

2023

Loophole Entrepreneurship

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Recommended Citation

Brian M. Sirman, Loophole Entrepreneurship, 29 Fordham J. Corp. & Fin. L. 33 (2023).

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LOOPHOLE ENTREPRENEURSHIP

*Brian M. Sirman**

ABSTRACT

All entrepreneurs seek favorable legal or regulatory treatment for their businesses. Sometimes this leads an entrepreneur to build a business within a gap in the law—a loophole. In so doing, these “loophole entrepreneurs” may avoid steep regulatory compliance costs that otherwise would beset (or perhaps prohibit) their businesses, thereby gaining advantages over competitors. Despite these benefits, loophole entrepreneurship is fraught with risks. Loopholes, by nature, are fragile, and their contours are often uncertain. Moreover, the stigma of “exploiting a loophole” (which connotes unfairness or deception) can provoke ill will among competitors, policymakers, and the public.

The ranks of loophole entrepreneurs include companies that have become household names (Southwest Airlines), front-page headlines (Theranos), industry pioneers (DraftKings and FanDuel), and hometown institutions (children’s lemonade stands). Loophole entrepreneurship is not only common but inevitable: wherever there is a law—and a will to evade it—there is a loophole entrepreneur. Yet loophole entrepreneurship remains an understudied area of law. This Article seeks to fill this gap by creating a conceptual framework for understanding the phenomenon, presenting a variety of case studies that reveal some of its nuances and intricacies, and gleaning from these case studies some lessons about the nature of loophole entrepreneurship.

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INTRODUCTION

A pencil costs \$550 at No Kids Allowed (“NKA”), a shop five blocks from the United States Capitol in Washington, D.C.¹ Pencils of seemingly identical quality are available elsewhere for less than 15 cents.² NKA’s pencil is not especially distinctive: wood, #2 lead, flimsy brass ferrule, pink eraser. What about this pencil, then, could justify a retail price more than three thousand times its apparent value?

1. NKA, <https://www.nokidsallowed.club/shop/deans-list-flower> [<https://archive.ph/DrNx0>] (last visited Nov. 8, 2022).

2. See, e.g., *Jot Brightly-Colored #2 Wooden Pencils, 12-ct. Packs*, DOLLARTREE.COM, <https://www.dollartree.com/jot-brightly-colored-2-wooden-pencils-12ct-packs/188535> [<https://archive.li/TwVAo>] (last visited Nov. 14, 2023) (listing a 12-pack of pencils for \$1.25—less than 11 cents each).

The answer lies in a loophole in a Washington, D.C. law known as Initiative 71, a ballot measure approved by the city's voters in 2014.³ "I-71" allows a person 21 years of age or older to possess up to two ounces of marijuana for recreational use.⁴ At first blush, I-71's enactment might have seemed like a promising opportunity for an entrepreneur hoping to be a pioneer in the recreational marijuana market, which was sure to grow into a lucrative and competitive new industry. However, even with the enactment of I-71, *buying* or *selling* marijuana for recreational use remained illegal.⁵ Of course, a would-be entrepreneur could have waited for further loosening of the city's marijuana laws in the hope that sales would eventually be legalized. But despite support from local officials, intransigent opposition in Congress made such a move unlikely, at least in the near term.⁶ On the other hand, an entrepreneur could have simply flouted the law and started selling marijuana—though doing so would risk criminal prosecution with penalties of up to five years imprisonment and a \$50,000 fine.⁷

Facing this choice of either too little reward for strict compliance, or too much risk for wanton disobedience, many entrepreneurs would likely have welcomed a third option. A loophole in the law provided just that. While prohibiting the "sale" of marijuana in exchange for money, goods, or services, I-71 also allows an individual to "transfer" up to one ounce of marijuana to another person as a gift.⁸ Under the aegis of this "gift

3. *Summary of D.C.'s Initiative 71*, MARIJUANA POL. PROJECT, <https://www.mpp.org/states/district-of-columbia/summary-of-d-c-s-initiative-71/>[<https://archive.li/hdpLZ>] (last visited Nov. 8, 2023).

4. See Marc Fisher et al., *With Marijuana Legalization, Green Rush Is on in D.C.*, WASH. POST (Feb. 25, 2015), https://www.washingtonpost.com/local/with-marijuana-legalization-green-rush-is-on-in-dc/2015/02/25/23c3f1de-bc78-11e4-b274-e5209a3bc9a9_story.html [<https://archive.li/brmXg>].

5. See Government of the District of Columbia, *Facts on Marijuana in DC*, https://mayor.dc.gov/sites/default/files/dc/sites/mayoromb/release_content/attachments/I-71Factsheet.pdf [<https://archive.li/RpP5U>] (last visited Apr. 29, 2022).

6. See Martin Auster Muhle, *Congress Maintains Ban on D.C. Legalizing Sales of Recreational Marijuana*, NAT'L PUB. RADIO (Mar. 10, 2022), <https://www.npr.org/local/305/2022/03/10/1085701595/congress-maintains-ban-on-d-c-legalizing-sales-of-recreational-marijuana> [<https://archive.li/xq1B0>]. Since 2015, Congress has imposed a rider on D.C.'s appropriations bill, essentially prohibiting the city from legalizing sales of recreational marijuana. *Id.*

7. D.C. CODE § 48-904.01 (2022).

8. Perry Stein, *Yes, You Can Give the Gift of Marijuana in D.C. Without Going to Jail*, WASH. POST (Jan. 7, 2016), <https://www.washingtonpost.com/news/local/wp/2016/>

loophole,” scores of entrepreneurs opened shops where each customer receives a “free gift” of marijuana with the purchase of an overpriced novelty item (such as a tee-shirt, coffee cup, keychain, rubber bracelet, sticker, or even a baseball card of former Cleveland Indians shortstop Julio Franco).⁹ This explains NKA’s \$550 pencil, which comes with such a free gift: one ounce of “Hoodie Pop,” an exotic marijuana flower.¹⁰

By exploiting this loophole, NKA and other I-71 shops avoided the risk of almost certain criminal penalties inherent in engaging in illegal activity.¹¹ And even if D.C. law were eventually to allow explicit sales of recreational marijuana, I-71 shops will have gained a first-mover advantage over any new market entrants by having already established their retail infrastructure, honed their business models, and garnered a customer base.¹²

01/07/yes-you-can-give-the-gift-of-marijuana-in-d-c-without-going-to-jail/
[<https://archive.li/Zh9Qn>]; see also *Facts on Marijuana in DC*, *supra* note 5.

9. Sophia Solano, *Keychains, QR Codes and Other ‘Gifts’ People Buy to Get Pot in D.C.*, WASH. POST (Apr. 19, 2023), <https://www.washingtonpost.com/dc-md-va/2023/04/19/i-71-cannabis-gifting-washington-dc/> [<https://archive.li/q5jWu>]; see also Ashraf Khalil, *Washington D.C. Has a Marijuana Loophole—You Can’t Sell It, but You Can ‘Gift’ It*, BUS. INSIDER (Sept. 28, 2017), <https://www.businessinsider.com/washington-dc-weed-gift-loophole-2017-9> [<https://archive.li/ZRQvZ>].

10. NKA, *supra* note 1.

11. Government of the District of Columbia, *Marijuana Arrests*, <https://opendata.dc.gov/datasets/DCGIS::marijuana-arrests/about> [<https://archive.li/NxzZD>] (last visited May 2, 2022). For example, D.C. police statistics show nearly 200 arrests in 2019 alone for distribution or possession with intent to distribute. *Id.*

12. See Gino Fanelli, *New York Cannabis Board Says Businesses Giving Away Marijuana Are Breaking the Law*, WXXI NEWS (Oct. 25, 2021), <https://www.wxxi.com/news/local-news/2021-10-25/new-york-cannabis-board-says-businesses-giving-away-marijuana-are-breaking-the-law> [<https://archive.li/jzlQM>] (last visited Jan. 17, 2023) (noting that “entrepreneurs are trying to get a jump on the new [recreational marijuana] industry through ‘gifting.’”). Also of note is the competitive advantage I-71 shops enjoy over the city’s licensed medical cannabis dispensaries, which must endure a tortuous and costly licensing process and, until 2023, could sell marijuana only to persons diagnosed with “qualifying medical conditions” who had obtained “medical marijuana cards” from physicians. See Government of the District of Columbia, *Medical Cannabis Program*, ALCOHOLIC BEVERAGE REGUL. ADMIN., <https://abra.dc.gov/page/medical-cannabis-program> [<https://archive.li/NOxaT>] (last visited May 2, 2022). Understandably, the licensed medical cannabis dispensaries lobbied the city government (unsuccessfully) to close the gifting loophole. See Andrew Beaujon, *‘We’ll Have to Close the Doors’: DC Cannabis Gifting Services Say New Legislation Would Obliterate Recreational Sales*, WASHINGTONIAN (Apr. 5, 2022), <https://www.washingtonian.com/2022/04/05/dc-cannabis-gifting-services-emergency-legislation/> [<https://archive.li/5e3ik>].

“Gifting” marijuana is one example of *loophole entrepreneurship*. Entrepreneurship, at its core, is the discovery, evaluation, and exploitation of a business opportunity;¹³ this Article defines loophole entrepreneurship as entrepreneurial activity where the opportunity being exploited is rooted in a legal loophole. Although no previous scholarship has focused on this topic, it is an ideal subject for the field of law and entrepreneurship because it reveals how legal rules and practices both *shape* and *adapt to* entrepreneurial activities.¹⁴

This Article seeks to establish a conceptual framework for understanding loophole entrepreneurship. Part I defines the concept, both independently and in relation to two similar phenomena: regulatory entrepreneurship and regulatory arbitrage. Part II presents a variety of case studies. By illustrating loophole entrepreneurship and revealing some of its nuances and complexities, these examples refine our understanding of the phenomenon. The case studies also suggest lessons for entrepreneurs, lawyers, policymakers, and the public.

Part III focuses on these lessons, which include the potential risks and rewards of building a business upon the inherently unstable foundation of a legal loophole, as well as the implications of loophole entrepreneurship both for policymakers and the public. A brief conclusion suggests additional areas for further research on this understudied subject.

I. UNDERSTANDING LOOPHOLE ENTREPRENEURSHIP AS A DISTINCT PHENOMENON

In defining loophole entrepreneurship, we must first understand the phrase’s constituent parts. Entrepreneurship has already been defined,¹⁵ so this Part begins by explaining the concept of loopholes or, more specifically, legal loopholes. From there, this Part will offer a general definition of loophole entrepreneurship, which will be refined through comparison to two related phenomena: regulatory entrepreneurship¹⁶ and regulatory arbitrage¹⁷.

13. See Darian M. Ibrahim & D. Gordon Smith, *Entrepreneurs on Horseback: Reflections on the Organization of Law*, 50 ARIZ. L. REV. 71, 84 (2008).

14. See *id.* at 88.

15. See *supra* note 13 and accompanying text.

16. See *infra* Part I.B.1.

17. See *infra* Part I.B.2.

A. LEGAL LOOPHOLES

A “legal loophole” is a discrete gap, an ambiguity, or a textual imperfection in a legal or regulatory scheme, which permits activity that formally complies with a law but in practice (at least arguably) avoids the law’s intended purpose.¹⁸ Legal loopholes are inevitable, given that even the most carefully crafted language is to some extent imprecise, and policymakers cannot possibly anticipate every technological, social, cultural, or entrepreneurial development that may come to bear on a law’s application.¹⁹ There are three ways legal loopholes typically form, and all of these give rise to entrepreneurial opportunities. These three ways will be discussed in turn.

1. *Intentional Loopholes*

Some loopholes are intentional, such as when policymakers deliberately carve out of an otherwise generally applicable law an exemption for a particular activity or business.²⁰ Although intentional loopholes by their nature admit some activity taking place outside the scope of a broader regulatory scheme, they may also operate in ways that

18. Adapted from Daniel T. Ostas, *Legal Loopholes and Underenforced Laws: Examining the Ethical Dimensions of Corporate Legal Strategy*, 46 AM. BUS. L. J. 487, 509 (2009). Professor Ostas defines “legal loophole” as follows: “an imperfection in the linguistic formulation of a legal text whereby a literal interpretation of that text does not conform to the definitive interpretation dictated by a good-faith application of formal legal reasoning techniques.” *Id.* For the purposes of this Article, the Author finds Professor Ostas’s definition too narrow. Some—but not all—legal loopholes are linguistic “imperfections,” others are deliberate and intentional products of careful policymaking, and, as such, cannot be characterized as “imperfections.” *See id.*; *see also infra* Part I.A.1 (discussing intentional loopholes) and Part I.A.3 (discussing intra-legal loopholes).

19. *See* Dan L. Burk, *Perverse Innovation*, 58 WM. & MARY L. REV. 1, 7–10 (2016); *see also* Ronny Frith, *Preventing and Avoiding Loopholes and Unintended Consequences in Legislation*, NAT’L CONF. OF STATE LEGISLATURES (Oct. 11, 2012).

20. While a comprehensive exploration of the political-economic implications of loophole entrepreneurship is largely beyond the scope of this Article, intentional loopholes raise important and contentious questions about cronyism, regulatory capture, rent seeking, and public choice/interest group theories of political economy. For example, when policymakers carve out of a regulation a loophole benefitting one business or industry, it may be the result of political rent-seeking. *See infra* Conclusion; *see also* Michael C. Munger & Mario Villareal-Diaz, *The Road to Crony Capitalism*, 23 INDEP. REV. 331 (2019) (describing generally how state actors selling off rents incentivizes entrepreneurs to become rent seekers).

policymakers neither intended nor foresaw. Marijuana “gift” exceptions, such as Washington, D.C.’s I-71, demonstrate how an intentional loophole can lead to unexpected consequences.²¹ Adam Eiding, I-71’s author, intended for the gifting loophole merely to allow individuals to share a small amount of marijuana, without compensation and only with their friends and family.²² He did not intend—and claims he did not foresee—that this provision would spawn commercial activity militating against the law’s explicit prohibition of recreational marijuana sales.²³

But the I-71 gifting exception did just that because of its broad language, which allows a person 21 years of age or older to “[t]ransfer to another person 21 years of age or older, without remuneration, marijuana weighing one ounce or less.”²⁴ By contrast, some other jurisdictions that prohibit recreational marijuana sales, but permit gifting, employ statutory language tailored to avoid unintended commercialization.²⁵ Connecticut’s gifting provision, for example, allows for a “gift of cannabis *between individuals with a bona fide social relationship*, provided such gift is made without consideration and is *not associated with any commercial transaction*.”²⁶ Both the requirement of a bona fide social relationship and the stipulation that the gift not be *associated with any* commercial transaction, foreclose the possibility that Connecticut’s loophole would

21. See *infra* notes 24–26 and accompanying text. Another example is Florida’s “Busch Gardens loophole,” described below in the Florida Craft Breweries case study. See *infra* Part II.H. In short, the Florida legislature created a loophole intended to benefit only one business (Busch Gardens). See *id.* But it unexpectedly proved advantageous to the state’s craft breweries, and virtually all of them were operating under the loophole by 2015. See *id.* Likewise, Section 230 of the Communications Decency Act (discussed *infra* Part II.B) is an intentional loophole, exempting from common law publisher liability creators of websites where third parties post defamatory material.

