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Digital currency lawsuits: Bitcoin scrambles to boost consumer confidence

Digital currency lawsuits reveal weaknesses in a burgeoning industry with little regulatory oversight. Bitcoin is turning to third parties to reassure users that millions of dollars of value will not vanish without a trace.

By **Gloria Goodale**, Staff writer | AUGUST 1, 2014

Los Angeles

Digital currencies, such as bitcoin, are slowly gaining ground. At least one new version, called Stellar, launched this week, and a national Digital Currencies conference in New York was held Tuesday to explain virtual currency to bankers from around the nation.

But amidst this crypto-creep, the growth is also revealing the weaknesses inherent in a system with little regulatory oversight or any centralized controls.

This week, the Tokyo Metropolitan Police Department announced that it has opened a criminal investigation of the failure of Mt. Gox, once the web's largest bitcoin exchange, which filed for bankruptcy in Japan for what remain murky reasons on Feb. 28.

Also this week, the same team handling a lawsuit against Mt. Gox on behalf of consumers filed yet another class-action suit against Coinabul, the web's largest bitcoin-to-precious metal site. This suit alleges that the site continued to take users' bitcoin while not sending product – for as long as a year.

"Rather than delivering the metals promised to their customers, defendants chose to capitalize on the lack of effective regulatory oversight in this burgeoning industry, and instead defrauded their customers out of millions of dollars worth of bitcoins," the complaint states.

Coinabul did not return e-mailed requests for comment on the lawsuit.

This suit shows the need for some sort of third party escrow or intermediary form of protection for consumers using bitcoin, says attorney Chris Dore, who is on the Chicago legal team at Edelson PC that is pursuing both suits.

"My hope is that the case will increase the systems that will protect consumers," he says. "I expect this response when you have this much money disappear."



A Bitcoin (virtual currency) paper wallet with QR codes and coins are seen in an illustration picture taken at La Maison du Bitcoin in Paris July 11, 2014. (Benoit Tessier/REUTERS)

These complaints raise the profile of calls for government action. In the past year, both Congress and the state of New York have held hearings on the issue of regulatory controls for digital currency, although to date only advisory memos have been issued at both the federal and state levels.

Meanwhile, the industry itself is scrambling to fill the trust and security void with new third-party services to reassure bitcoin users.

Market forces are more likely to step in to build trust in what is still a nascent, though growing, form of payment, says Nashville attorney Will Norton, who specializes in business technology issues. He points to escrow or exchange-type services, such as Coinbase, that have already emerged to help buffer consumers and businesses alike against the risks of a form of payment that many still regard as experimental.

Mr. Norton points to some important successes to date.

What will truly drive mainstream acceptance is major companies such as Dell adopting virtual currencies, he says. The company recently announced that it would accept bitcoin through Coinbase, Norton notes.

For bitcoin and the bitcoin community, the Dell announcement is a “major coup,” says Norton. This is particularly true as many have been declaring bitcoin’s imminent death, he notes. “It shows that bitcoin is not just for Internet businesses. This is the first major product/equipment provider to embrace the currency,” he says.

It is also significant that a bitcoin vendor such as Coinbase reached out to Dell and was able to convince them to use the currency, says Norton.

These are familiar growing pains for a young technology that has all the earmarks of being the wave of the future.

“The basic idea of cryptocurrency is not going to go away,” says Duke University Business School professor Campbell Harvey, who admits that he owns bitcoin. But he is quick to add, with a laugh, that it is just one and “I bought it strictly for teaching purposes so I could take my students through all the steps.”

Nonetheless, he says the idea behind bitcoin and other virtual currencies is one that is growing in its appeal to a wide range of people.

On Thursday, Wikimedia Foundation announced that, partnering with Coinbase, it will begin accepting contributions in bitcoin.

“Members of our community have asked the Foundation to start accepting bitcoin. These requests, coupled with recent guidance from the US Internal Revenue Service, encouraged the Foundation to once again review our capacity to accept bitcoin,” said Lisa Gruwell, chief revenue officer of Wikimedia Foundation, in a statement.

At the same time, Coinbase announced that it will waive processing fees for qualified nonprofits who accept bitcoin for donations. "Adding bitcoin as a donation option is a natural next step for nonprofits because it eliminates one of the most significant costs remaining – payment processing fees," Coinbase said.

"I actually believe that we are moving toward a system in the future in which cryptography and decentralization will become incredibly important," says Professor Harvey.

Whether bitcoin or some other form of digital cash will prevail remains to be worked out by the marketplace, he points out. But he suggests that these new forms of virtual cash are emerging for compelling reasons that are not going to diminish. If nothing else, people's pocketbooks will drive use, he says, because the peer-to-peer system that bypasses centralized controls greatly reduces transaction costs.