



Does Your Blockchain Game Loot Box Constitute Gambling?

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Traditional web2 video games, or off-chain games,² that feature loot boxes have frequently been accused of constituting a form of illegal gambling. Most US courts have ruled that gambling requires the possibility of earning rewards with real-world value and that virtual item prizes that cannot be cashed out into fiat currency don't constitute such real-world value. In the blockchain game³ context, however, digital assets⁴ generally *can* be transferred out of the game and exchanged into fiat currency. Therefore, blockchain game companies face a much higher risk than off-chain games that their chance-based mechanics constitute gambling.

This legal update, the fourth in our series exploring US regulations impacting blockchain games, provides an overview of the elements of US gambling regulations, considers how those rules have been applied to loot boxes in off-chain games, and how those rules will likely apply to chance-based mechanics in blockchain games.⁵ This legal update also includes a list of actions that can help mitigate regulatory risk associated with chance-based game mechanics in blockchain games.

I. Overview of Federal and State Gambling Regulations

Currently, federal law does not provide an explicit definition of gambling, delegating the responsibility to define the scope of gambling regulation to the states.⁶ Although the definition of gambling varies from state to state, most states regard gambling as consisting of three elements:⁷

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² Here, “off chain” refers to transactions that occur outside of a blockchain network, encompassing games that do not use blockchain technology.

³ Blockchains are decentralized, distributed digital ledgers of verified transactions, which blockchain games often incorporate by using non-fungible tokens (“NFTs”) as in-game virtual items and fungible tokens as in-game virtual currencies.

⁴ Here “digital assets” refer to both fungible tokens and NFTs. Blockchain games often use fungible tokens as in-game currency and NFTs as in-game items.

⁵ Please see our previous US Tech Law Updates, [Mobile Platform Rules on Blockchain Games Remain Unclear Despite Updates – But Popular Mobile Blockchain Games Provide Clarity](#), [Is Your Blockchain Game Digital Asset a Security](#), and [When Do Money Transmitter Rules Apply to Blockchain Games](#).

⁶ John Bennett, [Fake Loot, Real Money: The Uncertain Legal Future of Loot Boxes](#), AMERICAN BAR ASSOCIATION (April 28, 2023).

⁷ Alexandra M. Prati, [Video Games in the Twenty-First Century: Parallels between Loot Boxes and Gambling Create an Urgent Need for Regulatory Action](#), VANDERBILT JOURNAL OF ENTERTAINMENT AND TECHNOLOGY LAW (2020); see also 31 U.S. Code § 5362.



1. Risking something of value
2. On the occurrence of a chance event
3. For a potentially valuable prize.

In essence, for a game mechanic to be considered gambling, it must involve (1) consideration, (2) chance, and (3) a prize.

II. Gambling Analysis of Loot Boxes

The issue of gambling often arises in games that feature loot boxes, which offer items ranging from cosmetic upgrades like character skins to gameplay-affecting items like weapons and additional characters.⁸ The rarity and value of an item often determine its likelihood of appearing in a loot box, incentivizing players to collect as many loot boxes as possible to increase their chances of obtaining coveted items. Loot boxes can usually be purchased with real money, purchased with in-game virtual currency, or earned by achieving gameplay milestones. Whether loot boxes constitute gambling often depends on whether players can "cash out" their chance-based rewards, exchanging those rewards for fiat currency.

A. Consideration

For an activity to constitute gambling players must risk or stake something of value, which serves as the consideration for the potential wager. Although wagers of fiat currency will satisfy the consideration element, jurisdictions have different interpretations of what constitutes sufficient consideration in the context where the item risked is not fiat currency. Some jurisdictions require consideration to have monetary value, narrowly defined as something directly exchangeable for fiat currency.⁹ Other jurisdictions interpret "something of monetary value" more broadly. For example, the Ninth Circuit held that virtual items extending entertainment privileges may constitute consideration in gambling analyses under Washington state law.¹⁰ A minority of jurisdictions, including New York, view consideration in gambling similarly to consideration in contract law, encompassing "any right, interest, profit, or benefit accruing to one party, or some forbearance, detriment, loss, or responsibility given, suffered, or undertaken by the other."¹¹ In any of these jurisdictions, digital assets that are exchangeable for fiat currency will likely constitute consideration in a gambling analysis.