22. See *With Pot Legalized in DC, Some Are Gifting Marijuana for the Holidays*, FOX 5 DC (Dec. 21, 2015), <https://www.fox5dc.com/news/with-pot-legalized-in-dc-some-are-gifting-marijuana-for-the-holidays> [<https://archive.li/EP1tx>]. In December 2015, the first holiday season after I-71 passed, Eiding said in an interview, “It’s a lovely holiday season because you can give cannabis to your friends in Washington, D.C.” *Id.* Eiding emphasized that “gifts” should involve only homegrown marijuana, and only in amounts less than one ounce, only to be consumed in private homes. *Id.*

23. Ellison Barber, *Are D.C.’s Weed Delivery Services Legal?*, WUSA9 (Feb. 12, 2017), <https://www.wusa9.com/article/news/local/dc/are-dcs-weed-delivery-serviceslegal/65-407594118> [<https://archive.ph/Cc9xj>].

24. D.C. CODE § 48-904.01(a)(1)(B).

25. See CONN. PUB. ACTS 22-103 § 2.

26. *Id.* (emphasis added).

provide reasonable legal justification for the kind of gifting shops that I-71 (at least arguably) permits.

2. Unintentional Loopholes

Unlike an intentional loophole (which may or may not lead to unintended consequences), an unintentional loophole was never intended to be a loophole at all. Unintentional loopholes typically arise either from sloppy draftsmanship or from unforeseen changes in circumstances, such as technological advancements that were not contemplated by policymakers at the time a law was enacted.²⁷ The revision of the Copyright Act in 1976 is an example of both.²⁸ In an effort to bring the 1909 Copyright Act “into greater conformity with new technologies of cable television, xerography, and computer-aided information retrieval,”²⁹ the 1976 statute gives a copyright owner the exclusive right, “in the case of . . . motion pictures and other audiovisual works, to perform the copyrighted work publicly.”³⁰ The Act defines “publicly perform” to include “to transmit or otherwise communicate a performance or display of the work to . . . the public”³¹

In a 2008 case, the Second Circuit noted that “the transmit clause is not a model of clarity.”³² For instance, would “transmit or otherwise communicate”³³ include a home recording of a live, local television broadcast that a single family could watch later? And would that single family count as “the public”?³⁴ In short, the clause is susceptible to multiple, perhaps competing, interpretations that could form the basis of an unintentional loophole. Additionally, the Act’s application to rapidly evolving video recording and transmission technology has proven challenging.³⁵ In 1984, amidst the growing popularity of VCRs, the

27. See Ostas, *supra* note 18, at 510, 520.

28. See *infra* notes 29–38 and accompanying text.

29. Stanley M. Besen et al., *Copyright Liability for Cable Television: Is Compulsory Licensing the Solution?*, RAND CORP., Feb. 1977, at 9–10, <https://www.rand.org/content/dam/rand/pubs/reports/2006/R2023.pdf> [<https://archive.li/WLEGP>].

30. 17 U.S.C. § 106(4).

31. *Id.* § 101.

32. *Cartoon Network LP v. CSC Holdings, Inc.*, 536 F.3d 121, 136 (2d Cir. 2008).

33. 17 U.S.C. § 106(4).

34. *Id.*

35. *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417, 500 (1984) (Blackmun, J., dissenting) (noting the “many . . . problems created by the interaction of copyright law with new technologies”); see also *infra* Part II.D.

Supreme Court held that the Act's "fair use" exception permitted the home recording of a TV program for later private viewing.³⁶ In 2008, the Second Circuit's decision in *Cartoon Network* expanded this exception to include remote-storage DVR ("RS-DVR") systems that record and then rebroadcast for private viewing individual copies of TV programs selected by customers.³⁷ Thus, in determining the inapplicability of an ambiguous provision to a novel technology, courts effectively created a legal loophole, out of which grew entrepreneurial activity.³⁸

3. *Inter-legal Loopholes*

Still other loopholes may form when a law interacts with other laws. These "inter-legal loopholes" can be intentional or unintentional.³⁹ They often result from intrastate preemption, which occurs when a local government's authority to legislate or regulate in a particular area has been supplanted by state law.⁴⁰ Examples are legion, and they address

36. *Sony Corp.*, 464 U.S. at 454–55.

37. *Cartoon Network*, 536 F.3d at 135 (The Second Circuit held that such a system did not violate the Act, given that "if each transmission is to an audience of one, the transmission is not 'public.'").

38. *Id.* The court-created loophole in the transmit clause spawned not only VCRs and RS-DVRs but also *American Broadcasting Companies, Inc. v. Aereo, Inc.*, 573 U.S. 431 (2014) [hereinafter "*ABC v. Aereo*"], described in the case study below. See *infra* Part II.D.

39. See, e.g., *infra* Part II.E (describing an *intentional* inter-legal loophole); *Lieutenant Kenton Turner Honored with the Recreational Boating Safety Program's Award of Excellence*, NAT'L ASS'N OF STATE BOATING L. ADMIN. (Mar. 7, 2023), <https://community.nasbla.org/blogs/taylor-matsko/2023/03/07/lt-turner-honored-rbs-program-award-excellence> [<https://archive.li/pYa0f>] (noting that a Coast Guard Interim Final Rule created an *unintentional* inter-legal loophole in states' enforcement of inland navigation rules).

40. See Paul Diller, *Intrastate Preemption*, 87 B.U. L. REV. 1113, 1114 (2007). Diller points out that local (and state) laws are of course subject to federal preemption, but it is intrastate preemption that most often leads businesses and industry groups to initiate litigation to "block local policies that may impose additional costs and regulatory burdens." *Id.* Intrastate preemption can be used "both as a scalpel to carve out specific local laws and as a nuclear bomb to decimate . . . a locality's ability to regulate whole sectors of the government." *Preemption 101: Part One: State Preemption Unleashed*, NEW AM., <https://www.newamerica.org/political-reform/reports/punching-down/part-one-state-preemption-unleashed/> [<https://archive.li/cx3ER>] (last visited Feb. 4, 2023).

issues ranging from smoking in bars,⁴¹ to fossil fuels,⁴² to for-hire vehicles.⁴³

One loophole created by intrastate preemption has fostered business activity among some of the youngest entrepreneurs.⁴⁴ In June 2015, two sisters, ages seven and eight, set up a lemonade stand in Overton, Texas, to raise money to take their father to a water park for Father's Day.⁴⁵ Within hours, local police shut it down.⁴⁶ The girls—who were selling lemonade for fifty cents and kettle corn for one dollar (with a special price of one dollar for both items)—had already earned \$25 when the city's code enforcement officer and police chief arrived and ordered the girls to cease operations because they lacked both a \$150 “peddler's permit” from the city and a health permit from Rusk County.⁴⁷

41. Since the 1980s, 25 states enacted statutes circumscribing local governments' authority to regulate smoking. Eric Crosbie & Laura A. Schmidt, *Preemption in Tobacco Control: A Framework for Other Areas of Public Health*, 110 AM. J. PUB. HEALTH 345, 345 (Mar. 2020). A 1994 Tennessee law, for instance, preempted local government authority to regulate smoking in public places. TENN. CODE § 39-17-155 (“The general assembly preempts and occupies the entire field of legislation concerning the regulation of tobacco products, smokeless nicotine products, and vapor products.”). As a result, many of Nashville's famous honky-tonks continued to permit smoking, with some even touting smoking as part of their “culture.” Cassandra Stephenson, *Council: No More Smoking in Nashville Bars*, TENNESSEAN (Oct. 18, 2022), <https://www.tennessean.com/story/news/local/davidson/2022/10/19/nashville-bars-city-council-passes-ordinance-prohibiting-smoking/69564160007/> [<https://archive.li/sDbHf>]. The preemption law was repealed in 2022, and Nashville's local government swiftly passed an ordinance banning smoking in the city's bars and honky-tonks. *Id.*

42. See, e.g., Patrick Gleason, *Why States Continue to Overrule Local Regulation of Fossil Fuels*, FORBES (Apr. 19, 2022), <https://www.forbes.com/sites/patrickgleason/2022/04/19/why-states-continue-to-overrule-local-regulation-of-fossil-fuels/?sh=7611a33769e2> [<https://archive.li/dRGgO>].

43. See *infra* Part II.E (describing Nashville party buses' exploitation of an inter-legal loophole). Other case studies involving entrepreneurship based on inter-legal loopholes are Blueseed and DraftKings/FanDuel. See *infra* Parts II.F and II.G.

44. Kenneth Dean, *Support Overflows for Lemonade Stand Girls in Overton*, TYLER MORNING TEL. (June 9, 2015), https://tylerpaper.com/news/local/update-support-overflows-for-lemonade-stand-girls-in-overton/article_3da64883-3fdf-52c2-9520-23f274934832.html [<https://archive.ph/xnwpD>].

45. *Id.*

46. *Id.*

47. *E. Texas Police Shut Down Girls' Lemonade Stand, Demand Permit*, KLTV (June 9, 2015), <https://www.kltv.com/story/29279529/e-texas-police-shut-down-girls-lemonade-stand-demand-permit/> [<https://archive.li/0hjEH>]. Since most children's lemonade stands could be expected to reap profit in the double digits or low triple digits, the compliance costs of permitting regulations such as these would be prohibitive,

In response to public outcry, the Texas legislature passed a bill, signed into law by Governor Greg Abbott in 2019, preempting local authority to regulate lemonade stands.⁴⁸ This “Lemonade Stand Law,” provides:

Notwithstanding any other law, a municipality, county, or other local public health authority may not adopt or enforce an ordinance, order, or rule that prohibits or regulates, including by requiring a license, permit, or fee, the occasional sale of lemonade or other nonalcoholic beverages from a stand on private property or in a public park by an individual younger than 18 years of age.⁴⁹

The law also prohibits property owners’ associations (“HOAs”) from adopting or enforcing restrictive covenants that would disallow lemonade stands.⁵⁰ The state law thereby creates an inter-legal loophole in local regulations, allowing young lemonade-stand entrepreneurs to avoid otherwise prohibitive regulatory compliance costs.

4. Courts and Legal Loopholes

Like legislatures and regulators, courts have a role in creating, maintaining, closing, and defining the contours of legal loopholes. This Article already mentioned one example of this phenomenon.⁵¹ As previously discussed, the Supreme Court in the 1980s first created a legal loophole for home recording equipment (“VCRs”) in the Copyright Act, and in the early 2000s, the Second Circuit expanded that loophole to cover remote-service RS-DVRs.⁵² But in 2014, the Supreme Court narrowed that loophole when it excluded Aereo (discussed in detail below), despite a colorable—and, according to many, compelling—argument that Aereo’s technology fit neatly into the loophole courts had established in the two earlier cases.⁵³

effectively chilling such entrepreneurial activity. *Id.* The girls had initially considered starting a paper route, but they opted instead for a lemonade stand to raise the money more quickly. *Id.*

48. *Lemonade Stand Bill Passes!*, TEX. COTTAGE FOOD L., <https://texascottagefoodlaw.com/lemonade/> [<https://archive.li/mbcTg>] (last visited Feb. 4, 2023).

49. TEX. LOC. GOV’T CODE § 250.009.

50. *Id.* § 202.020.

51. *See supra* Part I.A.2.

52. *See supra* notes 32–38 and accompanying text.

53. *See infra* Part II.D.

The Court's creation of a loophole in the Copyright Act stemmed from ambiguity in the statutory language, further complicated by the advent of new technology (VCRs and RS-DVRs) that was not available at the time the law was drafted. But courts have taken active roles in loophole management even where statutory language is clear. In the case of "revenge porn" and "sextortion" website UGotPosted (also discussed in detail below), the court ruled that a publisher-liability loophole created by Section 230 of the Communications Decency Act ("CDA") did not apply, even though under a plain language reading of the statute, it did.⁵⁴ The Act states, "No provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider."⁵⁵ Kevin Bollaert, the loophole entrepreneur who founded UGotPosted, created the website, but he did not personally post any unlawful content to the site (this was provided by ex-lovers or personal enemies).⁵⁶ Bollaert argued, therefore, that he was not liable as an "information content provider."⁵⁷

Although the Court agreed that the CDA had "been held to confer broad immunity against defamation and other civil liability for those who use the Internet to publish information originating from another source,"⁵⁸ the court ultimately found that Bollaert's actions fell "outside the scope of CDA immunity."⁵⁹ The Court reasoned that his site was "designed to solicit" content that was unlawful, "demonstrating that Bollaert's actions were not neutral, but rather materially contributed to the illegality of the content and the privacy invasions suffered by the victims."⁶⁰ Nothing in the Act suggests an exception to Section 230 immunity for websites that are "designed to solicit" content—even unlawful content—from third parties.⁶¹ But the Court seemed to go out of its way to close the loophole

54. See *infra* Part II.B.

55. 47 U.S.C. § 230(c)(1); see also *People v. Bollaert*, 248 Cal. App. 4th 699, 709 (Ct. App. 2016) (citing 47 U.S.C. § 230(e)(3)) (noting "The CDA further states: 'No cause of action may be brought and no liability may be imposed under any State or local law that is inconsistent with this section.'").

56. *Bollaert*, 248 Cal. App. 4th at 706, 710.

57. See *id.* at 704.

58. *Id.* at 709.

59. *Id.* at 721.

60. *Id.*

61. See 47 U.S.C. § 230(c)(1). Indeed, any site that allows users to post content can be characterized as "designed to solicit" content to some degree. Under the court's logic, the exception would seemingly swallow the rule. See Eric Goldman, *Some Comments on the CA/TX Attorneys' General Prosecution of Backpage's Executives*, TECH. &

because of the specific facts and circumstances of the case: a wholly unsympathetic defendant engaging in activity that most people would find reprehensible.⁶²

The role of courts in creating and closing loopholes is controversial, implicating issues of separation of powers and democratic self-government.⁶³ After all, in a republican democracy, it is the role of the elected legislature to make the laws and to provide, or not to provide, exceptions.⁶⁴ The judiciary is merely authorized to apply the laws as enacted.⁶⁵ Justice Antonin Scalia addressed this issue in *ABC v. Aereo*.⁶⁶ Again, details of the loophole at issue are discussed in the *Aereo* case study below, but it is worth noting here that while a six-justice majority closed the loophole, Justice Scalia believed this constituted judicial usurpation of legislative authority. “[W]hat we have before us must be considered a ‘loophole’ in the law.”⁶⁷ “It is not the role of this Court to

MARKETING L. BLOG (Oct. 13, 2016) (arguing that Section 230’s “edges have become so rough that the exceptions are beginning to swallow up the rule”).

