling space has been tentative because of the anonymous nature of the transactions. While its convenience, security and cost effectiveness show promise, its use presents challenges for controlling money laundering and underage gambling.

Bitcoin-based gambling websites licensed in offshore jurisdictions—or not regulated at all—have nevertheless entered the market and are growing increasingly popular. As was the case with online gambling in general, the highly regulated industry must beat them or join them. And for the reasons stated above, beating them (i.e. blocking access to Bitcoin gambling sites) seems like an unattainable end.

The United Kingdom Gambling Commission (UKGC) saw the writing on the wall and adapted its rules accordingly. On October 31, 2016, the UKGC implemented updates to Section 5.1.1 of its license conditions to add “digital curren-



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cies” to its list of allowable cash equivalents. Now, customers of William Hill, Paddy Power, Bet365 and other UK-licensed sports books can fund their accounts – and receive payouts – using Bitcoin. Meanwhile, sites that are not licensed by the UKGC are not authorized to provide Bitcoin-gambling to UK customers.

The United Kingdom is not the only European jurisdiction to allow the use of cryptocurrencies in the online gambling space. The Isle of Man’s Gambling Supervision Commission approved cryptocurrency earlier in 2016. And as part of a national strategy currently under development, the Malta Gaming Authority has commissioned a study that will propose a legal and regulatory framework for allowing its online gambling licensees to deal in virtual currencies.

Conversely, Turkey has banned cryptocurrency gambling altogether through a law that expressly prohibits operating the sites as well as gambling on them. And in most prohibitive jurisdictions, existing laws banning Internet gambling can be interpreted to extend to sites dealing with cryptocurrency.

In the United States, the language of 31 U.S.C. § 5363 (the section of UIGEA that prohibits “acceptance of any financial instrument for unlawful Internet gambling”) is probably broad enough to apply to cryptocurrencies.

Despite the utility of existing online gambling laws drafted in anticipation of unforeseen innovations, however, the enforcement issue looms large. Perhaps a glimmer of hope for law enforcement lies in targeting inchoate offenses on the basis that it takes human action to bring the technology to market as well as to steer users toward it. It is conceivable that one who facilitates technology designed to enable cryptocurrency transactions for gambling can be charged with conspiring to establish an unlawful enterprise (akin to going after the supplier rather than the operator). But, could prosecutors overcome the burden of proving that such versatile technology was indeed intended for gambling purposes?

Another means of enforcement could be prosecuting the human reporter who verifies the transactions on an aiding and abetting theory, but what if this person is outside the United States? Unlike conventional online transaction processing, which at some point requires a financial facility to deliver the funds to the gambler, cryptocurrency can be injected into the market from anywhere and is accessible to anyone with an Internet connection.

Most striking is that nailing the person who poisoned the stream doesn’t eliminate the poison. Once open-source software enters the market, it is virtually there to stay, and the so-called bad actor becomes inconsequential.

Further, as to be expected, enforcement won’t get any easier with the advancement of Blockchain technology. The use of Bitcoin and similar cryptocurrencies for gambling is at least confined to non-house-booked games, but the next generation of cryptocurrency accommodates house-booked games without needing a centrally located operator. Whereas Bitcoin gambling sites enable gambling on events with outcomes determined externally – namely sports – Ethereum enables

the use of pseudorandom number generator-based gambling software that exists entirely on Blockchains.

Decentralized gambling platforms like this could dramatically change the online gambling industry. The DAO.casino protocol, for example, seeks to replace “traditional” centralized online casinos with gambling systems based on collaborative participation of multiple parties. The participants would be compensated in DAO.casino’s native Ethereum-based cryptocurrency, which floated on June 29, 2017. Independent developers would provide the games as well as the smart contracts that facilitate the transactions, while platform operators would provide the front ends through which players would access the games. The system also relies on individual participants to bankroll the games. Each participant would receive a predetermined cut of the tokens accumulated by game contracts immediately upon completion of each game. Additionally, if applicable, a referrer (i.e. affiliate) would receive a portion for acquiring the player. The system supports various Ethereum clients, including Metamask, Parity, Mist, or MyEtherWallet.

From a consumer standpoint, the key component of smart contracts and cryptocurrencies is the elimination of the need for trust. Theoretically, there can be no fraudulent casino operator if the casino operator does not exist. Thus, eliminating the third parties who are relied upon to be fair and honest eliminates the potential for being cheated.

It is worth noting, however, that cryptocurrencies are not bulletproof. This was illustrated on July 17, 2017, when hackers altered the code on CoinDash’s website, essentially steering at least \$6 million of funding for its Initial Coin Offering to a fraudulent Ethereum address. The incident fueled conspiracy theorists, who speculated that the “hack” was a scam perpetrated by CoinDash. Naturally, such occurrences can rattle consumer confidence.

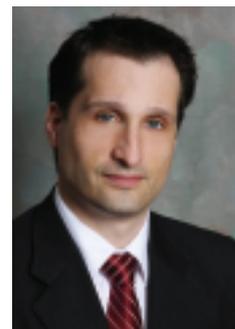
Also cause for concern is the volatility of cryptocurrency markets. In June 2017, a multimillion-dollar sell on the GDAX Ethereum exchange triggered hundreds of automatic stop loss orders, resulting in the price of Ethereum plummeting from \$317 to as low as \$0.10 in a matter of seconds. Ethereum rebounded quickly, but the crash illustrates the riskiness of dealing in new markets.

Nevertheless, Blockchain technology appears to be the future of commerce, and the aforementioned incidents from 30,000 feet look much more like hiccups than roadblocks.

So where does this leave the US gambling industry? As it stands, US law is not clear on Blockchain gambling. No law explicitly prohibits persons located in the US from taking part in it. While UIGEA appears broad enough to apply, nowhere does US law deem cryptocurrencies to be legal currencies. UIGEA applies to “designated payment systems,” which it defines as “any system utilized by a financial transaction provider that the Secretary and the Board of Governors of the Federal Reserve System, in consultation with the Attorney General, jointly determine, by regulation or order, could be utilized in connection with, or to facilitate, any restricted transaction.” To date, cryptocurrency has been the subject of no such determination. Likewise, the execution of smart contracts does not require a “financial transaction provider,” as defined by UIGEA. Digging further, Blockchain technology yields financial instrumentation that doesn’t fit neatly under any of the laws that the UIGEA draws upon (the Electronic Fund Transfer Act, The Uniform Commercial Code and others) for clarification.

More importantly though is the issue of where gambling law lands once there’s been time to catch up with technology. Even if it were deemed that funding gambling activity with cryptocurrencies does not run afoul of UIGEA, the Act could be amended accordingly. But, what will the states that have authorized Internet gambling (per UIGEA exemption) do with Blockchain technology? Consumer protection is of paramount importance in the regulation of gambling in the United States, and with that, the entry of Blockchain technology into the gambling space is a double-edged sword. On the one hand, the elimination of potentially fraudulent activity comports with high standards for consumer protection. On the other, it is difficult to imagine how US regulators would deal with a depleted toolbox when it comes to Know Your Customer (KYC) demands and problem gambling safeguards.

Perhaps whether US jurisdictions elect to approve the use of cryptocurrencies in the gambling space will come down to whether Blockchain gambling sites can be blocked and, if not, whether they pose a threat to the US-regulated online gambling industry. The latter seems likely, while the former remains to be seen. If Blockchain technology is the force that it is believed to be—and there is little, if any, reason to believe that it is not—then its approval in the United States is virtually inevitable. ♣



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