Even if digital assets constitute consideration, they must still be "risked or staked" to satisfy the first element of gambling. Although US courts have not directly addressed whether purchasing loot boxes alone is sufficient to meet the "risking or staking" requirement, in cases involving chance-based vending machines, courts have generally considered machines that dispense merchandise claimed to be equivalent in value to the inserted money, along with random additional amounts of money or other valuable items, as gambling devices.¹² In those

⁸ Elijah Tredup, *Loot Boxes and the Question of Gambling*, NEVADA GAMING LAWYER (September 2019).

⁹ Bennett, *Fake Loot, Real Money: The Uncertain Legal Future of Loot Boxes*.

¹⁰ *Kater v. Churchill Downs Inc.*, No. 16-35010 (9th Cir. 2018).

¹¹ Dennis Vacco, *A Proposed Real Estate Sales Program Called the "good As Gold" Promotion Would Violate the Anti-gambling Provisions of New York State Law*, NY Attorney General Opinion (Jan. 29, 1996).

¹² See, e.g., *Boyton v. Ellis*, 57 F.2d 665 (10th Cir. 1932); *Mueller v. Wm. F. Stoecker Cigar Co.*, 131 N.W. 923 (Neb. 1911); *State v. Branney*, 160 P.2d 972 (Wyo. 1945).



cases, even when players received merchandise equivalent in value to the inserted money, where players did not receive the random additional valuable items that enticed them to insert money into the vending machine, courts have ruled that players lost the full consideration staked to purchase the vending machine prize. Applied to loot boxes, if a player buys a loot box and receives common items equal in value to the purchase price rather than rare items that enticed them to buy the loot box, courts may decide that the player has effectively lost the full consideration staked to purchase the loot box. Thus, the mere purchase of a loot box with either digital assets or fiat currency could meet the requirement of "risking or staking" consideration, even if the player receives an item of some value or equivalent value to the purchase price.

B. Chance

For an activity to constitute gambling there must be an element of chance, where events are outside the player's control. Loot boxes generally satisfy all jurisdictional interpretations of chance-based games because a player's skill or in-game performance usually does not influence the items contained in the loot boxes. Instead, loot box content is typically predetermined based on the statistical rarity assigned to individual items. Players cannot use skill or knowledge to affect the random element of a loot box, meaning any player, regardless of in-game engagement or skill level, may receive items of the same rarity. Consequently, chance is an inherent element of most loot boxes.

C. Prize

For an activity to constitute gambling, the player must have the potential to win a valuable prize, or "something of value." Courts generally interpret "something of value" for the prize element of gambling the same way they interpret "something of value" for the consideration element. Generally, loot box mechanics in traditional games have not satisfied this "prize" element because virtual items that cannot be cashed out into fiat currency are typically not considered valuable by courts.

For example, in *Taylor v. Apple*, a California trial court ruled that loot boxes in the mobile game Brawl Stars did not constitute illegal gambling devices because the virtual item prizes offered within the game lacked value outside of the game.¹³ Another California trial court, in *Coffee v. Google LLC*, held that even loot box items with value on secondary trading markets did not qualify as things of value for gambling statutes if those trades violated the applicable terms of use.¹⁴ Similarly, in *Mason v. Machine Zone*, the Fourth Circuit found no grounds for recovery under Maryland's gambling loss recovery statute when a plaintiff only had the chance to win virtual currency that could not be exchanged for real-world currency.¹⁵ In sum, loot boxes and chance-based rewards in off-chain games are generally not considered gambling since the prizes offered cannot be cashed out by exchanging for fiat currency.