62. See, e.g., Kirstina Davis & Pauline Repard, *SD Man Arrested in “Revenge Porn” Case*, S.D. UNION-TRIB. (Dec. 10, 2013), <https://www.sandiegouniontribune.com/sdut-bollaert-revenge-porn-arrest-2013dec10-story.html> [<https://perma.cc/H7RU-KWYP>] (quoting California Attorney General Kamala Harris describing Bollaert’s conduct as “reprehensible”); Thomas Gorton, *Operator of Heinous Revenge Porn Site Convicted in Court*, DAZED DIGIT. (Feb. 3, 2015), <https://www.dazeddigital.com/artsandculture/article/23485/1/u-got-posted-revenge-porn-site-operator-convicted> [<https://perma.cc/MPA3-9LFZ>] (describing the site as “heinous” and “a moral graveyard,” and noting that Bollaert’s own lawyer admitted that what Bollaert did was “gross and offensive”).

63. See, e.g., Eric Black, *How the Supreme Court Has Come to Play a Policymaking Role*, MINNPOST (Nov. 20, 2012), <https://www.minnpost.com/eric-black-ink/2012/11/how-supreme-court-has-come-play-policymaking-role/> [<https://perma.cc/SB6B-6QLT>] (criticizing the Court for using “the power of judicial review to expropriate from Congress the role of lawmaker” when the Court created a “loophole” in campaign finance law).

64. See *ABC v. Aereo*, 573 U.S. at 462 (Scalia, J., dissenting) (noting that “Congress can [close a loophole] . . . in a much more targeted, better informed, and less disruptive fashion [than the Court].”); but see Bruce G. Peabody, *Legislating from the Bench: A Definition and a Defense*, 11 LEWIS & CLARK L. REV. 185, 185 (2007) (suggesting that certain “aspects of legislating from the bench are both inevitable and desirable”).

65. See, e.g., Donald B. Verilli Jr., *The Rule of Law: More than Just a Law of Rules*, NEB. L. REV. (Sept. 28, 2018), <https://lawreview.unl.edu/rule-law-more-just-law-rules> [<https://perma.cc/2E4W-NGMQ>] (quoting Senator Chuck Grassley’s opening statement at the Kavanaugh confirmation hearing: “The role of the judge is to apply the law as written”).

66. *ABC v. Aereo*, 573 U.S. at 462–63 (Scalia, J., dissenting).

67. *Id.* at 462.

identify and plug loopholes. It is the role of good lawyers to identify and exploit them and *the role of Congress* to eliminate them if it wishes.”⁶⁸

In fact, this is precisely what Congress did when it amended the Copyright Act in 1976.⁶⁹ In cases in 1968 and 1974, the Court had held that community antenna television (“CATV”) systems fell outside the scope of the Act because these systems did not “perform” the works they transmitted.⁷⁰ Thus, the cable television industry was exempted from paying royalties to copyright owners whose programs the cable networks carried.⁷¹ At that point, the Act had remained unchanged since 1909—decades before television (much less cable television) existed.⁷² Congress amended the Act in 1976 specifically to close this court-created loophole and bring cable television within the scope of the Act.⁷³ Justice Scalia would likely contend that this is how the system is supposed to work. But as the *ABC v. Aereo* majority⁷⁴ and the *Bollaert* decision⁷⁵ show, this is not always the case, and in reality, courts play active and essential roles in loophole management.

68. *Id.* (emphasis added). Of course, Justice Scalia failed to mention that the loophole at issue in *ABC v. Aereo* was the VCR and RS-DVR exception to the Copyright Act’s transmit clause, which courts themselves had created in two earlier cases. *See supra* notes 29–38 and accompanying text. Given that courts—not Congress—had created the loophole, one might justifiably argue that it was the Court’s—not Congress’s—prerogative to narrow (or even close) it. But be that as it may, the history of the Copyright Act supported Justice Scalia’s point, given that Congress had previously closed court-created loopholes in the Act. *See infra* notes 69–73 and accompanying text.

69. *See infra* notes 70–73 and accompanying text.

70. *Fortnightly Corp. v. United Artists Television, Inc.*, 392 U.S. 390 (1968); *Teleprompter Corp. v. Columbia Broad. Sys., Inc.*, 415 U.S. 394 (1974).

71. *See id.*; *see also* Susan C. Greene, *The Cable Television Provisions of the Revised Copyright Act*, 27 CATH. U. L. REV. 263, 265 (1978) (noting that although the 1909 Act conferred copyright liability on the broadcast media, courts had never interpreted the Act to impose similar liability on cable television systems).

72. GENERAL GUIDE TO THE COPYRIGHT ACT OF 1976 (U.S. COPYRIGHT OFF. Sept. 1977), <https://www.copyright.gov/reports/guide-to-copyright.pdf> [<https://perma.cc/7SLA-WLAB>].

73. *See* Greene, *supra* note 71, at 26; *see also* GENERAL GUIDE TO THE COPYRIGHT ACT OF 1976 7:3, *supra* note 72 (“Under the definition of ‘perform’ in section 101 [of the 1976 Act], it is clear that the following would constitute a performance a work: . . . transmission and retransmissions by cable . . .”).

74. *See supra* note 53 and accompanying text.

75. *See supra* notes 59–62 and accompanying text.

B. DEFINING LOOPHOLE ENTREPRENEURSHIP

Having thus defined both constituent words in the term, we can define “loophole entrepreneurship” as follows: the discovery, evaluation, and exploitation of an opportunity created by a legal loophole that is fundamental to the entrepreneur’s business model.⁷⁶ Loophole entrepreneurship occurs when a legal loophole is the *source* of an entrepreneurial opportunity. This definition excludes the exploitation of loopholes that are merely *incidental* to a business model (e.g., loopholes in tax, zoning, employment, or other laws that are generally not a material part of the business plan).⁷⁷ Such laws apply broadly, and all companies naturally want them to bear favorably on their businesses.⁷⁸ What distinguishes loophole entrepreneurship from mere loophole exploitation is that the former requires not simply taking advantage of a favorable legal loophole, but rather building a business on that loophole. Of course, this definition raises a question of boundaries: at what point does a legal loophole become “fundamental enough” to an entrepreneur’s business plan to make the company a loophole entrepreneur?⁷⁹ Admittedly, the answer will often depend on specific circumstances, and there will be some close cases. But the main issue this Article addresses is not to establish a precise boundary. Rather, it is to recognize loophole entrepreneurship as a distinctive activity—wherever its boundaries may

76. This definition is adapted from Ibrahim and Smith’s general definition of “entrepreneurship.” Ibrahim, *supra* note 13, at 84 (“entrepreneurship is often defined as the discovery, evaluation, and exploitation of opportunities”).

77. There may, however, be cases where such laws are in fact fundamental to the business model. For example, a loophole in European tax laws exempts nonresidents from paying Value-Added Tax (“VAT”) on goods purchased within the EU. See Shoshanna Solomon, *VAT-Refund Startup Refundit Raises \$9.8 Million Led by Travel-Tech Giant Amadeus*, TIMES OF ISR. (Nov. 14, 2019), <https://www.timesofisrael.com/vat-refund-startup-refundit-raises-9-8-million-led-by-travel-tech-giant-amadeus/> [<https://perma.cc/J3TM-4JSE>]. One company, Refundit, created a business based on this loophole. *Id.* Refundit’s mobile app allows nonresidents easily to receive refunds on the VAT paid in EU countries. *Id.* In this case, the tax loophole is not simply benefiting the company for the purposes of its own tax liability, but rather it is the company’s *raison d’être*. See *id.*

78. See Elizabeth Pollman & Jordan M. Barry, *Regulatory Entrepreneurship*, 90 S. CAL. L. REV. 383, 392 (2017).

79. See *id.* at 392–93. This question—and the answer that follows—are adapted from a point Pollman and Barry make about boundaries in “regulatory entrepreneurship,” which is discussed more fully below. See *infra* Part I.B.1.

lie. This will allow for examination of the implications that flow from the phenomenon.⁸⁰

Loophole entrepreneurship arises in almost every regulated industry from airlines⁸¹ to psychedelic drugs.⁸² And loophole entrepreneurship can occur not only on a large-scale, industry-changing level (in the way that, as we will see, Southwest Airlines contributed to airline deregulation),⁸³ but also in a wholly local context (such as D.C.'s I-71 shops or Texas's lemonade stands).⁸⁴

1. Loophole Entrepreneurship vs. Regulatory Entrepreneurship

Elizabeth Pollman and Jordan Barry have identified a phenomenon they call regulatory entrepreneurship: “pursuing a line of business in which changing the law is a significant part of the business plan.”⁸⁵ One high-profile example is Uber, which flouted for-hire vehicle regulations in New York City and elsewhere, with the deliberate intention of changing those laws in favor of its business.⁸⁶ Like regulatory entrepreneurs, loophole entrepreneurs “pursue a line of business that has a legal issue at its core.”⁸⁷ For regulatory entrepreneurs “changing the law is . . . a material part of the business plan,”⁸⁸ but loophole entrepreneurs, by contrast, at least initially, usually do not seek any change in the law.⁸⁹

80. See Pollman, *supra* note 78.

81. See *infra* Part II.A. Southwest Airlines, for example, was founded on a loophole in the Civil Aeronautics Act, which generally exempted *intrastate* carriers from regulatory oversight by the federal Civil Aeronautics Board. See *Courting Success: Early Southwest Legal Battles*, SW. AIRLINES, <https://southwest50.com/our-stories/courting-success-early-southwest-legal-battles/> [<https://perma.cc/M2AT-RUFR>] (last visited Mar. 17, 2022).

82. See Jessica Bateman, *Berlin Now Has an LSD Shop, Thanks to a Loophole in the Law*, VICE (June 21, 2021), <https://www.vice.com/en/article/y3dbn7/berlin-bsd-shop-carl-trump> [<https://perma.cc/V44Q-XNVS>] (LSD Store in Berlin sells novel LSD analogs not (yet) prohibited by German narcotics laws, which ban specific chemical compounds rather than broad categories of drugs (e.g., psychedelics)); see also *infra* Part II (discussing LSD Store as a case study in loophole entrepreneurship).

83. See *infra* Part II.A.

84. See *supra* notes 1–12 and accompanying text, and notes 44–50 and accompanying text.

85. Pollman, *supra* note 78.

86. See *id.* at 385–86.

87. *Id.* at 392.

88. *Id.* at 393.

89. Moreover, and more to the point of distinguishing loophole and regulatory entrepreneurship, a loophole entrepreneur does not *need* the law to change at the *outset*

Rather, they benefit from the law as it exists and would likely regard change as detrimental, given that the current law (the loophole) is a source of competitive advantage.⁹⁰ Admittedly, there will be some marginal cases where the distinction is debatable. But differentiating the two generally turns on the straightforward question: “Does the law necessarily need to change for the business model to be (arguably) legal?” A regulatory entrepreneur would answer “yes;” a loophole entrepreneur would answer “no.”

Of course, some might argue that exploitation of a loophole is not legal when it contravenes a law’s “spirit” even if it is technically compliant with the “letter” of the law. For example, despite the pretext of free gifts, D.C.’s I-71 shops are quite obviously engaging in *de facto* sales of recreational marijuana in a city that expressly prohibits it.⁹¹ One D.C. police official said of the gifting shops, “In our estimation, that’s still illegal” (though the police have generally declined to pursue marijuana gifting as a crime).⁹² Even I-71’s author, Adam Eidinger, has suggested that the gifting shops’ activity is not within the scope of the law: “We voted on legalization without commercialization As the author of the law, as someone who has consulted multiple lawyers to interpret what we

in order for the business model to be legal—notwithstanding the fact that some *future* change in the law may eventually be *desirable*.

90. That said, while forming a business in a legal loophole can be advantageous, the contours of the loophole may circumscribe future growth. For example, under the so-called laboratory developed test (“LDT”) loophole in FDA regulations, Theranos was able to avoid the FDA’s lengthy and costly “premarket approval” process for its testing devices. But under this loophole, only Theranos’s own labs could use the devices, foreclosing the possibility that Theranos could have sold the devices to other labs (a potentially lucrative market). See JOHN CARREYROU, *BAD BLOOD: SECRETS AND LIES IN A SILICON VALLEY STARTUP* 121 (Alfred A. Knopf, 1st ed. 2018); see also *infra* Part II.C. Similarly, Southwest Airlines would have been confined to operating only within Texas had it not been for airline deregulation in the late-1970s. See Jibrán Khan, *Herb Kelleher’s Southwest Airlines Showed the Value of Playing Fair*, NAT’L REV. (Jan. 10, 2019), <https://www.nationalreview.com/2019/01/herb-kelleher-southwest-airlineschang-ed-air-travel-forever/> [<https://perma.cc/XY9G-LV93>]. But whatever future benefit a loophole entrepreneur may derive from a change in the law does not detract from the competitive advantage (in the form of avoidance of regulatory costs borne by its competitors) gained from the existing law at the time a loophole entrepreneur starts a business.

91. See *supra* notes 1–12 and accompanying text.

92. Khalil, *supra* note 9.

wrote, there's nothing in there that says you can get money for marijuana."⁹³ In short, according to Eiding, there is no loophole.⁹⁴

Be that as it may, compliance with a law need not be wholehearted and fulsome in order to be legitimate.⁹⁵ And D.C.'s gifting shops appear to take I-71 compliance seriously, being careful never to suggest that marijuana is their merchandise, and making clear to customers at all stages of the transaction that the customers are buying the novelty items—not the marijuana.⁹⁶ To that end, the FAQ section of NKA's website, in response to "What do you sell?" explains, "We offer custom pencils in the local Washington, DC area."⁹⁷ With every purchase, you receive a free Initiative 71 gift."⁹⁸ Similarly, the owner of HighSpeed, an I-71 business selling cold-pressed juice (and "a side of 'love'" for a higher price), emphasizes, "Before anything else. We are a cold press juice delivery company. We sell cold pressed juice. Anyone that has used HighSpeed [the juice] and got cannabis it was Christmas And that's why we're legal."⁹⁹ The marijuana advocacy website "Cannassentials" notes that I-71 shops will almost invariably deny service to anyone who asks outright

93. Barber, *supra* note 23. Interestingly, Eiding has openly admitted to patronizing gifting services: a *Washington Post* article about Dreamy, an I-71 business that sells motivational talks (with a free gift), mentions that Eiding had twice ordered a Dreamy speech. Justin Wm. Moyer, *To 'Gift' Marijuana, D.C. Companies Must Sell Something. This One Sells Motivational Speeches*, WASH. POST (Mar. 19, 2022), <https://www.washingtonpost.com/dc-md-va/2022/03/19/dreamy-dc-marijuana-motivational-speech/> [<https://perma.cc/N3RT-DABW>].

94. Barber, *supra* note 23. In some jurisdictions, gifting has officially been deemed illegal. *See, e.g.*, Fanelli, *supra* note 12 (describing the New York Cannabis Control Board decision declaring that promotional marijuana "gifts" are illegal under the state's law).

