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Shocking U.S. "Loot Box" Bill Should Surprise No One: The Video Game Industry Under Attack

Video games are big business: from the latest blockbuster, an indie hit, a mobile time-passer for your transit ride, or a packed esports arena with massive online viewership, there's good money in creating engaging and immersive entertainment products. However, game economics have changed, particularly in the internet era, and developers and publishers have had to pursue revenue by adopting more creative and sustainable monetization models, including up-front, service-based, microtransaction-based, or even ad-based revenue streams. Against this backdrop, and against a negative media and political bias towards video games,[1] we have seen an increasing appetite worldwide for governments to step in and regulate the games industry.

So it comes as no surprise that, even in the United States, the federal government has made a move to protect the populace from perceived exploitation, even if the new legislation, a bill from Republican Senator Josh Hawley and endorsed by two Democratic senators, is shockingly broad in its application.

[1] The World Health Organization, for example, voted on May 26, 2019, to add "gaming disorder" to its international classification of diseases. This addition is very controversial, as the science is definitely out on whether compulsive gaming is its own disorder or simply a symptom of other disorders such as depression, ADHD or anxiety.

Background — The Current State of Games and the Rise of In-Game Monetization

In 2018, digital games and interactive media revenues grew 13% to reach USD$119.6 billion. To put that in perspective, that is more than ten times the global recorded music industry (USD$19 billion [+9.7%]) and rapidly approaches the vaunted global film industry (USD$135.6 billion [+2.5%]).

With competition for consumers' entertainment time at a fever pitch across many converging industries,[2] game developers are under immense pressure to deliver immersive, compelling, perfectly-executed games that take full advantage of the latest technology. In the past twenty years, average game development costs have increased approximately ten times to USD$90 million while retail prices for AAA console and PC games have remained relatively stagnant (drastically decreasing when taking into account inflation) at approximately USD$60. Further, these development costs do not take into account marketing costs which are regularly 80-100% of the development budget for console and PC games and 300%-1,000% of the development budget for mobile games.

These competitive pressures combined with rising costs and the remarkable persistence in the general price for AAA titles has driven developers and publishers to seek alternative business models and creative revenue streams to remain profitable. In fact, one such alternative model is known as "free-to-play" or "freemium", defers the traditional up-front cost of acquiring a game for revenue is generated via a collection of other methods such as in-game advertisements and microtransactions that can include controversial "pay-to-win" mechanics and "loot boxes".[3] Many games that have an up-front or subscription fee also deploy these microtransactions.

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[2] For example, consider this quote from Netflix's 2018 earnings report: "We compete with (and lose to) [Epic's game] *Fortnite* more than HBO", also noting that "consumer screen time" is its most valuable metric.

[3] Famously, one of the first microtransactions to attract negative consumer attention was a US$2.50 purchase for an offline game, whereby players of Bethesda's *The Elder Scrolls IV: Oblivion* could acquire armour for their virtual steed, a purely cosmetic item.

For the uninitiated, microtransactions are in-game transactions using real currency (or by either watching an in-game advertisement or spending virtual currency that was acquired through effort or real currency) whereby users can purchase virtual goods ranging from purely cosmetic items, to boosts or gameplay advantages, to additional playable content. When those virtual goods afford the user with some advantage over those users who do not purchase the item, this is considered a "pay-to-win" mechanic. "Loot boxes", on the other hand, are a type of in-game microtransaction whereby a user effectively purchases (again, with virtual currency, real world money or by watching advertisements) a chance to win a virtual good, or some other advantage (though the term is sometimes more broadly defined to include any random or "black box" set of virtual goods or advantages that, through microtransaction or in game effort, can be acquired by players).

Developers have employed psychologists, economists, and human behaviour experts to maximize player engagement with their products via high pressure, data driven, and arguably addictive methodologies. These methodologies spread quickly throughout the industry as developers follow the examples set by the highest grossing titles. Free-to-play titles accounted for over 80% of all digital games revenue in 2018 and it is no coincidence that the highest grossing game of 2018, Fortnite (USD$2.4B), is one such title. In fact, of the 10 titles that grossed over USD$1B in 2018, 9 were free-to-play. This, of course, encourages other companies to follow suit with their own games.

It is no surprise that, now that in-game monetization has reached this level of success, the business practices of the game distributors and publishers have come under the close scrutiny of regulators and consumer organizations around the world.