¹³ *Taylor v. Apple, Inc.*, No. 20-cv-03906-RS (N.D. Cal. 2022); see also California Penal Code § 330b(f), "Pinball and other amusement machines or devices, which are predominantly games of skill, whether affording the opportunity of additional chances or free plays or not, are not included within the term slot machine or device, as defined in this section."

¹⁴ *Coffee v. Google*, No. 5:20-cv-03901-BLF (N.D. Cal. 2020) (citing *Kater v. Churchill Downs Inc.*, 886 F.3d 784, 788 n. 2 (9th Cir. 2018)) ("[T]he 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.")

¹⁵ *Mason v. Machine Zone, Inc.*, No. 15-2469 (4th Cir. 2017).



III. Beyond Loot Boxes: Chance in Blockchain Games

A core element of blockchain games is that the digital assets from those games can be traded on secondary markets, cashed out and exchanged for fiat currency. This core difference between off-chain games and blockchain games has significant implications for gambling analysis with respect to in-game loot boxes. As noted above, chance-based mechanics like loot boxes are not regarded as gambling in off-chain games because the prizes offered cannot be cashed out and exchanged for fiat currency. Since the cash out mechanism is a fundamental element of blockchain games, developers of the new blockchain products will need to be very cautious with any use of chance-based game mechanics, including loot boxes, to ensure their games do not include illegal gambling mechanics.

Chance-based mechanics in games are not limited to loot boxes. Another popular chance-based mechanic allows players to spend virtual currency to create and remix in-game NFT assets in a random manner. For example, in Axie Infinity, players can "breed" their playable characters by exchanging in-game virtual currency for a newly minted NFT with randomly generated traits, some cosmetic and others providing gameplay advantages.¹⁶ Both types of traits can increase the newly minted NFT's value in secondary trading. Thus, consideration exists as players spend in-game virtual currency with real-world value; chance exists as the resulting NFTs have randomly generated traits; and a potentially valuable prize exists as some traits are more valuable than others in-game and on the secondary trading market.

Other chance-based mechanics in blockchain games could face similar regulatory scrutiny. In Wolf Game, players can stake their in-game assets to validate other blockchain transactions and receive rewards. When a player wants to withdraw staked fungible tokens, the player can choose between paying a 20% tax or risking their staking rewards with a 50/50 chance of losing everything or winning a larger reward.¹⁷ If the tokens in Wolf Game were not transferable, this mechanism would likely not constitute gambling. However, because players can cash out the reward, such a mechanic could be considered gambling under US law.

IV. Reducing Regulatory Risk

We have listed various actions below that can help to reduce regulatory risk related to chance-based mechanics. However, implementing these strategies may remove some of the value blockchain technology offers to video games or the excitement associated with chance-based mechanics. Moreover, these strategies go beyond those typically undertaken by off-chain games given that the cash out mechanism for in-game digital assets makes blockchain games more likely to meet the elements of gambling under applicable US law.

¹⁶ [Axie Infinity Whitepaper, Breeding and \\$SLP.](#)

¹⁷ Wolf Game, [Risky Game.](#)



- i. *Consideration.*
 - Do not offer access to loot boxes or other chance-based mechanics in exchange for fiat currency or digital assets, but solely through in-game engagement and achievement of in-game milestones.
 - Manage player expectations by disclosing potential rewards and their odds before engaging with chance-based mechanics.
- ii. *Chance.*
 - Reveal the contents of loot boxes or rewards for mini-games in advance.
 - Base the outcome of mystery items or breeding mechanics on player experience level or engagement instead of statistical probabilities beyond the player's influence.
- iii. *Prize.*
 - Prohibit the exchange, transfer or cash out of rewards received from chance-based mechanics – both in the game's terms of service and through the lack of trading functionality for those items.
 - Offer as rewards in loot boxes or other chance-based mechanics only digital assets that cannot be cashed out or otherwise redeemed for real-world value.