95. As Ludwig von Mises famously observed, "What is a loophole? If the law does not punish a definite action or does not tax a definite thing, this is not a loophole. It is simply the law." Joseph T. Salerno, *What Ludwig von Mises Taught Gottfried Haberler and Paul Samuelson About Tax Loopholes*, MISES INST. (Nov. 27, 2012), <https://mises.org/wire/what-ludwig-von-mises-taught-gottfried-haberler-and-paul-samuelson-about-tax-loopholes> [<https://perma.cc/JV8B-VV6W>].

96. *FAQ*, NKA, <https://www.nokidsalloweddc.com/#FAQ> [<https://perma.cc/E3DM-E5LJ>] (last visited May 4, 2022).

97. *Id.*

98. *Id.*

99. Barber, *supra* note 23.

to buy marijuana.¹⁰⁰ Instead, the site claims that both buyers and sellers conform to a coded language throughout the transaction:

Here is an example of how a conversation will go:

Buyer: “Hi I would like to see your [I-71] Gift Menu Please”

DC Smoke Shop: “sure here are all our gifts”

Buyer: “Ok I would like to buy this \$70 art print and take this 8th of Tropicana Cookies as my gift”

DC Smoke Shop: “Sure no problem let me ring you up for this art print first”

Notice the unique verbiage there? You have to always refer to the marijuana as a gift and the item (sticker, art print, etc[.]) as the item you are purchasing.¹⁰¹

Moreover D.C.’s government recently considered legislation that would have eliminated the gifting loophole, in an effort to close the I-71 shops.¹⁰² The bill was ultimately defeated, but the fact that it was even considered suggests that the gifting shops are legal under current law—otherwise the proposed legislation would have been superfluous.

Although regulatory entrepreneurship and loophole entrepreneurship are thus distinct, they may employ some of the same strategies to create or maintain a favorable legal scheme, such as political lobbying, “guerilla growth” (i.e., growing “too big to ban”), and mobilizing stakeholders as a political force.¹⁰³ But regulatory entrepreneurs would use these techniques to change the law; loophole entrepreneurs would use them to preserve the loophole.

100. *How to Buy Weed in DC Safely in 2023*, CANNASSENTIALS (July 31, 2023), <https://cannassentials.co/how-to-find-weed/dc-weed-top-dc-smoke-shop> [<https://perma.cc/5JHP-E5BC>].

101. *Id.*

102. Martin Austermuhle, *D.C. Council Votes down Bill That Would Have Shuttered Marijuana Gifting Businesses*, DCIST (Apr. 5, 2022), <https://dcist.com/story/22/04/05/dc-council-rejects-bill-closing-marijuana-gifting-shops/> [<https://perma.cc/ER57-GJRV>].

103. See Pollman, *supra* note 78, at 390.

2. Loophole Entrepreneurship vs. Regulatory Arbitrage

Loophole entrepreneurship and regulatory entrepreneurship are also distinguishable from regulatory arbitrage, which occurs when a business changes the form of a transaction, but not its substance, to take advantage of more favorable regulatory treatment.¹⁰⁴ For example, Blackstone Group's 2007 IPO sold limited partnership units rather than common stock to investors, so Blackstone could retain partnership tax status and its advantageous tax rate on carried interest and avoidance of corporation level tax.¹⁰⁵ Whereas regulatory entrepreneurs "seek to change the law as part of their plan to earn profits," regulatory arbitrageurs, on the other hand, "essentially take the law as a given, then try to take advantage of the law as best they can by making minor alterations to their behavior."¹⁰⁶

Like regulatory arbitrageurs, loophole entrepreneurs "essentially take the law as given"¹⁰⁷ so loophole entrepreneurship may, at first blush, seem to be a form of regulatory arbitrage. For instance, like Blackstone, which chose to sell partnership units rather than common stock to investors so that it could benefit from a more favorable tax law, Washington, D.C.'s I-71 retailers deliberately sell novelty items (with free gifts of marijuana) rather than selling marijuana directly in order to benefit from the loophole that renders their business model legal.¹⁰⁸ But tailoring business plans in this way can hardly be considered "*minor* alterations to [entrepreneurs'] behavior."¹⁰⁹ Rather, loophole entrepreneurship requires *the entire business model* to be designed to fit the contours of a legal loophole.¹¹⁰

Loophole entrepreneurship differs from regulatory arbitrage in other ways as well. Victor Fleischer characterizes regulatory arbitrage as a "pernicious" phenomenon, which is "often privately beneficial and

104. *Id.* at 397; see Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227 (2010) (offering a comprehensive discussion of regulatory arbitrage).

105. Fleischer, *supra* note 104, at 245.

106. Pollman, *supra* note 78, at 397.

107. *See id.*

108. *See supra* notes 1–12 and accompanying text.

109. *See* Pollman, *supra* note 78, at 397.

110. The case studies below further illustrate this point. *See infra* Part II. Southwest Airlines, for instance, formed as an intrastate—rather than interstate—airline to avoid being subject to regulation by the federal Civil Aeronautics Board. *See infra* Part II.A. Blueseed's tech incubator would have been a seastead (rather than based on land) to avoid U.S. immigration laws. *See infra* Part II.F.

socially wasteful” and “shift[s] regulatory burdens in unjust ways.”¹¹¹ He further argues that the “rich, sophisticated, well-advised, and politically connected” exploit regulatory arbitrage to avoid regulatory burdens “the rest of us” comply with.¹¹²

Loophole entrepreneurship, by contrast, is not inherently pernicious. While loophole entrepreneurs certainly seek private benefit (what for-profit business does not do so?), this is not necessarily socially wasteful. In fact, loophole entrepreneurship can expose and help to defeat socially wasteful aspects of a regulatory scheme that promotes rent-seeking over value creation.¹¹³

Whereas Fleischer presents regulatory arbitrage as an arrow in the quiver of established, wealthy, powerful firms, loophole entrepreneurship pits startup Davids against corporate Goliaths, as illustrated by the case studies below.¹¹⁴ Southwest Airlines, for example, was a scrappy startup battling industry giants Continental and Braniff.¹¹⁵ Similarly, Theranos took on LabCorp and Quest Diagnostics,¹¹⁶ while Florida’s craft brewers fought the powerful wholesalers’ lobby and “big beer” for market share.¹¹⁷

In short, while both regulatory arbitrage and loophole entrepreneurship involve structuring business transactions in ways that afford favorable regulatory or legal treatment, the two differ in terms of the nature of the transactions at issue (fundamental to the business model vs. “minor alterations” in behavior), as well as the character of the businesses involved (startups vs. established firms).

II. CASE STUDIES IN LOOPHOLE ENTREPRENEURSHIP

Part I provided an abstract definitional framework for loophole entrepreneurship, and Washington, D.C.’s I-71 shops illustrated several

111. Fleischer, *supra* note 104, at 229, 234–35.

112. *Id.* at 229.

113. Loophole entrepreneurship *may* be detrimental—as the UGotPosted and Theranos case studies show. *See infra* Parts II.B and II.C. But other examples, such as the Florida craft brewers case study, show that it is not necessarily pernicious, in the way that Fleischer suggests regulatory arbitrage is. *See infra* Part II.H.

114. *See infra* Part II.

115. *See infra* Part II.A.

116. *See infra* Part II.C.

117. *See infra* Part II.H.

aspects of the phenomenon well.¹¹⁸ But loophole entrepreneurs are active in many industries, and their experiences and outcomes are varied. The additional examples below provide further details and nuances that will flesh out our understanding of loophole entrepreneurship and reveal its complexity. These case studies also suggest instructive lessons for loophole entrepreneurs, policymakers, and the public, which will be explored in Part III.¹¹⁹ Each case study presents a summary of (1) the general law; (2) the loophole and the entrepreneur's exploitation thereof; and (3) the outcome, including the fate of the business and the loophole.

A. SOUTHWEST AIRLINES

In April 2020, Southwest Airlines became the world's largest airline.¹²⁰ As of January 2023, Southwest serves 121 airports in 11 countries, carrying as many as 130 million passengers a year.¹²¹ Yet few would have foreseen this feat when Southwest was founded as a fledgling startup—built on a legal loophole—more than fifty years earlier.¹²² Back then, not only was Southwest subject to relentless and ruthless attacks by its established competitors,¹²³ but also its operations were strictly limited by federal law, which prohibited Southwest from flying outside of Texas.¹²⁴ Southwest's unlikely achievements make it perhaps the greatest success story in loophole entrepreneurship, demonstrating the potential rewards—and the inherent risks—for a company, an industry, and society at large.

118. See *supra* Part I.

119. See *infra* Part III.

120. See Mary Schlangenhein, *Southwest Grabs Spot as the World's Largest Airline (This Week)*, BLOOMBERG (Apr. 17, 2020), [https://www.bloomberg.com/news/articles/2020-04-17/southwest-grabs-spot-as-the-world-s-largest-airline-this-week?](https://www.bloomberg.com/news/articles/2020-04-17/southwest-grabs-spot-as-the-world-s-largest-airline-this-week?https://archive.ph/bd5u3) [https://archive.ph/bd5u3].

121. *Company Overview*, SW. AIRLINES INV. RELS., <https://www.southwestairlinesinvestorrelations.com/our-company/company-overview> [https://perma.cc/AVS6-WE7B] (last visited Jan. 2, 2023).

122. See James Fallows, *The Great Airline War: Flying the Not-so-friendly Skies of Texas*, TEX. MONTHLY (Dec. 1975), <https://www.texasmonthly.com/news-politics/the-great-airline-war/> [https://perma.cc/F8RS-6RTK].

123. See *id.*

124. *Id.* In 1972, a federal district judge ruled that Southwest could not fly charters out of state without contravening the Civil Aeronautics Act. See *id.*

1. General Law

The Civil Aeronautics Act of 1938 created the Civil Aeronautics Board (“CAB”), an independent regulatory agency vested with broad authority to control market entry, carrier routes, ticket rates, and intercarrier transactions.¹²⁵ In passing the Act, Congress believed the interstate airline industry was in its infancy, and hoped, as Paul Stephen Dempsey has noted, to “avoid the deleterious consequences of ‘cutthroat’, ‘wasteful’, ‘destructive’, ‘excessive,’ and ‘unrestrained competition, and the economic ‘chaos’ which had so plagued the rail and motor carrier industries.”¹²⁶ To that end, the Act regulated airlines as a public utility, protecting the nascent industry from (what some perceived to be) injurious competition in a challenging economic environment.¹²⁷ Hewing close to this doctrine, CAB did not authorize a single new domestic trunkline carrier during its entire forty-year history, despite receiving more than six dozen applications.¹²⁸ Thus, an entrepreneur in the 1960s would have had little hope of entering the interstate airline market, given CAB’s expansive mandate and its demonstrated aversion to market competition.

2. Loophole

Rollin King and his lawyer, Herb Kelleher, identified a loophole in the Civil Aeronautics Act: CAB’s authority was generally limited to *interstate* carriers—airlines whose planes crossed state lines.¹²⁹ King and Kelleher realized that an airline with flights limited to a single state (in this case Texas) would avoid CAB oversight.¹³⁰ On November 27, 1967, with only \$500 in the bank, Southwest filed an application with the Texas Aeronautics Commission (“TAC”) to serve Dallas, Houston, and San

125. Paul Stephen Dempsey, *Rise and Fall Civil Aeronautics Board – Opening Wide Floodgates Entry*, 11 TRANSP. L.J. 91, 93 (1979).

126. *Id.* at 95.

127. *Id.* at 96. The New Deal precept that industrial policy is inherently beneficial pervaded Congressional debate about the Act. *Id.* at 97. Dempsey notes that “governmental regulation was viewed as fundamental to the creation of an economic environment of sufficient order and stability to insure the attraction of capital sufficient to maintain the requisite growth of the aviation industry.” *Id.*

128. *Id.* at 115.

129. *Courting Success: Early Southwest Legal Battles*, *supra* note 81.

130. *Id.*

Antonio.¹³¹ In February 1968, TAC unanimously approved Southwest's application.¹³² As an *intrastate* carrier, Southwest did not need to seek CAB certification, which, given CAB's record, almost certainly would have been denied.¹³³

3. Outcome

Only one day after the TAC vote, Braniff, Texas International, and Continental¹³⁴ obtained a temporary restraining order from Travis County District Court prohibiting TAC from delivering Southwest's certificate of public convenience and necessity.¹³⁵ These airlines dragged Southwest through four years of litigation in state and federal courts—as well as CAB administrative review—before Southwest's first plane took off on June 18, 1971.¹³⁶

Eventually, Southwest's successful business model bolstered growing public and political support for airline deregulation.¹³⁷ Unlike its CAB-regulated competitors, Southwest had not only the freedom, but also the incentive to innovate. In particular, Southwest focused on cutting expenses to offer fares far lower than its competitors.¹³⁸ Many of

131. 1967-1971, SW. AIRLINES, <https://swamedia.com/pages/1966-to-1971> [<https://perma.cc/W2LA-JXVB>] (last visited Mar. 7, 2022); see also 1972-1977, SW. AIRLINES, <https://www.swamedia.com/pages/1972-to-1977> [<https://perma.cc/G2PPD2HJ>] (last visited Mar. 7, 2022).

132. *Courting Success: Early Southwest Legal Battles*, *supra* note 81.

133. Robert C. Means & Barry Chasnoff, *State Regulation of Air Transportation: The Texas Aeronautics Commission*, 53 TEX. L. REV. 653, 679 (1975) (“For Southwest, refusal of interstate traffic is the only means of avoiding the ruinous costs and doubtful prospects of a CAB certification proceeding.”); see also *Tex. Int’l Airlines, Inc. v. Civ. Aeronautics Bd.*, 473 F.2d 1150 (D.C. Cir. 1972) (holding that Southwest did not require CAB certification to operate within Texas). Incorporated in 1967 as Air Southwest Co., the airline changed its name to Southwest Airlines Co. on March 29, 1971, two months before its first flight took off. 1967-1971, *supra* note 131; see also 1972-1977, *supra* note 131.

134. Southwest's main competitors in the Texas market—all interstate carriers regulated by CAB.

135. 1967-1971, *supra* note 131; see also 1972-1977, *supra* note 131.

136. Fallows, *supra* note 122.

137. Robert Peterson, *Impacts of Airline Deregulation*, TR NEWS 315, 12 (May–June 2018), <https://onlinepubs.trb.org/onlinepubs/trnews/trnews315airlinedereg.pdf> [<https://perma.cc/69RQ-ELE9>].

