

## Are Loot Boxes An Illegal Gambling Mechanic?

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A member of the United Kingdom's Parliament has opened an inquiry into the legality of loot boxes. Loot boxes are virtual items that may be redeemed to receive a randomized selection of additional virtual items. Various countries around the world have recently moved to regulate the provision of loot boxes in video games, often in response to inquiries from consumers or legislators, such as the aforementioned inquiry in the UK. This leads to the ultimate question: are loot boxes legal?

Some believe that they are a form of gambling. Others see them as an effective, but legal, game monetization technique. The answer, as it is with many legal issues, is "it depends."

The primary legal issue is whether the loot box mechanic constitutes gambling. Other issues, which are addressed below, include whether the age rating of games with loot box mechanics should be impacted based on the inclusion of the game mechanic, and whether consumer protection laws require disclosure of the odds of obtaining certain virtual items through loot boxes.

The short answer on the primary issue is that most, "standard" loot box mechanics should not be deemed gambling, in most countries. However, a number of factors discussed below could alter the result. It is critical to understand that this issue is quite fact-specific and slight changes in the facts can lead to a different result. Furthermore, the relevant laws vary by jurisdiction. Various jurisdictions are looking into the need for further regulation in this area, so it is important to stay abreast of continuing developments.

### Background

Loot boxes are a mechanic used in many video games. They are a form of virtual item that can be given to or acquired by players. In some instances, they are free. In others, loot boxes can be a lucrative monetization mechanic.

Loot boxes have been used in massive multiplayer online games (MMOs) dating back to at least 2007, but as free to play video games proliferated, this mechanic has been increasingly employed as a monetization technique in other games. Loot box mechanics are known by various other names, including loot crates, lockboxes, crates, and packs, among others.

When "accessed," loot boxes provide players with a random set of other virtual items. These other virtual items can range from aesthetic items, which make something in the game look good (e.g., a visual customization for a player's avatar or weapons), to functional items that improve in-game performance (e.g., weapons, power-ups, powers, etc.). Loot boxes can be "accessed" in a variety of ways, such as by earning access via game play or purchasing a "key" using virtual currency or real money to unlock the loot box. Once unlocked, the virtual items are added to the player's inventory.

Typically, the virtual items a player may receive from a loot box can range from common, easy to acquire items to rare or super rare items, which are hard or nearly impossible to acquire from a loot box or otherwise. Often, the quest for these rare items drives players to spend a great deal of time and/or money. It is this compulsion to pursue these elusive items that creates much of the controversy associated with loot boxes.

In general, when a player receives a loot box, whether earned or purchased, they are going to receive some virtual items—they just don't know which ones until they access or open the loot box. Many analogize this to

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buying a pack of baseball cards. You pay money and you know you are going to receive a set of baseball cards. You just don't know which ones they will be. Will it be an average less sought after player or a superstar? The odds of receiving a less sought after player is always greater than those for receiving a superstar. The rarity of the superstar cards is often what drove people to purchase pack after pack of baseball cards in hopes of getting lucky.

Just as trading baseball cards was incredibly popular, so too is trading loot boxes and/or virtual items. If a player acquires a virtual item they do not want, they can trade with another player within the game. This is often referred to as part of an in-game economy. In other cases, players may trade or sell their unwanted virtual items on a secondary market. Secondary markets are typically run by third parties (not the game company). Often those trades are not part of the in-game economy, are not authorized by the game company, and are a violation of the game's terms of use.

One aspect of virtual item "trading" that has garnered a lot of recent attention is skin trading. Skins are aesthetically pleasing customizations for virtual items, often weapons. A number of sites offer what is referred to as "skin gambling," where players "stake" skins on the outcome of some event, oftentimes a game of chance. Many secondary markets exist for skins to be traded and sold for real money.

Some loot box mechanics are more complex than others. A popular mechanic, particularly in some video games in Asia, was known as "Kompu Gacha." With this mechanic, players typically acquired a loot box or "random" pack of virtual items, typically by payment of some amount of money. As discussed above, the player would get some set of virtual items, they just didn't know which ones until they accessed or open the loot box. The goal with Kompu Gacha was to collect a complete set of specific virtual items. Upon completion of the set, the player earned a rare virtual item. Typically, some items in the set were easily acquired but there was always one or more that were harder to get. This is just one example of variations in the use of loot boxes. Many other variations on the loot box model have been and are currently used.