The Proposed Legislation — Much More than Just Protecting Children from "Loot Boxes"

Hawley's bill purports to "regulate certain pay-to-win microtransactions and sales of loot boxes in interactive digital entertainment products", and would make it illegal for a game publisher or distributor to make available a "minor-oriented video

game" containing pay-to-win microtransactions or loot boxes. It also prohibits making available an "interactive digital entertainment product" *even if it is not minor-oriented*, if the game contains microtransactions that are pay-to-win or loot boxes, in situations where the publisher or distributor has "constructive knowledge that any of its users are under the age of 18".

Defining "interactive digital entertainment product" and "minor-oriented video game" very broadly, the bill looks substantively at the product in question, for example, determining a game to be "minor-oriented" if its target audience is individuals under the age of 18, as demonstrated by its subject matter, visual content, music/audio, use of animated characters appealing to minors, age of characters or models in the game, presence of celebrities who are under 18 or who appeal to those under 18, the language and content of advertising used, and other empirical evidence about the composition of the product's audience, either actual or intended.

The "minor-oriented video game" prohibitions of the bill may not, themselves, represent a true industry barrier. Despite popular impression, microtransaction games generally do not target their game at children: children are not as likely as adults to stick with a game (and tend to head to the most recent or popular game), and they do not spend as much money adults, whose greater disposable income and brand loyalty makes them a much more attractive audience.

Instead, it is the bill's stretch beyond games targeted towards minors and instead to games that *could* be played by minors that should cause concern. It is well known that popular games are played by those under the age of 18, as a NewZoo study found that two popular games (Epic's *Fortnite* and Bluehole's *PUBG*, both of which heavily feature microtransactions) had majority player populations between the ages of 10 and 30, with between 10 and 20 percent of players identified as "students" (And we note that both games have terms and conditions that anticipate those under 18 must required to

obtain parental permission to play).[4] Specifically, there are features of this proposed legislation that affect games more broadly than the "children's loot box bill" unofficial moniker would suggest:

- the bill prohibits games with loot box or pay-to-win microtransactions that are constructively known to have players under 18 (presumably, even if the publisher or distributor takes efforts to exclude them), and while this constructive knowledge is not legislatively defined, merchandising, streaming viewership audiences, third party studies, and forum activity may count towards it;[5]

- the bill's definition of transactions includes not just transactions where the *player* pays the money, but *anyone* gives value to the distributor or publisher (or an affiliate or anyone for their benefit) if the transaction could also be conducted by the payment of money; and

- the definition of a "pay-to-win" transaction is incredibly broad, focusing on progression through the game by easing progress, assisting achievements, or obtaining or elongating access to awards that might otherwise taken be away — in each case even if these can be done without purchase.

As such, the bill is very broad in its reach, perhaps to a point where a court would not find it enforceable. We note, for example, that not even adult-oriented businesses are prohibited from offering services where it is constructively known that minors participate (for example, a bar or adult entertainment website must exclude minors if known but must certainly know that minors do participate from time to time). There is a long line of cases in the United States that establish, in the trading card space and under federal racketeering legislation that purchasers who buy a pack of cards without knowing

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[4] These statistics ignore the massive and increasing viewership audience for games such as *Fortnite*, which audience of course includes children. Famously, video game streamers such as Tyler Blevins aka Ninja make 8-figure incomes from streaming gameplay to viewers.

[5] Generally, constructive knowledge is defined under case law, at least in Canada, as "knowledge of circumstances which would indicate the facts to an honest person, or knowledge of facts which would put an honest person on inquiry".

the contents are not aggrieved if they chase rewards, because the purchaser is receiving exactly what they bargained for: a random assignment of cards including a chance for higher-value cards. Finally, while regulating games based on their content is questionable enough under the very strong U.S. First Amendment, we find the definition of "minor-oriented video games" to be problematic on its own, not clearly differentiating games that appeal to minors as opposed to people in general — many games strongly preferred by adults (such as King's Candy Crush Saga) feature many of the listed elements.

The Case for Government Regulation has Evolved — and is Persuasive

As a disclaimer, I and my co-authors are lifelong gamers — supportive of the industry, encouraged by its successes, and heartened to see it more inclusive and widespread than ever before. We played as children, we play as adults, and we believe that games are social, engaging, meaningful, artistic, and skill-building in ways society is just starting to understand.