138. Fallows, *supra* note 122. In 1975, for example, Southwest's “flights between Houston, Dallas, San Antonio, and the Rio Grande Valley cost 25 per cent, 40 per cent, 50 per cent less than do comparable ones on Braniff and TI.” *Id.*

Southwest's novel efficiencies would become standard throughout the industry over the subsequent fifty years, but were unheard of in the early 1970s: eliminating the first-class cabin, using a single type of aircraft (to reduce maintenance costs), a "ten-minute turn" (to increase the number of flights per aircraft), point-to-point (instead of hub-and-spoke) routes, offering peanuts (instead of a full-service inflight meal), and serving secondary airports (sometimes closer to city centers than large regional airports).¹³⁹

In 1978, Congress passed the Airline Deregulation Act, which both dismantled the "regulatory umbrella" that shielded established carriers from market competition and abolished CAB altogether.¹⁴⁰ Following deregulation, Southwest was free to scale up its business to become one of the largest, most efficient, and most profitable interstate carriers and "a model for a new generation of airlines."¹⁴¹ Southwest has been credited with "democratizing the skies,"¹⁴² and the result of its efficient, popular business model led the U.S. Department of Transportation to coin a phrase, "The Southwest Effect," to describe the soaring passenger traffic that invariably resulted when Southwest entered a new market.¹⁴³

Southwest's experience represents the best that any loophole entrepreneur can hope for: a business that gains early advantages from skillful and innovative use of a loophole, and then becomes so successful

139. Ben Mutzbaugh, *Southwest's Herb Kelleher: Five Innovations that Shaped U.S. Aviation*, U.S.A. TODAY (Jan. 4, 2019), <https://www.usatoday.com/story/travel/flights/todayinthesky/2019/01/04/southwest-airlines-herb-kelleher-innovations-shaped-aviation/2483196002/> [<https://perma.cc/L3TQ-357V>]. On this last point, Herb Kelleher said, "The passenger has a right to travel from Dallas to Houston, and not from Grapevine to Conroe," (in reference to Southwest's serving Dallas's Love Field and Houston's Hobby Airport—both closer to the city centers than the suburban Dallas Fort Worth Airport and George Bush Intercontinental Airport). Fallows, *supra* note 122.

140. Dempsey, *supra* note 125, at 93.

141. *Airline Deregulation: When Everything Changed*, SMITHSONIAN NAT'L AIR & SPACE MUSEUM (Dec. 17, 2021), <https://airandspace.si.edu/stories/editorial/airline-deregulation-when-everything-changed> [<https://perma.cc/G74W-29XD>].

142. When Herb Kelleher died in 2019, United States Senator from Texas John Cornyn honored him in a speech on the Senate floor, noting that Kelleher's "entrepreneurial spirit was credited with democratizing the skies by disrupting the airline industry." 165 Cong. Rec. S257 (daily ed. Jan. 16, 2019) (Statement of Sen. John Cornyn).

143. Randall D. Bennett & James M. Craun, *The Airline Deregulation Evolution Continues: The Southwest Effect*, U.S. DEP'T OF TRANSP. (May 1993).

that the loophole eventually overcomes the law, allowing the business to expand its operations and rise to the pinnacle of the industry.

B. UGOTPOSTED.COM

Many Americans—even those who favor robust economic regulation—would recognize that Southwest’s success story demonstrates that social benefits can flow from a gap in a regulatory regime, as one airline sparked the “democratization of the skies.”¹⁴⁴ But not all loophole entrepreneurs are as public spirited as Herb Kelleher and Rollin King, and not all business models founded on legal loopholes are broadly beneficial. In fact, some are downright shameful. “Revenge porn” site UGotPosted.com illustrates the dark side of loophole entrepreneurship.¹⁴⁵

1. General Law

Under the common law, publishers are liable for defamatory material they publish.¹⁴⁶ For example, if a book includes a defamatory statement, the publisher is subject to the same liability as the author.¹⁴⁷ Publisher liability seeks to discourage defamation by providing a negative incentive for those who have the power to control its dissemination.¹⁴⁸ A newspaper, for instance, can be expected to vet letters to the editor before

144. See Fallows, *supra* note 122; see also Cornyn, *supra* note 142.

145. See *infra* Part II.B.2.

146. See *Immunity for Online Publishers Under the CDA*, DIGIT. MEDIA L. PROJECT, <https://www.dmlp.org/legal-guide/immunity-online-publishers-under-communications-decency-act> [<https://perma.cc/VJ5V-JV78>] (last visited Nov. 14, 2021).

147. See *id.*

148. See Eugene Volokh, *47 U.S.C. § 230 and the Publisher/Distributor/Platform Distinction*, REASON (May 28, 2020), <https://reason.com/volokh/2020/05/28/47-u-s-c-%C2%A7-230-and-the-publisher-distributor-platform-distinction/> [<https://perma.cc/RN2R-876N>]. Professor Volokh is careful to distinguish among common law rules for (1) publishers (such as newspapers), (2) distributors (such as bookstores), and (3) platforms (“such as telephone companies, cities on whose sidewalks protestors demonstrate, or broadcasters running candidate ads that they are required to carry”). *Id.* For this Article, the nuances of these distinctions are not as important as the general notion that platforms enjoyed categorical immunity because they did not *choose* which messages users communicated on them, whereas publishers screened materials they would publish, and distributors chose which material to sell. *Id.*

publishing them, given that the newspaper would be liable for defamatory statements contained within a published letter.¹⁴⁹

2. Loophole

The Internet Revolution, which enabled the masses cheaply and instantaneously to post material that would be globally accessible, compelled policymakers to rethink the common law publisher liability doctrine as it applied to novel media.¹⁵⁰ To ensure that free speech could thrive on the internet, Congress passed Section 230 of the CDA, stating that “[n]o provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider.”¹⁵¹ This provision essentially immunizes a website owner from publisher liability for content that third parties post on the site.¹⁵² Perceiving protection from liability under this loophole, Kevin Bollaert created a “revenge porn” website, UGotPosted.com, where users uploaded more than 10,000 sexually explicit photos of others without their permission.¹⁵³ The photos were accompanied by the victims’ names, locations, and ages, as well as links to their Facebook profiles.¹⁵⁴ Most of the people whose photographs appeared on the site were women, and many of them said that they were subject to harassment and feared for their lives.¹⁵⁵ Bollaert simultaneously created a second site,

149. *Id.*

150. *See Immunity for Online Publishers Under the CDA*, *supra* note 146.

151. 37 U.S.C. § 230(c)(1).

152. *See* Volokh, *supra* note 148 (this provision also treats websites as platforms rather than publishers (or distributors)).

153. *See* Samantha Payne, *California Takes Action Against ‘Revenge Porn’ Site*, INT’L BUS. TIMES (Dec. 14, 2013), <https://www.ibtimes.co.uk/kevin-bollaert-arrest-revenge-porn-bullyville-hunter-530177> [<https://perma.cc/26ZC-7HNZ>]. “Revenge porn” is the term ascribed to the “dissemination of sexually explicit images of others without their permission.” *See, e.g.*, Pam Greenberg, *Fighting Revenge Porn and ‘Sextortion’*, 27 LEGISBRIEF (Aug. 2019), https://www.akleg.gov/basis/get_documents.asp?session=32&docid=79763 [<https://perma.cc/JH3C-8UD7>].

154. *See* Tim Walker, *Man Who Got Rich from ‘Revenge Porn’ Website UGotPosted Is Finally Exposed*, THE INDEP. (Dec. 12, 2013), <https://www.independent.co.uk/news/world/americas/man-who-got-rich-from-revenge-porn-website-is-finally-exposed-9001709.html> [<https://perma.cc/G427-KKKS>].

155. *Id.*

ChangeMyReputation.com, where victims would pay up to \$250 to have the revenge porn photos removed.¹⁵⁶

3. Outcome

In December 2013, Bollaert was arrested and charged with conspiracy, identity theft, and extortion.¹⁵⁷ He was convicted of 27 felony counts and sentenced to 18 years imprisonment.¹⁵⁸ The court's opinion in the case includes a lengthy discussion of Section 230's application to these circumstances.¹⁵⁹ Ultimately, the court concluded that UGotPosted.com was “‘*designed to solicit*’ content that was unlawful, demonstrating that Bollaert's actions were not neutral, but rather materially contributed to the illegality of the content and the privacy invasions suffered by the victims. In that way, he developed in part the content, taking him outside the scope of CDA immunity.”¹⁶⁰

Most people would find “revenge porn” and “sextortion” morally reprehensible, so it is no surprise that prosecutors and the court went out of their way to shut down UGotPosted even though there was at least a colorable (and perhaps even compelling) argument that the company's business was not illegal.¹⁶¹ As one commentator observed in the wake of Bollaert's arrest: “If a company finds a loophole that benefits their business model, they should not give legislators a reason to close it.”¹⁶²

156. See Payne, *supra* note 153.

157. See Dan Brekke, ‘Revenge Porn’ Site Operator Arrested: YouGotPosted, and HeGotBusted, KQED (Dec. 10, 2013), <https://www.kqed.org/news/120382/revengeporn-site-operator-arrested-yougotposted-and-hegotbusted> [<https://perma.cc/XVZ6-3BTW>].

158. Lyndsay Winkley & Dana Littlefield, *Sentence Revised for Revenge Porn Site Operator*, SAN DIEGO UNION-TRIB. (Sept. 21, 2015), <https://www.sandiegouniontribune.com/sdut-kevin-bollaert-revenge-porn-case-resentencing-2015sep21-story.html> [<https://perma.cc/2WHG-T84U>] (later reduced to eight years imprisonment and ten years supervised release).

159. *People v. Bollaert*, 248 Cal. App. 4th 699, 721 (2016).

160. *Id.*

161. See Eric Goldman, *Should We Cheer the California Attorney General's Revenge Porn Arrest—Or Find It Alarming?*, FORBES (Dec. 11, 2013), <https://www.forbes.com/sites/ericgoldman/2013/12/11/should-we-cheer-the-california-attorney-generals-revenge-porn-arrest-or-find-it-alarming/?sh=6e0415e85d07> [<https://perma.cc/QN6G-TRRZ>] (“The complaint exhibits the kind of intellectual corner-cutting we typically see when a prosecutor decides a person should go to jail even if no crime actually fits the facts.”).

162. Olga V. Mack, *How to Avoid Legal Landmines: Homejoy & UGotPosted*, STARTUPGRIND, <https://www.startupgrind.com/blog/the-risky-business-of-disruptingesta>

Section 230 had long been controversial, and Bollaert's abuse of its apparent protections fanned the flames of controversy.¹⁶³ Critics characterize it as an obsolete loophole, shielding internet companies from liability for malicious content posted on their sites.¹⁶⁴ Indeed, there is widespread congressional support for overhauling Section 230, but efforts to do so have so far fallen victim to partisan squabbling.¹⁶⁵ However, opponents of such an overhaul (including many Big Tech companies) suggest that narrowing or eliminating Section 230 would have a chilling effect on free speech.¹⁶⁶ "Congress passed this bipartisan legislation because it recognized that promoting more user speech online outweighed potential harms," observes the Electronic Frontier Foundation, a nonprofit digital rights group.¹⁶⁷ "When harmful speech takes place, it's the speaker that should be held responsible, not the service that hosts the speech."¹⁶⁸

In 2023, Section 230 faced its biggest challenge in decades as the Supreme Court considered a case brought by the family of an American college student who was killed during the 2015 Paris terrorist attacks.¹⁶⁹ The family sued Google for failing to remove some ISIS terrorist videos from YouTube, claiming that Google is liable for aiding and abetting under the Anti-Terrorism Act.¹⁷⁰ With congressional action on Section 230 unlikely, many hoped that the Court in this case would, like the court in *Bollaert*, narrow the contours of the Section 230 loophole, with either

blished-legal-trends-and-ethics/ [https://perma.cc/X8XA-DHTV] (last visited Mar. 20, 2022).

163. See, e.g., Mary Graw Leary, *The Indecency and Injustice of Section 230 of the Communications Decency Act*, HARV. J.L. & PUB. POL'Y 553, 573 (2018) (citing the Bollaert case as an example of how Section 230 had morphed into a "regime of de facto absolute immunity").

164. See, e.g., Nitsana Darshan-Leitner, *We Must End the Lethal Loophole of Section 230*, N.Y. POST (Feb. 22, 2023), <https://nypost.com/2023/02/22/we-must-end-the-lethal-loophole-of-section-230/> [https://perma.cc/X2S4-JU4B].

165. John D. McKinnon, *Google Case Heads to Supreme Court with Powerful Internet Shield Law at Stake*, WALL ST. J. (Feb. 20, 2023), <https://www.wsj.com/articles/google-case-heads-to-supreme-court-with-powerful-internet-shield-law-at-stake-e548e241> [https://perma.cc/Q7WD-ZYC5].

166. See *Section 230*, ELEC. FRONTIER FOUND., <https://www EFF.ORG/issues/cda230> [https://perma.cc/4HSY-22Q8] (last visited Mar. 3, 2023).

167. *Id.*

168. *Id.*

169. *Gonzalez v. Google LLC*, No. 21-1333, slip op. at 2-3 (May 18, 2023).

170. *Id.*

positive or negative repercussions for internet entrepreneurs.¹⁷¹ Ultimately, the Court held that the plaintiffs failed to state a claim for aiding and abetting, and sidestepped the Section 230 issue, leaving the loophole intact.¹⁷²

C. THERANOS

Theranos provides another example of a loophole entrepreneur behaving badly.¹⁷³ Like Kevin Bollaert, Theranos founder, Elizabeth Holmes, exploited an intentional loophole.¹⁷⁴ Whereas Bollaert used a loophole to engage in what he believed was legal (albeit morally reprehensible) activity, Theranos used a loophole to cover up fraudulent activity by avoiding regulatory oversight.¹⁷⁵ UGotPosted never attempted to conceal what it was doing—in fact, the company flaunted it, and had at least a colorable argument that the Section 230 loophole legalized its business model.¹⁷⁶ Theranos, however, used a loophole to build a shady business based on fraud and deception.¹⁷⁷

1. General Law

The Food and Drug Administration (FDA) requires premarket approval (“PMA”) for most medical devices, including in vitro diagnostic equipment for human use.¹⁷⁸ The PMA process involves the FDA’s review of extensive documentation (including clinical studies) regarding

171. *Id.*

172. *Id.*

173. *See infra* Part II.C.3.

174. *See infra* Part II.C.2.

175. *See infra* Part II.C.3.

176. Even critics of Section 230—perhaps *especially* critics of Section 230—would likely concede that Bollaert’s websites were legal within the contours of the loophole. After all, UGotPosted illustrates precisely the kind of reckless and destructive behavior that critics have long prophesied that Section 230 would foment.

177. *See* Press Release, United States v. Elizabeth Holmes, et al., U.S. Att’y’s Off., N.D. Cal., <https://www.justice.gov/usao-ndca/us-v-elizabeth-holmes-et-al> [<https://perma.cc/7DG3-U449>] (last visited Mar. 3, 2023) (noting that Theranos founder Elizabeth Holmes and her inner circle were indicted for defrauding doctors, patients, and investors, and Holmes was eventually found guilty of defrauding investors).