## **The Concerns Associated With Loot Boxes**

There is a great debate about whether loot boxes constitute gambling. According to some, loot boxes are part of the "compulsion loop" of game design to keep players invested in a game. Such compulsion loops are alleged to contribute to video game addiction, which is often analogized to gambling addiction. Drilling down, this is believed to stem from the use of a "variable-rate reinforcement schedule" similar to how slot machines award prizes. But these allegations are not universally accepted.

## **Select Gambling Laws**

The gambling laws vary by country, and in the United States, by state as well. Most laws do not specifically address virtual items. However, some countries have recently addressed that issue specifically. It is beyond the scope of this paper to cover every country's laws. However, the following are examples of loot box-related laws or legislative activity in a few countries.

UK - The UK Gambling Commission issued a [discussion paper](#) in August 2016 and a subsequent [position paper](#) in March 2017, each entitled "Virtual currencies, eSports and social casino gaming" (collectively referred to as the "paper"). The paper sets forth specific guidance on the applicability of the Gambling Act of 2005 to in-game items or currencies and activities in video games. Under the Act, "[g]ambling is defined as betting, gaming or participating in a lottery." The paper specifically addresses certain loot box-like mechanics, stating:

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.

Additional consumer protection in the form of gambling regulation, is required in circumstances where players are being incentivised to participate in gambling style activities through the provision of prizes of money or money's worth. 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.

Based on the foregoing passage, it would seem that were the virtual items that can be acquired are restricted to those that can be used in the game, it would not be gambling. However, the paper goes on to note that the presence of a secondary market, even if not authorized by the game publisher, may need to be considered. It states:

Adopting a zero-tolerance approach to small scale or ad-hoc secondary markets for in-game items (thereby bringing activities conducted in games themselves or on games platforms within the definitions of gambling) may not be practical or proportionate to the risks posed to the licensing objectives. The proximity of any facilities for gambling to the means of exchanging items for cash, overt relationships between the two and/or the ease with which such transactions are conducted, are likely to be the key considerations when prioritising our enforcement activity. On occasions where serious concern exists under those criteria we are clear that primary responsibility lies with those operating the unlicensed gambling websites. However, we will also liaise with games publishers and/or network operators who may unintentionally be enabling the criminal activity.

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All interested parties should be clear, that where gambling facilities are offered to British consumers, including with the use of in-game items that can be converted into cash or traded (for items of value), a licence is required.

From this, it appears the UK Gambling Commission is looking to game publishers to assist in curtailing unauthorized secondary markets.

The paper also addressed skins betting and stated: "Where 'skins' are traded or are tradeable and can therefore act as a de facto virtual currency and facilities for gambling with those items are being offered, we consider that a licence is required." More specifically, the paper stated:

We are also paying close attention to the growing popularity of other forms of virtual currencies or 'in-game' items, which can be won, traded, sold or used as virtual currency to gamble with and converted into money or money's worth. These include digital commodities (such as 'skins') which can be won or purchased within the confines of computer games and can then be used as a form of virtual currency on a growing number of gambling websites.

We recognise that the term 'skin' can mean different things in different games. In the context of this paper we are referring to 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. In 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. These types of 'skins' have a monetary value derived from the current market price and can be converted into money.

US – In the United States, most of the relevant substantive gambling law is state law. At a high-level, an overly simplified definition of gambling involves: staking something of value (consideration) for a chance to win something of value (a prize). If all three elements are present in an activity (prize, chance, and consideration), it may be gambling. If you remove one of the three elements, it may not be gambling.

Few if any laws specifically address gambling based on virtual items. However, there have been a number of cases in the past couple of years that are quite relevant. In these cases, there were social casino games or larger strategy games that incorporated casino mini-games. Players typically got a limited number of free spins or other chances in the casino min-game, but could buy more with an ingame virtual currency that could be earned in-game or by paying money. Players could win more virtual currency or other virtual items that could be used in the game.