While the industry itself is opposed to this type of regulation (as one would suspect), we note that in our observations, reactions from the playerbase are not quite as clear-cut in opposition, with many players feeling that games have, indeed, gone too far with monetization efforts.[6] I and many others have written and spoken to game enthusiasts, developers, lawyers and the industry at large for years, ourselves at events like Game Developers' Conference, PAX and PAX Dev, TwitchCon, continuing legal education and Video Game Bar Association events, and indie meet-ups. At these presentations and dialogues, we often note that the video game industry has lived in a bit of a protective bubble: largely ignored by regulators, protected by US courts on First Amendment bases, benefitting from the ubiquity and transborder reach of (and difficulties of governance brought by) the Internet, and treated as "kid's stuff" and not the massive, Hollywood-beating industry it has become. Within that

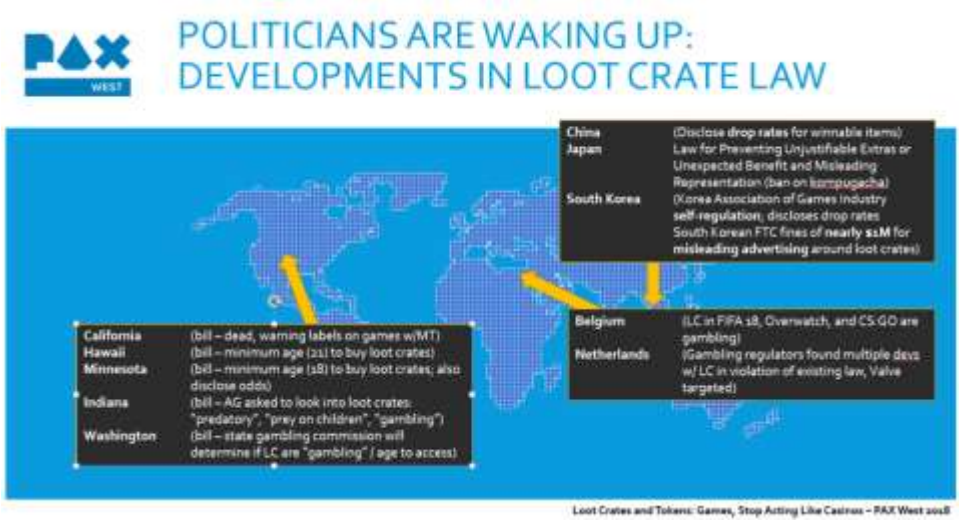
[6] At this time, anecdotally from the authors' experience in reading online discussions about the legislation, to be updated with cites.

protective bubble, those making money from video games have started to act as if they *could not be regulated* in the same way that other industries and businesses have been regulated. This may come as a result of some unwarranted confidence from consistent, early court wins.

As video games became more realistic and engaging throughout the latter part of the 20th century and into the 21st, attempts at regulating the mature content of video games in the United States failed. In the landmark U.S. case of Brown v. Entertainment Merchants Assn, the Supreme Court ruled that video games qualify for First Amendment protection "like the protected books, plays and movies that preceded them" through traditional devices "such as characters dialogue plot and music" and through features that only electronic entertainment can provide "such as the player's interaction with the virtual world". More importantly, the Court made two important determinations: first, there is no real, established link between exposure to violent video games and any effects on minors (the Court even noted that the "research psychologists" whose studies were presented as evidence "have been rejected by every court to consider them, and with good reason: they do not prove that violent video games cause minors to act aggressively", and "suffer from significant, admitted flaws in methodology"); and, second, that self-regulation had been very effective to prevent the purchase of games by minors.

Regulation for content in other jurisdictions has fared better (notably, for example, China and Germany), but it generally took some time before the worldwide regulatory focus shifted from the *content* of games to the *economics* of games. Slowly but surely, different jurisdictions (even some states in the United States) started to look closely at how games and games company behaved *economically*, not just as producers and publishers of expression, speech and artistic content. From efforts in Japan and Korea to regulate certain gambling-like gaming mechanics or compulsive gaming hours, to the European Commission's positions on the marketing of "free-to-play" games ("an on-line game cannot be marketed as 'free' where the consumer cannot, without making in app purchases, play the game in a way that he/she would reasonably expect"), in fact, regulation

has begun to take hold more globally. In fact, in recent years several jurisdictions throughout Europe, Asia have taken an interest in microtransactions and "loot boxes" from from various perspectives including gambling, child protection, consumer and even money-laundering. At a PAX West 2018 panel on which I participated, we noted that regulations had been attempted (or were being enforced) internationally and even throughout the US:



The most common comparison for video games in *business* (as opposed to video games as art) is the casino and gambling industry, no doubt aided and abetted by industry usage of gambling terms like "whales" for big spenders and "minnows" for the masses of non-spenders and the similar metrics used to evaluate success. Certainly, for some games (imagine a social casino mobile game where players can play for free but can buy virtual currency for real-world money, whether or not they can be cashed out) the comparison is very obvious, and for other games (imagine a soccer game where you can buy a pack of random "booster" items that might improve your gameplay, make you look better, or unlock a feature of the game) the comparison is not as clear.