178. *PMA*, FDA, <https://www.fda.gov/medical-devices/premarket-submissions-selecting-and-preparing-correct-submission/premarket-approval-pma> [<https://perma.cc/TH6F-WXYP>] (last visited Mar. 3, 2022).

the safety and effectiveness of a device.¹⁷⁹ While this requirement is intended to ensure that medical devices are safe and effective,¹⁸⁰ the cost of compliance is prohibitively high for some manufacturers.¹⁸¹

2. Loophole

The FDA generally has not enforced its PMA requirements on laboratory developed tests (“LDTs”)—a type of in vitro diagnostic test that is designed, manufactured, and used in a single laboratory.¹⁸² The purpose of this loophole is to allow research hospitals to modify commercial tests to suit their ever-changing needs.¹⁸³ Theranos took advantage of this loophole to bypass the FDA’s PMA process for its testing devices.¹⁸⁴ Thus, Theranos was able to market its tests to doctors and patients without seeking FDA approval.¹⁸⁵ At its peak, Theranos was valued at \$9 billion, and its founder, Elizabeth Holmes, became the world’s youngest female billionaire at 29 and was lauded as “the next Steve Jobs.”¹⁸⁶

179. *Id.*

180. *See generally* 21 C.F.R. § 814.20 (2013) (stating purpose of premarket approval investigation is to establish, inter alia, a “thorough device review process”).

181. *See* Charles Warren, *When the Feds Have Taken the Field: Federal Field Preemption of Claims Against Manufacturers Whose Medical Devices Have Received PMA by the FDA*, 9 OKLA. J. L. & TECH. 1, 12 (2013) (noting “the stringency of the premarket approval process, and the lengths to which manufacturers will go to avoid the time and expense required to secure premarket approval”).

182. LDTs, FDA, <https://www.fda.gov/medical-devices/in-vitro-diagnostics/laboratory-developed-tests> [<https://perma.cc/D54J-EHJL>] (last visited Mar. 3, 2022).

183. Arielle Duhaime-Ross, *FDA Wants to Close the Loophole that Theranos Used, but Republicans Don’t Understand Why*, THE VERGE (Nov. 17, 2015), <https://www.theverge.com/2015/11/17/9750048/ldt-loophole-fda-hearing-theranos-lab-tests> [<https://perma.cc/GW4K-JE6Y>] (pointing out that “because academic researchers tend to publish their results anyway, this form of regulation hasn’t raised too many eyebrows”).

184. *See* CARREYROU, *supra* note 90, at 125; *see also* Duhaime-Ross, *supra* note 183.

185. Kezia Parkins, *The Theranos Saga: A Wake-Up Call for the LDT Market*, MED. DEVICE NETWORK (Jan. 25, 2022), <https://www.medicaldevice-network.com/features/theranos-ldt-regulation/> [<https://perma.cc/J6X3-78JU>].

186. Abigail Stevenson, *World’s Youngest Female Billionaire—Next Steve Jobs?*, CNBC (Sept. 23, 2015), <https://www.cnbc.com/2015/09/23/worlds-youngest-female-billionaire-next-steve-jobs.html> [<https://perma.cc/2GB8-FVD4>].

3. Outcome

In October 2015, investigative journalist John Carreyrou wrote a series of Wall Street Journal articles exposing flaws in Theranos's proprietary diagnostic equipment which caused patients to receive erroneous test results.¹⁸⁷ Further investigations uncovered a massive fraudulent scheme to cover up the fact that Theranos's much-vaunted testing device did not work.¹⁸⁸ The company—once the darling of biotech and Silicon Valley—ceased operations in 2018.¹⁸⁹ Holmes was convicted of defrauding investors and sentenced to more than 11 years in federal prison, followed by three years of supervision.¹⁹⁰

Despite calls for the FDA to close the LDT loophole in the wake of the Theranos scandal, the loophole remains open as of January 2022,¹⁹¹ and several other startups have since made use of it.¹⁹² One healthcare products expert, in explaining the FDA's lack of action on this issue, noted that when the FDA creates a regulatory loophole (in this case enforcement discretion for LDTs), "whole industries are built around that enforcement discretion After a while, it becomes harder for the agency to rein that industry back in."¹⁹³

D. AEREO

Few would likely mourn the demise of UGotPosted or Theranos, but a loophole entrepreneur may fail even if the business model is not malicious, unpopular, or fraudulent. The downfall of telecommunications innovator Aereo demonstrates that despite good intentions and a socially beneficial product, the risk inherent in loophole entrepreneurship does not always pay off.

187. See generally CARREYROU, *supra* note 90.

188. See *id.*

189. Reed Abelson, *Theranos Is Shutting Down*, N.Y. TIMES (Sept. 5, 2018), <https://www.nytimes.com/2018/09/05/health/theranos-shutting-down.html> [<https://archive.ph/TpAfT>].

190. Press Release, United States v. Elizabeth Holmes et al., *supra* note 177.

191. Parkins, *supra* note 185.

192. Duhaime-Ross, *supra* note 183.

193. Parkins, *supra* note 185.

1. General Law

As briefly described above,¹⁹⁴ the Copyright Act was revised in 1976, bestowing upon a copyright owner the exclusive right, “in the case of . . . motion pictures and other audiovisual works, to perform the copyrighted work publicly.”¹⁹⁵ The Act defines “publicly perform” to include “to transmit or otherwise communicate a performance or display of the work to . . . the public”¹⁹⁶ Prompting these revisions was the 1909 Act’s inapplicability to newer forms of broadcast technology (especially cable television), which undermined the fundamental purpose of copyright law.¹⁹⁷

2. Loophole

Because this provision of the Copyright Act (as the Second Circuit noted) “is not a model of clarity,”¹⁹⁸ the Act’s application to rapidly evolving video recording and transmission technologies has proven challenging.¹⁹⁹ In 1984, the Supreme Court held that the Act’s “fair use” exception permitted home VCR technology that could make a recording of a broadcast TV program for later private viewing.²⁰⁰ In 2008, this

194. See *supra* notes 29–31 and accompanying text.

195. 17 U.S.C. § 106(4).

196. *Id.* § 101.

197. See, e.g., Greene, *supra* note 71.

Copyright law is founded upon the premise that, for a limited period of time, authors and creators of intellectual works have the exclusive right to their products. This right can be sold or distributed as the creators wish, and those seeking use of copyrighted material must negotiate a satisfactory royalty payment with the copyright owner.

Id. at 263–64. Two Supreme Court decisions, discussed above, held that the 1909 Act did not require cable television operators to make royalty payments to copyright owners for retransmitting broadcast television programs to cable subscribers in other markets. See *supra* note 70.

198. *Cartoon Network LP v. CSC Holdings, Inc.*, 536 F.3d 121, 136 (2d Cir. 2008).

199. See *supra* note 35.

200. *Sony Corp. of Am. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984).

exception was expanded to include RS-DVRs that record and rebroadcast individual copies of broadcasts selected by customers.²⁰¹

In light of these loopholes created by judicial interpretations of the Act, entrepreneur Chet Kanojia founded Aereo, which built data centers to record over-the-air TV programs selected by customers for later viewing via an internet platform.²⁰² In an effort to conform to the contours of the loophole created by the Second Circuit in *Cartoon Network*,²⁰³ Aereo received the broadcast signals through hundreds of thousands of dime-sized antennas (one for each customer).²⁰⁴

At the time the Copyright Act was revised in 1976, Aereo—and even RS-DVRs and VCRs—would have seemed the stuff of science fiction to lawmakers. These future technologies were understandably not explicitly covered by the language of the Act, which targeted the high-tech broadcast system of the time: cable television.²⁰⁵

3. Outcome

Broadcast networks immediately took Aereo to court.²⁰⁶ The Second Circuit ruled in favor of Aereo, finding that, like the RS-DVR technology at issue in *Cartoon Network*, Aereo's system created a unique copy for each user, which could then be transmitted only to that user.²⁰⁷ Though Judge Chin, in dissent, criticized Aereo for its scrupulous efforts to fit within the RS-DVR loophole, calling Aereo's technology "a Rube

201. *Cartoon Network*, 536 F.3d at 135 (holding that such a system did not violate the Act, given that "if each transmission is to an audience of one, the transmission is not 'public'").

202. See Brian Stelter, *New Service Will Stream Local TV Stations in New York*, N.Y. TIMES (Feb. 14, 2012), [https://archive.nytimes.com/2012/02/14/new-service-will-stream-local-tv-stations-in-new-york/?smid=tw-nytimstv&seid=auto](https://archive.nytimes.com/mediadecoder.blogs.nytimes.com/2012/02/14/new-service-will-stream-local-tv-stations-in-new-york/?smid=tw-nytimstv&seid=auto) [<https://archive.li/KOH8p>]. Entertainment industry veteran Barry Diller was an enthusiastic early supporter of Aereo. *Id.* Diller joined Aereo's board, and his company, IAC/InterActiveCorp, led a \$20.5 million round of financing for the startup. *Id.*

203. See *supra* note 201 and accompanying text.

204. Larry Downes, *Aereo TV: Barely Legal by Design*, HARV. BUS. REV. (Mar. 7, 2013), <https://hbr.org/2013/03/aereo-tv-barely-legal-by-desig> [<https://perma.cc/M3D2-AL2H>]; see also Kevin W. Yoegel, Comment, *The Aereo Loophole: A Retrospective Inquiry into the Legality of Antenna Farms and Internet-Based Television*, 87 TEMPLE L. REV. (2015).

205. Greene, *supra* note 71, at 263–64.

206. *WNET v. Aereo, Inc.*, 712 F.3d 676, 697 (2d Cir. 2013).

207. *Id.*

Goldberg-like contrivance, over-engineered in an attempt to avoid the reach of the Copyright Act.”²⁰⁸ The Supreme Court reversed, holding that Aereo did “publicly perform” the copyrighted work, in violation of the statute, because its service bore a closer resemblance to cable TV than to VCRs or RS-DVRs.²⁰⁹ Aereo shut down less than a week after the Court’s decision.²¹⁰

In contrast to UGotPosted and Theranos, Aereo offered a socially beneficial service.²¹¹ Yet despite its painstaking efforts to conform with

208. *Id.* (Chin, J., dissenting). But isn’t it the prerogative of every entrepreneur—including loophole entrepreneurs—to tailor their businesses in such a way as to receive the most favorable legal or regulatory treatment? One might justifiably accuse Southwest Airlines of “over-engineering” its route map in an attempt to avoid the reach of the CAB. And beyond the realm of loophole entrepreneurship, companies frequently find creative ways to take advantage of favorable regulations. *See* Fleischer, *supra* note 104 (describing regulatory arbitrage); *see also supra* Part I.B.2.

209. *ABC v. Aereo*, 573 U.S. 431.

210. Mike Snider, *Aereo Shuts Down Just Days After Court Decision*, USA TODAY (June 28, 2014), <https://www.usatoday.com/story/tech/personal/2014/06/28/aereo-ceo-shuts-down-service/11619083/> [<https://perma.cc/N3LN-KRF6>]. Although the Supreme Court ultimately closed (or at least tightened) the loophole in *ABC v. Aereo*, its rationale for doing so has been widely panned as unpersuasive. *See, e.g., The Supreme Court Kills Aereo Because It Found a Loophole*, THE [LEGAL] ARTIST (June 26, 2014), <https://www.thelegalartist.com/blog/supreme-court-kills-aereo-found-loophole> [<https://perma.cc/7H76-7HYZ>]; Mark P. McKenna, *The Limits of the Supreme Court’s Technological Analogies*, SLATE (June 26, 2014), <https://slate.com/technology/2014/06/abc-v-aereo-ruling-the-supreme-courts-terrible-technological-analogies.html> [<https://perma.cc/5XAG-AYFE>]; Mike Masnick, *The Aereo Ruling Is a Disaster for Tech, Because the ‘Looks Like Cable’ Test Provides No Guidance*, TECHDIRT (June 27, 2014), <https://www.techdirt.com/2014/06/27/aereo-ruling-is-disaster-tech-because-looks-like-cable-test-provides-no-guidance/> [<https://perma.cc/T2QV-A7T7>]; Ben Collins, *It’s Official: The Supreme Court Is Pro-Cable Oligopoly*, ESQUIRE (June 25, 2014), <https://www.esquire.com/news-politics/news/a29551/supreme-court-aereo-decision/> [<https://perma.cc/S5A5-S53T>]. *ABC v. Aereo* also raises the question of “who decides” whether to close a loophole in response to its exploitation by entrepreneurs. *See supra* Part I.A.4. This is among the issues Justice Scalia addresses in his thundering dissent. *See supra* notes 66–68 and accompanying text.

211. *See* Katherine Boehret, *Aereo Shines with Limited Live TV on the Go*, WALL ST. J. (July 18, 2012), <https://www.wsj.com/articles/SB10001424052702303612804577533070691481182> [<https://perma.cc/YL2T-CXCU>] (concluding, “If you’re a fan of TV and want a better way to watch it on the go, Aereo is a pleasure”); *see also* Mario Aguilar, *Aereo Hands-On: Watch Broadcast TV Wherever and Whenever You Want*, GIZMODO (Mar. 14, 2012), <https://gizmodo.com/aereo-hands-on-watch-broadcast-tv-wherever-and-wheneve-5893248> [<https://perma.cc/BG9M-VZXC>] (“Aereo might not last forever, but we sure hope it does, because it’s a pretty excellent option for people who hate

the contours of a seemingly well-established loophole, just one court decision shut it down, highlighting the fragility of loopholes and the consequent risks inherent in loophole entrepreneurship.²¹²

E. NASHVILLE PARTY BUSES

Nashville’s party bus industry is an example of inter-legal loophole entrepreneurship.²¹³ Nashville—a “blue” city (and the state capital) in a largely “red” state—is fertile ground for state laws preempting local regulations.²¹⁴ But the inter-legal loophole that allowed the city’s party buses to flourish ultimately was narrowed because of the industry’s excesses, thus providing a cautionary tale for other loophole entrepreneurs.²¹⁵

1. General Law

The Metropolitan Transportation Licensing Commission of Nashville and Davidson County, Tennessee, strictly regulates for-hire vehicles operating in the city and county.²¹⁶ These regulations include provisions concerning vehicle maintenance and inspections; insurance; driver eligibility; vehicle size, age, and capacity; mandatory safety devices; fares; and driver and passenger behavior.²¹⁷

cable”); *see also* Nathaniel Wice, *A Cord-Cutter’s Dream Come True*, BARRON’S (Mar. 24, 2012).

212. *See infra* Part III.B.

213. *See supra* Part I.A.3.

214. *See* Reyhan Harmanci, *Republican States are Coming for their Blue Cities*, BLOOMBERG (Aug. 30, 2023), <https://www.bloomberg.com/news/newsletters/2023-08-30/nashville-tennessee-demonstrates-red-state-blue-city-tensions> [<https://archive.li/1srgA>] (“In red states across the South, Republican legislatures are increasingly interfering in the governance of Democratic cities Nowhere is the trend of states superseding cities more pronounced than in Nashville.”).

215. *Metropolitan Transportation Licensing Commission, Rules and Procedures*, METRO. GOV’T OF NASHVILLE & DAVIDSON CNTY., TENN. (Apr. 26, 2023), <https://www.nashville.gov/sites/default/files/202304/TransportationLicensingCommissionRules.pdf?ct=1682597364> [<https://perma.cc/7F97-7HWP>].