Significantly, in each case the player could not cash out the virtual items from the game operator, but unauthorized secondary markets to sell virtual items existed. In each of these cases, the courts found that this was not gambling, in part based on the conclusion that under these facts, the players were not winning a prize having value. The courts noted that it was a significant fact that the game operators did not provide and/or participate in the secondary markets and precluded such activity via their terms of use.

Applying a similar analysis, it is likely that these courts would conclude that most standard loot box mechanics are not gambling, assuming that the game operator does not participate in any secondary market.

Japan – As mentioned above, even if a loot box mechanism is not illegal gambling, consumer protection is another concern. In some cases, players are unaware of the odds for obtaining certain items, particularly rare virtual items, via a loot box. This in part, led to a crackdown in Japan on the Kompu Gacha mechanic.

In May 2012, Japan's Consumer Affairs Agency (similar to the U.S. Federal Trade Commission) issued a legal opinion that effectively banned the Kompu Gacha mechanic described above. This was due in part to allegations that some game operators did not disclose the odds of getting the items needed to complete a set and the further allegation that the odds were not fixed, thus making it harder to get the rare items.

China – China also has taken action with respect to the disclosure of item probabilities for in-game loot boxes.

China reportedly passed legislation in 2016 that requires publishers to clearly disclose both potential item drops and the probabilities of getting each item for random loot boxes with chance-based drops. It also banned the direct sale of “lottery tickets,” which includes loot boxes.

## Other Thoughts

Another issue that arises with loot boxes and other game mechanics is whether the presence of these mechanics in a game should impact that game’s age and content ratings. Content ratings typically indicate the appropriate age group for and type of content including in a video game. Some advocate that even if these mechanics are not gambling, they have an addictive effect and therefore this should be reflected in the games rating. Major ratings organizations have not agreed.

In a recent article, Dirk Bosmans, from European video game rating organization PEGI was quoted as saying: “Loot crates are currently not considered gambling: you always get something when you purchase them, even if it’s not what you hoped for. For that reason, a loot crate system does not trigger the gambling content descriptor.” Bosmans stated further:

It’s not up to PEGI to decide whether something is considered gambling or not—this is defined by national gambling laws. If something is considered gambling, it needs to follow a very specific set of legislation, which has all kinds of practical consequences for the company that runs it. Therefore, the games that get a PEGI gambling content descriptor either contain content that simulates what is considered gambling or they contain actual gambling with cash payouts. If PEGI would label something as gambling while it is not considered as such from a legal point of view, it would mostly create confusion.

In the U.S. and Canada, the Entertainment Software Rating Board (ESRB), takes a similar stance. In that same article, the ESRB was quoted as saying:

ESRB does not consider this mechanic to be gambling because the player uses real money to pay for and obtain in-game content. The player is always guaranteed to receive something— even if the player doesn’t want what is received. Think of it like opening a pack of collectible cards: sometimes you’ll get a brand new, rare card, but other times you’ll get a pack full of cards you already have. That said, ESRB does disclose gambling content should it be present in a game via one of two content descriptors: Simulated Gambling (player can gamble without betting or wagering real cash or currency) and Real Gambling (player can gamble, including betting or wagering real cash or currency). Neither of these apply to loot boxes and similar mechanics.

It is likely that things will continue to evolve in this area. According to published reports, there is a petition calling for the UK government to adopt stricter controls over the use of loot boxes in video games. Currently there are over 14,000 signatures on the petition.

In other efforts, OpenCritic, one of the largest game review sites, has taken matters into its own hands. In a recent social media post, it declared: “We’re going to take a stand against loot boxes. We’re looking into ways to add business model information to OpenCritic.”

## Conclusion

In the current legal landscape, standard loot box mechanics are likely legal in most countries, but the regulatory landscape is evolving. In the interim, it is certainly worthwhile for game operators to consider various steps to take when offering loot box mechanics. These steps can include obtaining legal advice on: (i) the legality of your implementation of loot boxes and similar mechanics; (ii) disclosure of probabilities or winning virtual items; and (iii) developing and implementing strategies for enforcement against unauthorized secondary markets that improperly sell your virtual items.

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