But let's ignore gambling for the moment: worldwide, we can clearly see examples of behaviours that have been deemed worthy of regulation; in fact, most of the business-to-consumer world is heavily regulated, both directed at minors and otherwise. High pressure tactics, exploiting consumer weakness, playing on time sinks or up-

front investments, confusing contracts/terms, unknown or not clearly represented rewards and other similar factors have caused governments to regulate everything from dance studios to door-to-door salespeople. In 2016, at a presentation at Game Developers' Conference, I spoke on the topic of gaming vs. gambling[7] and pointed out that the rationales behind regulating and prohibiting behaviours (and requiring cancellation and other consumer rights) in those industries are quite familiar to anyone who has played a modern game, particularly one that relies heavily on microtransactions:

It is key to note that this is new type of regulation is no longer about the artistic value or content of the game itself,[8] but the effects of the business conducted through the games. Depending on perspectives, games might look like: trading cards; art; gambling; online services; or predatory consumer practices. But there is little doubt that many of today's interactive games rely on mechanisms common in the gambling world and well-known in regulated industries as encouraging spend, including:

1. **variable and random reward systems**, exploiting a psychological concept known as "variable rate reinforcement", where people are more likely to engage in activities that result in

[7] With my child psychiatrist brother, Dr. Tyler Black, no less!

[8] Though in our view, the proposed bill unnecessarily focuses on the content of games with the questionable "minor-oriented video game" concept.

uncertain rewards (such as a slot machine payout table) as opposed to predictable rewards (such as knowing that 5 spins nets a known reward);

2. **abstracted layers of currency** (it is easier to spend in-game currency, virtual coins or casino chips than it is to spend actual money);

3. **complicated and changing exchange rates for currency**, with difficult-to-grasp relationships to real-world value and the in-game purchases made (for example, if 50 in-game gems are $4.99 on sale from $7.99, and a particular item costs 20 in-game gems, it is harder to determine what the actual cost of that item is);

4. **high-pressure techniques such as discounts and time limited offers**, that focus on encouraging purchases based on frequent discounts or time limits;

5. **reward removal**, such as giving a time-limited reward (e.g., a trial) or advantage that will be taken away without a microtransaction, exploiting a person's desire not to lose a reward which can be stronger than the desire to gain a reward; and

6. **lack of real world signalling**, by creating an immersive environment unconnected to the real world, such as not showing how much time has elapsed, a real-world clock, or suppressing notifications from outside sources.

Combined with the scientific research that shows that the frontal lobe, the part of the human brain responsible for executive functions, planning, resisting urging and decision-making, does not fully develop until approximately 24 years of age, it is clear to see why regulation, particularly regulation focused on young people, is attractive to governments: as Dr. Black states therein, "Children have developing brains, parents love their children, politicians love parents, and so politicians will care about children's brains." We would take it a step further and say that governments also have a strong tendency to protect consumers of any age from perceived exploitative practices.

The Case for Self-Regulation (and not Government Interference) is Also Persuasive

In the video game industry, self-regulation has been effective, not just in preventing children from accessing content not meant from them, but also in staving off legislation. The Entertainment Software Ratings Board (ESRB) was established in 1994 by the Entertainment Software Association (ESA) to administer "a rating system [that] should inform and suggest, not prohibit" games, after a series of U.S. Senate hearings focusing on the violent content of games such as *Mortal Kombat* and *Night Trap*. The ESRB rating system suggests age-appropriateness of games using rating categories, including content descriptors that indicate certain types of content that may trigger a rating (such as violence, nudity or alcohol references) and interactive elements advising about user interactions (such as sharing location with others, if there are in-app purchases, or if internet access is provided that may allow children to access inappropriate content). In Canada, ESRB ratings are enforced under many provincial laws. Sample ESRB ratings show how they inform parents and purchasers:

As mentioned above, the ESRB ratings system were an instrumental part of the California government's defeat in its attempt to pass a bill that would purport to restrict game sales to minors, with the US Supreme Court stating:

> [...] California cannot show that the Act's restrictions meet a substantial need of parents who wish to restrict their children's access to violent video games but cannot do so. The video-game industry has in place a voluntary rating system designed to inform consumers about the content of

> games. [...] In 2009, the Federal Trade Commission (FTC) found that, as a result of this system, **"the video game industry outpaces the movie and music industries"** in "(1) restricting [marketing] of mature-rated products to children; (2) clearly and prominently disclosing rating information; and (3) restricting children's access to mature-rated products at retail." [...] **This system does much to ensure that minors cannot purchase seriously violent games on their own, and that parents who care about the matter can readily evaluate the games their children bring home.** Filling the remaining modest gap in concerned-parents' control can hardly be a compelling state interest. [Emphasis ours.]