216. *Id.*

217. *See id.*

2. Loophole

Under Tennessee law, commercial for-hire vehicles of more than 15 passengers or more than 10,001 pounds are regulated exclusively by the state.²¹⁸ As a result, more than forty “transportainment” companies have formed over the past decade, deliberately using vehicles falling outside of the stringent municipal regulations.²¹⁹ Catering especially to the influx of bachelorette parties to the city in recent years, the vehicles include modified school buses,²²⁰ hay wagons pulled by farm tractors,²²¹ a converted fire engine,²²² and a hot tub on wheels.²²³ Despite complaints from local residents and businesses about safety, noise, and traffic, the transportainment industry has flourished because local government has

218. TENN. CODE § 65-15-111(a)(2).

219. See Mike Reicher & Maria Timms, *Nashville Party Vehicles Fall into Regulatory Loophole, with No Local Oversight*, TENNESSEAN (Oct. 12, 2018), <https://www.tennessean.com/story/news/2018/10/12/party-bus-nashville-safety-inspection-loophole/1570487002/> [<https://perma.cc/R7KA-8M9Z>]; see also Rick Rojas, *In the Heart of Nashville, Rolling Parties Rage at Every Stoplight*, N.Y. TIMES (Sept. 19, 2021), <https://www.nytimes.com/2021/09/19/us/nashville-party-vehicles.html> [<https://archive.li/7OwYt>].

220. See HONKY TONK PARTY EXPRESS, <https://honkytonkpartyexpress.com/> [<https://archive.li/9ZQvR>] (last visited Mar. 17, 2022).

221. See THE NASHVILLE TRACTOR, <https://www.thenashvilletractor.com/> [<https://perma.cc/KG6V-GKDA>] (last visited Mar. 17, 2022).

222. See MUSIC CITY PARTY FIRE ENGINE, <https://www.partyfireengine.com/> [<https://perma.cc/P5YQ-LVXQ>] (last visited Mar. 17, 2022).

223. See Taylor Mead, *The Music City Party Tub Will Let You Tour Downtown Nashville in a Hot Tub on Wheels*, DELISH (May 18, 2019), <https://www.delish.com/entertaining/a27510922/music-city-party-tub-nashville-tennessee/> [<https://perma.cc/7MBS-PEGX>]. The Music City Party Tub ceased operation in late 2021 after the local Health Department found the owner in violation of an ordinance requiring a permit to operate a public swimming pool. See Cassandra Stephenson, *Metro Nashville Files Lawsuit to Shut Down Hot Tub on Wheels*, TENNESSEAN (Oct. 6, 2021), <https://www.tennessean.com/story/news/local/davidson/2021/10/07/nashville-hot-tub-on-wheels-lawsuit/6026160001/#:~:text=The%20entertainment%20vehicle%20composed%20of,health%20code%20violation%20on%20Aug> [<https://perma.cc/3ANG-44D9>]. The owner initially claimed that the party hot tub was exempt because of a loophole exempting hot tubs under a certain capacity; the city said there is no such exemption. Associated Press, *Hot Tub on Wheels: Suit Says Party Vehicle Lacks Pool Permit*, U.S. NEWS (Oct. 7, 2021), <https://www.usnews.com/news/best-states/tennessee/articles/2021-10-07/nashville-files-lawsuit-to-shut-down-hot-tub-party-vehicle> [<https://archive.li/3xRHS>].

been largely powerless to regulate it, given the loophole created by state law.²²⁴

3. Outcome

In November 2021, in response to a litany of complaints from businesses and residents, as well as the death of an inebriated passenger who fell off the back of a party wagon,²²⁵ Nashville's Metro Council passed an ordinance restricting alcohol consumption on unenclosed transportation vehicles.²²⁶ In March 2022, the Tennessee legislature passed a bill allowing local governments more oversight over party vehicles.²²⁷ Because many party vehicle operators enclosed their vehicles with plexiglass to exploit a loophole in the 2021 local ordinance, Metro Council amended its regulations in March 2022 to include enclosed vehicles.²²⁸ Had the party bus operators behaved better, they might not have incited the public outcry that led the state to tighten the loophole that had allowed the industry to flourish free of municipal regulation.

F. BLUESEED

The Nashville Party Bus example illustrates a business model founded on a relatively straightforward inter-legal loophole: state law governing a particular industry (transportation) preempts local law pertaining to that industry, thereby carving out an area in which an

224. Cole Villena, *Party Vehicles: Petition Calls for Regulation of Downtown Entertainment Vehicles*, TENNESSEAN (Aug. 10, 2021), <https://www.gcanews.com/safe-fun-nashville-launches-petition-to-bring-common-sense-to-transportation/> [<https://archive.li/Jgj9C>].

225. *See id.*

226. Press Release, Metropolitan Nashville Police Department, *New Ordinance Restricting Alcohol Consumption on Entertainment Transportation Vehicles Takes Effect* (Nov. 29, 2021), <https://www.nashville.gov/departments/police/news/new-ordinance-restricting-alcohol-consumption-entertainment-transportation> [<https://perma.cc/GZ6D-B83V>].

227. Cassandra Stephenson, *With the State's Party Vehicle Bill on Gov. Lee's Desk, Nashville Refines Local Regulations*, TENNESSEAN (Mar. 16, 2022), <https://www.tennessean.com/story/news/politics/2022/03/16/nashville-party-bus-entertainment-vehicle-rules-state-bill-gov-lee/7036740001/> [<https://perma.cc/B8CE-TVNS>].

228. *See id.*

entrepreneur can establish a business free from municipal regulation.²²⁹ But not all inter-legal loopholes are as clear-cut as a simple case of state preemption. Some emerge from the interaction of multiple laws—perhaps in different areas of the law—from multiple jurisdictions.²³⁰ Blueseed, the seasteading venture, was built on a complex (possible) loophole at the intersection of federal, state, and international laws, touching on immigration, employment, and maritime law.²³¹ Blueseed’s failure suggests that the more laws at play, the more precarious the loophole, and fatally for Blueseed, the more nervous potential investors will be about the viability of the business model.

I. General Law

U.S. Citizen and Immigration Services (“USCIS”) issues H-1B visas for highly skilled foreign workers to live and work in the United States.²³² The H-1B program is perennially oversubscribed, with demand far exceeding the number of visas issued.²³³ In 2017, for example, USCIS received 199,000 petitions for 85,000 available visas.²³⁴ In 2022, USCIS rejected about 400,000 (80%) of applicants because of the low quota,²³⁵ despite a historically tight labor market and high demand for workers.²³⁶

229. See *supra* Part II.E. Another example of a relatively simple inter-legal loophole is the Texas lemonade stand law, discussed briefly above. See *supra* notes 44–50 and accompanying text.

230. See *infra* Part II.F.1.

231. See *infra* Part II.F.2.

232. *H-1B Specialty Occupations, DOD Cooperative Research and Development Project Workers, and Fashion Models*, U.S. CITIZENSHIP & IMMIGR. SERVS., [https://www.uscis.gov/working-in-the-united-states/h-1b-specialty-occupations\[https://perma.cc/8ZK7-9HMD\]](https://www.uscis.gov/working-in-the-united-states/h-1b-specialty-occupations[https://perma.cc/8ZK7-9HMD]) (last visited Nov. 15, 2023).

233. See Nicole Torres, *The H-1B Visa Debate, Explained*, HARV. BUS. REV. (May 4, 2017), <https://hbr.org/2017/05/the-h-1b-visa-debate-explained> [https://perma.cc/VKS5-8XG8].

234. *Id.*

235. Stuart Anderson, *The Outlook On H-1B Visas and Immigration in 2023*, FORBES (Jan. 3, 2023), <https://www.forbes.com/sites/stuartanderson/2023/01/03/the-outlook-on-h-1b-visas-and-immigration-in-2023/?sh=1764ff1e6980> [https://perma.cc/J6QU-F63G].

236. See Gabriel T. Rubin, *Jobless Claims Fall, Pointing to Still-Tight Labor Market*, WALL ST. J. (Jan. 26, 2023), <https://www.wsj.com/articles/jobless-claims-fell-last-week-pointing-to-tight-labor-market-11674741049> [https://archive.li/1pRNk].

2. Loophole

Bluseed was a proposed tech-startup, which featured an incubator on a ship anchored in international waters near the San Francisco Bay Area.²³⁷ The founders of this seasteed venture planned to convert a cruise ship or barge into housing and coworking space for foreign entrepreneurs unable to obtain H-1B visas.²³⁸ Customers would be expected to obtain B-1 business/tourism visas (which are easier to obtain than H-1B visas).²³⁹ Customers could then travel to the U.S. mainland for meetings and conferences via a daily ferry service Bluseed would run between the ship and San Francisco.²⁴⁰ Under international law, the U.S. cannot exercise general sovereignty over the ship in international waters.²⁴¹

3. Outcome

Despite early enthusiasm from investors (including Peter Thiel),²⁴² the project struggled to raise enough funding and was put on hold in 2013.²⁴³ It remains unclear whether the project would have been legally viable, given the complex intersection of domestic and international immigration, maritime, employment, and environmental laws.²⁴⁴ Asked

237. Declan McCullagh, *Peter Thiel Floats Cash to Floating Tech Incubator*, CNET (Nov. 30, 2011), <https://www.cnet.com/news/privacy/peter-thiel-floats-cash-to-floating-tech-incubator/> [https://perma.cc/Q3YG-YC6W].

238. Timothy B. Lee, *Startup Hopes to Hack the Immigration System with a Floating Incubator*, ARSTECHNICA (Nov. 28, 2011), <https://arstechnica.com/tech-policy/2011/11/startup-hopes-to-hack-the-immigration-system-with-a-floating-incubator/?comments=1> [https://perma.cc/E7F3-VNJ6].

239. *Id.*

240. *Id.*

241. See Tom Innes et. al., *BLUSEED: ENVIRONMENTAL COMPLIANCE AND SUSTAINABILITY* (2012), <https://www.wm.edu/as/publicpolicy/documents/prs/bluseed.pdf> [https://perma.cc/PK9A-DDMN].

242. See McCullagh, *supra* note 237.

243. Asma Khalid, *Without a Special Visa, Foreign Startup Founders Turn to a Workaround*, WBUR (May 3, 2017), <https://www.wbur.org/npr/526549402/without-a-special-visa-foreign-startup-founders-turn-to-a-workaround> [https://perma.cc/GW2B-RZ6G].

244. See Innes et. al., *supra* note 241. Among the laws implicated by the project would be the National Marine Sanctuaries Act, Convention on the Continental Shelf (1958), Convention on the High Seas (1958), Convention on the Territorial Sea and Contiguous Zone (1958), International Convention for the Prevention of Pollution from Ships, Monterey Bay National Marine Sanctuary Rules and Regulations, International

to evaluate the idea of hosting “visa-free entrepreneurs” offshore in the Bay Area, one immigration attorney explained that Blueseed’s customers would face the risk of being turned away every time they attempted to enter the U.S. on a B-1 visa.²⁴⁵ The attorney pointed out that immigration officials have broad discretion to decide whether or not to let someone into the country.²⁴⁶ He also noted, however, that Blueseed’s founders had “bypassed the most difficult part of the process, which is getting a work visa to come to the U.S. By moving all of the productive work offshore, it increases the odds that people will be able to do business in Silicon Valley.”²⁴⁷

The current H-1B laws are widely recognized as inadequate.²⁴⁸ Yet Congress has long been at loggerheads to solve the problem, and increasing partisan polarization makes a solution unlikely.²⁴⁹ The insuperability of the obstacle, coupled with a persistently tight labor market, would seemingly make this an attractive area for loophole entrepreneurship. But as the Blueseed venture illustrates, the complexity of the laws involved (which touch on critical and often polarizing policy issues such as immigration, national security, and public entitlements) may render the waters of this loophole too turbulent for launching an entrepreneurial ship.

G. DRAFTKINGS AND FANDUEL

Although the complicated interplay of the laws at issue resulted in Blueseed never getting off the ground (or, rather, into the sea), not all entrepreneurs and investors shirk from complex inter-legal loopholes. Online sports betting behemoths DraftKings and FanDuel got their start

Convention for the Safety of Life at Sea, and United Nations Convention of the Law of the Sea. *Id.*

245. Lee, *supra* note 238.

246. *Id.*

247. *Id.*

248. See Laura Foote Reiff, *Congress Needs to Fix Immigration Quotas to Boost the Economy*, BLOOMBERG L. (Jan. 18, 2023), <https://news.bloomberglaw.com/us-law-week/congress-needs-to-fix-immigration-visa-quotas-to-boost-economy> [<https://perma.cc/2JNY-GKB7>].

249. See Rikha Sharma Rani, *Biden’s H-1B Conundrum*, POLITICO (Dec. 19, 2021), <https://www.politico.com/news/magazine/2021/12/19/biden-h-1b-visa-conundrum-524254> [<https://perma.cc/4HFP-RFHA>] (discussing the political challenges confronting H-1B reform).

in just such an inter-legal loophole involving federal and state law.²⁵⁰ Rather than being cowed by legal challenges, they tenaciously battled state attorneys general who tried to shut them down.²⁵¹

1. General Law

The federal 1992 Professional and Amateur Sports Protection Act (“PASPA”) prohibited (with a few exceptions) states from legalizing sports betting.²⁵² Additionally, the Unlawful Internet Gambling Enforcement Act (“UIGEA”), passed in 2006, sought to disrupt illegal online gambling by prohibiting financial firms from processing payments for gambling websites.²⁵³ UIGEA contains a rule of construction stating that no provision therein “shall be construed as altering, limiting, or extending any Federal or State law . . . prohibiting, permitting, or regulating gambling”²⁵⁴

2. Loophole

UIGEA defines “bet or wager” to include any “game subject to chance,” but it explicitly exempts fantasy sports contests where “skill” is a determining factor in the outcome.²⁵⁵ FanDuel (founded in 2009) and DraftKings (founded in 2012) seized on this language to pioneer the Daily Fantasy Sports (“DFS”) industry, in which users participate in one-day fantasy leagues, staking money on teams comprising players of the users’ choosing.²⁵⁶ Although the model looks like a sportsbook (which would be prohibited under PASPA), the companies pointed to the UIGEA carve-out for fantasy sports to argue that DFS was not in fact gambling.²⁵⁷ To further differentiate their businesses from prohibited gambling and to more firmly locate them within the apparent loophole created by UIGEA,

250. See *infra* Part II.G.2.

251. See *infra* Part II.G.3.

252. 28 U.S.C. §§ 3701–04.

253. 31 U.S.C. § 5361.

254. *Id.* § 5361(b).

255. *Id.* § 5362; see Joshua Shancer, *Daily Fantasy Sports and the Clash of Internet Gambling Regulation*, 27 DEPAUL J. ART TECH. & INTEL. PROP. L. 295, 303 (2017).