There are some inherent weaknesses in the ESRB ratings model that are becoming exposed in the modern video game infrastructure, though. First, while this type of rating on the packaging of a game does give clear disclaimers as presumably most parents and consumers would look at the package when purchasing the product, most games are not sold physically anymore: app stores (on mobile devices), online-enabled game consoles (Sony's Playstation Store and Microsoft's Xbox Store, as prime examples) and even PC-based electronic stores (such as Valve's Steam platform) have made purchasing games online the dominant model on a 4-to-1 basis. With the amount of games being published online and the ease with which a person can install a game, is a label somewhere on the advertising or digital package of the game sufficient? Second, the ESRB has been slow to move on microtransactions, with baby steps such as a "In-Game Purchases" mandatory label for physical games that is easy to criticize because most games feature in-game purchases (be it additional content or loot boxes) and the ubiquity of the label will likely render it meaningless. Last, ESRB ratings are opt-in and voluntary, and not all platforms mandate ESRB ratings as part of the sales process. Third, an entire new economy is building up around the viewership of games or others playing them for entertainment or competition, in the form of streaming services and esports industries (beyond the scope of this article), and so the consumption of games

no longer is solely a purchaser-distributor relationship, making labels on product packaging somewhat antiquated.

The ESRB has proven, though, that self-regulation can work. I and others have long advocated for the interactive entertainment industry to rally around a set of ethical monetization principles that would hopefully provide an ESRB-like defense to regulation such as that proposed by Senator Hawley. In my view, self-regulation would include the following steps:

- establishing clear, meaningful information or rating systems for in-game microtransaction mechanics;
- fully disclosing rewards schedules, tables and odds at key decision times;
- ensuring consumer-friendly policies and deference allowing for returns or cooling off periods;
- providing real-world cueing, such as in-game playtime reminders, purchase history reminders, clocks and other features;
- enabling self-exclusion programs for purchases or playtime;
- encouraging token economies instead of random, variable rewards;
- disincentivizing compulsive play by diminishing returns on rewards, and diminishing compulsive gaming hours;
- enabling parental locks and tools to prevent unwanted gaming behaviours; and/or
- establishing true and meaningful age-gating, as well as parental locks and tools.

Having been engaged in these talks since 2012, though, it is unclear to me whether the industry as a whole can, in fact, do so without regulation (though, to be fair, we do see in some games implement many of these features).

Conclusion

Whether this bill advances, or stands a chance politically or under judicial scrutiny, is a matter for my American colleagues to discuss and perhaps litigate, but clearly the push for regulation such as this bill will be appealing to politicians. The message will heavily focus on children's perceived exploitation: a big difference between video games and other forms of entertainment is that a significant portion of the population and politicians will have a negative attitude towards gaming on moralistic, paternalistic or other grounds. And so, much like the attempts to regulate games in the past for encouraging violent behaviour in children (when studies do not show any actual effect worth tackling), the "protect the children" tactic, combined with a dose of consumer protection, has clearly emerged as the preferred rationale for this type of business activity.[9]

And, as we suspected, here we see this rationale in full force and effect, with a bill that purports to enable the Federal Trade Commission to regulate the content and economic behaviour of video games: ostensibly for minors and to regulate consumer behaviour, but wide-sweeping across an entire industry. The government response is that unrestrained industry conduct must be restrained in order to protect children (and their parents as consumers). Senator Hawley has been quoted as saying "Only the addiction economy could produce a business model that relies on placing a casino in the hands of every child in America with the goal of getting them desperately hooked," with Democratic Senator Richard Blumenthal adding that "congress must send a clear warning to app developers and tech companies: children are not cash cows to exploit for profit" and Democratic Senator Ed Markey stating that "inherently manipulative game features that take advantage of kids and turn play time into pay time should be out of bounds".

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[9] To see what we mean, imagine your perception (or the perception of your parents or teachers) towards two hypothetical children: one spends the afternoon on a beach or in a park reading a book or listening to classical music, and the other spends the afternoon on a beach or in a park playing a video game. Neither is objectively getting much done, both are consuming entertainment products instead of enjoying the great outdoors, and both are learning and applying new skills to enjoy those products, but many people would perceive a difference in the quality of those activities.

Clearly, the regulatory bubble has been burst, and game companies must take seriously the concepts of self-regulation, meaningful parental controls, monetization restraint and consumer deference if they want to avoid the worst of it from governments around the world.

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a cautionary note