256. John T. Holden et al., *Regulatory Categorization and Arbitrage: How Daily Fantasy Sports Companies Navigated Regulatory Categories Before and After Legalized Gambling*, 57 AM. BUS. L. J. 113, 129 (2020).

257. *Id.*

FanDuel and DraftKings advertisements touted their games as “games of skill.”²⁵⁸

3. Outcome

FanDuel and DraftKings came under scrutiny from state attorneys general, who accused the companies of facilitating illegal sports betting and fraudulent advertising under state gambling laws.²⁵⁹ According to John T. Holden, “The companies aggressively fought the state [attorneys general], using the UIGEA carve-out for fantasy sports to justify their contention that DFS was not gambling.”²⁶⁰ The litigation and settlement costs caused the companies to bleed cash, yet they persisted in fighting allegations that their business model constituted illegal gambling.²⁶¹

In 2018, the Supreme Court invalidated PASPA, and many states began legalizing sports betting.²⁶² This rendered moot the question of whether UIGEA in fact created a loophole for DFS, or whether DFS constituted illegal sports gambling.²⁶³ Meanwhile, because of their existing customer bases, name recognition, and technological infrastructure, FanDuel and DraftKings were ideally situated to enter the

258. *Id.* at 131–32.

259. *Id.* at 133–34. Attorneys general in New York, Illinois, Hawaii, Mississippi, Nevada, Tennessee, and Texas determined that DFS was illegal under their state laws. *Id.* Other states, including Kansas, Rhode Island, and West Virginia, determined DFS was legal, while Connecticut, Ohio, and South Dakota determined the legal status of DFS to be unclear. *Id.*

260. Holden et al., *supra* note 256, at 134–35.

261. *Id.* This article notes that:

[d]espite various decisions that would seemingly make most legally reasonable DFS companies steer clear of a number of states, both DraftKings and FanDuel continued to test the limits of not only the UIGEA and other federal law, but also the will of various state-level authorities to intervene. Indeed, one of the core advantages in hindsight for both companies was their risk tolerance, irrespective of the legal soundness (or lack thereof) of their approach.

Id. (internal citations omitted).

262. *Id.* at 152; *see* Murphy v. Nat’l Collegiate Ass’n, 138 S. Ct. 1461 (2018) (holding that PASPA unconstitutionally encroached on states’ rights under the Tenth Amendment).

263. *See* Holden et al., *supra* note 256.

legal sports betting market with a formidable competitive advantage over any newcomers.²⁶⁴

H. FLORIDA CRAFT BREWERIES

Intentional loopholes sometimes generate unintentional business opportunities. Florida's craft brewers, for example, creatively capitalized on a state law loophole intended for a theme park.²⁶⁵ Moreover, the craft brewers' story also shows how loophole entrepreneurship can provide an effective counterweight to political rent-seeking and the power of established special interests.

1. General Law

After the repeal of Prohibition,²⁶⁶ Florida, like many states, adopted a "three-tier system" for its alcoholic beverage industry, generally requiring separate ownership for manufacturers, distributors, and vendors.²⁶⁷ Under the state's Beverage Law, a brewer can sell only to a distributor, a distributor can sell only to a vendor, and only a vendor can sell to the public.²⁶⁸ Those licensed as manufacturers or distributors are prohibited from obtaining a vendor license.²⁶⁹ The three-tier system was intended to ensure product safety and tax collection, while preventing market domination by prohibiting one tier from having a financial interest in another.²⁷⁰

264. See Rory Jones, *DraftKings and FanDuel Among Nine Approved Betting Operators in New York*, SPORTSPRO (Nov. 9, 2021), <https://www.sportspromedia.com/news/new-york-betting-draftkings-fanduel-sportsbook-licence-approval/> [<https://perma.cc/KXP3-Q3HU>]. For example, in November 2021, they were among nine recipients of sportsbook licenses from the New York State Gaming Commission. *Id.*

265. See *infra* Parts II.H.1 and II.H.2.

266. U.S. CONST. amend. XXI.

267. Matt Walsh, *There's Much More to the Beer Brawl than You Read*, BUS. OBSERVER (May 12, 2014), <https://www.businessobserverfl.com/article/theres-much-more-beer-brawl-you-read> [<https://archive.li/sVErd>].

268. FLA. STAT. § 561.14; see Samuel A. Rubert, *Florida Beer: Busch Gardens and an End to the "Tourism Exception"*, RUBERT L. (June 10, 2015), <https://www.rubertlaw.com/blog/2015/06/florida-beer-busch-gardens-and-an-end-to-thetourismexception/> [<https://archive.li/GbwvS>].

269. FLA. STAT. § 561.22.

270. *Alcohol Regulation 101: Three-Tier System*, NAT'L ALCOHOL BEVERAGE CONTROL ASS'N, <https://www.nabca.org/three-tier-system> [<https://perma.cc/569P-L9QR>] (last visited May 25, 2023). Proponents of the system blame vertical integration

2. Loophole

From 1959 until 2009, Anheuser-Busch operated a theme park and brewery in Tampa.²⁷¹ Visitors to Busch Gardens could purchase beer to drink in the theme park.²⁷² But under the three-tier law, they could not buy beer for off-site consumption because Anheuser-Busch was unable to operate as a vendor.²⁷³ In the 1980s, Busch Gardens lobbied the Florida legislature to create an exception to the three-tier system that would allow it to obtain a vendor's license even though it was a brewer.²⁷⁴ The legislature acceded to the request, writing an exception into the law allowing a brewer to obtain a vendor's license to sell beer to the public at the brewery for off-site consumption, as long as the brewery property included "such other structures which promote the brewery and the tourist industry in the state."²⁷⁵

Although this Busch Gardens exception was targeted for one company, dozens of craft brewery entrepreneurs in Florida took advantage of the loophole to obtain vendors' licenses for their tasting rooms, which, arguably, "promote tourism" by attracting visitors.²⁷⁶

among tiers for aggressive sales tactics and heavy alcohol consumption in the pre-Prohibition era. *Id.*

271. Rubert, *supra* note 268. In 2009, Blackstone Group bought the park. Mark Albright, *Blackstone Buys Busch Gardens*, TAMPA BAY TIMES (Dec. 2, 2009), <https://www.tampabay.com/archive/2009/12/02/blackstone-buys-busch-gardens/> [<https://archive.li/8tRCe>].

272. Rubert, *supra* note 268.

273. *Id.*

274. *Id.*

275. FLA. STAT. § 561.221; *see* Walsh, *supra* note 267.

276. Rubert, *supra* note 268. Of course, the scale of tourism promoted by a tasting room pales in comparison to that generated by a massive theme park such as Busch Gardens, which boasted 4.1 million visitors in 2018 alone. Veronica Brezina-Smith, *Busch Gardens, Adventure Island Attendance Grows*, TAMPA BAY BUS. J. (May 24, 2019), <https://www.bizjournals.com/tampabay/news/2019/05/24/busch-gardensadventure-island-attendance-grows.html> [<https://archive.li/4rHm5>]. While Florida legislators in the 1980s may have had only large-scale tourism in mind when creating the Busch Gardens exception, the law they enacted is vague in that it contains no scale threshold, so a brewer that attracts even a *single* visitor arguably qualifies as "promoting tourism" and thereby merits a vendor license under the loophole. *See* Rubert, *supra* note 268 (noting the "vague" nature of the "promoting tourism" requirement); *see also* Justin Grant, *Endless Litigation Still a Threat to Florida's Beer Tourism Industry*, TAMPA BAY TIMES (Jan. 29, 2015), <https://www.tampabay.com/things-to-do/food/spirits/endless-litigation-still-a-threat-to-floridas-beer-tourism-industry/2215590/> [<https://archive.li/Pn>]

Without the loophole, a craft brewer could still operate its tasting room, but in order to sell its canned or bottled beer to customers on site, the brewer would first have to sell it to a distributor, and then buy it back from that distributor.²⁷⁷ This cumbersome process would invariably have increased small brewers' costs and threatened their livelihoods, while doing nothing to improve the product or benefit consumers.²⁷⁸ By 2015, "virtually all" of Florida's craft brewers were operating under the Busch Gardens loophole.²⁷⁹

3. Outcome

In 2014, a Florida state senator introduced SB 1714, which would have eliminated the Busch Gardens exception and imposed restrictions on craft brewers.²⁸⁰ These restrictions included requiring a craft brewer to sell its canned or bottled beer to a distributor, and then purchase it back from the distributor in order to sell it to consumers at the brewery.²⁸¹ Unsurprisingly, the bill earned support from the Florida Beer Wholesalers Association (the distributors' trade group),²⁸² but it faced opposition from craft brewers and their devotees.²⁸³ The bill died in the state senate, but it

sSi] (discussing debate over whether Florida's craft breweries "promote tourism" in the manner intended by the law).

277. Brendan Farrington, *Bill that Could Hurt Small Breweries Moves Forward*, TALLAHASSEE DEMOCRAT (Apr. 22, 2014), <https://www.tallahassee.com/story/news/local/state/2014/04/22/bill-that-could-hurt-small-breweries-moves-forward/7994977/> [<https://archive.li/bIyYQ>]; see Walsh, *supra* note 267.

278. See Farrington, *supra* note 277. In response to a proposed bill that would have removed the Busch Gardens loophole, one craft brewer noted, "No mistake, this bill will seriously hinder and even kill growth in the craft beer industry." *Id.*

279. Walsh, *supra* note 267. In 2015, Florida ranked tenth in the United States for total number of craft breweries (110) and fifth in barrels of craft beer produced in a year. Baker Donelson, *Legislation Enhances Florida Craft Beer Industry*, JDSUPRA (June 25, 2015), <https://www.jdsupra.com/legalnews/legislation-enhances-florida-craft-beer-70383/> [<https://perma.cc/D8RT-KE2W>].

280. Farrington, *supra* note 277; see Walsh, *supra* note 267.

281. *Supra* note 280.

282. "The wholesale lobby claimed that, if this loophole weren't closed, the whole three-tier system could fall apart—leading to vertical consolidation that could hurt small business and threaten public safety by flooding the market with cheap alcohol." T.S. Strickland, *Life, Liberty and the Pursuit of Hoppiness*, 850 BUS. MAG. (Aug. 16, 2016), <https://www.850businessmagazine.com/life-liberty-and-the-pursuit-of-hoppiness/> [<https://perma.cc/8K4F-QW65>].

283. John Romano, *Political Nonsense Is on Tap in Tallahassee*, TAMPA BAY TIMES (Apr. 9, 2014), <https://www.tampabay.com/news/politics/political-nonsense-is-on-tap->

motivated the craft brewers to lobby for “an official law . . . on the record books” rather than a “flimsy loophole” sanctioning their businesses.²⁸⁴ The following year, the legislature passed SB 186, which was supported by the Florida Brewers Guild (the craft beer trade group).²⁸⁵ The new law removed the Busch Gardens loophole and authorized the state’s regulator to issue vendor licenses to breweries without requiring them to “promote tourism.”²⁸⁶

I. LSD STORE

Not all loophole entrepreneurs are as successful as Florida’s craft brewers at staving off legislative elimination of a loophole. But even if a legal loophole fundamental to a business model should close, a savvy

in-tallahassee/2174398/ [https://archive.li/9Btum]; see Michael Van Sickler, *Growler Bill Pits Florida Microbreweries Against Big-Money Beer Interests*, TAMPA BAY TIMES (Apr. 22, 2014), <https://www.tampabay.com/news/politics/stateroundup/growler-bill-pits-microbreweries-against-big-money-beer-interests/2176120> [https://archive.li/WkNDA]. Wholesalers’ trade groups have worked hard to fend off any change to the three-tier system. *Id.* Although they claim the system “protects consumers,” their advocacy has been panned as blatant rent-seeking. See, e.g., Alexander R. Steiger, *Fine(ing) Wine: Challenging Direct-Shipment Licensing Fees on Dormant Commerce Clause Grounds*, 62 WM. & MARY L. REV. 2107, 2111–12 (2021).

The tiered system has long been justified as a means of ‘promoting temperance,’ collecting state tax revenue, and ‘ensuring orderly market conditions.’ With the emergence of more efficient means of distribution, including ever-growing internet marketplace, states have become increasingly receptive to schemes in which wine producers are permitted to circumvent the traditional three-tiered system by obtaining a license to ship wine directly to consumers.

Id.; see also Tim Rowland, *My Goodness, My Rent-Seeking*, CATO INST. (2017), <https://www.cato.org/regulation/fall-2017/goodness-rent-seeking#> [https://perma.cc/PM9X-JD5G] (noting that the three-tier system “was designed, of course, to (*wink*) ‘protect consumers,’ which once upon a time maybe it did. But today, like many alcohol laws, it has been commandeered to protect commercial fiefdoms from competition”).

284. Jim Wells, *Controversial Florida Legislation Dies in Session*, BEER ADVOC. (June 2014), <https://www.beeradvocate.com/articles/11173/controversial-florida-legislation-dies-in-session/> [https://perma.cc/DY7B-2942]; see also Walsh, *supra* note 267.

285. *Government Affairs*, FLA. BREWERS GUILD, <https://www.floridabrewersguild.org/government-affairs> [https://perma.cc/SU98-EJRG] (last visited Mar. 1, 2022).

286. *Id.*; see also Rubert, *supra* note 268.

entrepreneur may yet be able to survive.²⁸⁷ The story of Berlin's LSD store shows how a determined loophole entrepreneur can stay one step ahead of legislative efforts to close a loophole and thereby remain in business.²⁸⁸ This case study also reveals that loophole entrepreneurship is not a uniquely American phenomenon; any society that has laws and new businesses can give rise to loophole entrepreneurship.

1. General Law

Germany's narcotics laws ban lysergic acid diethylamide ("LSD").²⁸⁹ Germany is not alone in doing so; many countries prohibit the substance, which was included in the 1971 United Nations Convention on Psychotropic Substances.²⁹⁰ According to the U.S. Department of Justice, LSD carries multiple risks, stemming from the unpredictability of the drug's effect on an individual, which may result in long-lasting psychoses such as schizophrenia or severe depression.²⁹¹

2. Loophole

German narcotics laws ban specific chemical compounds rather than set a blanket proscription on broad categories of drugs (e.g., psychedelic compounds).²⁹² Thus, novel analogs of banned narcotics are technically legal until the narcotics schedule is updated to include them.²⁹³ Although LSD has long been on the narcotics schedule, its recently developed

287. Though, as we have seen in the UGotPosted and Aereo examples, many do. *See supra* Parts II.B and II.D.

288. Though it is unclear how earnestly Germany's government wants to close the loophole in this case. Given Berlin's famously permissive culture, one might reasonably assume this is an intentional loophole, albeit not an admittedly intentional one. *See* Kate Connolly, *Berlin Park Designates 'Pink Zone' Areas for Drug Dealers*, THE GUARDIAN (May 9, 2019), <https://www.theguardian.com/world/2019/may/09/berlin-park-criticised-for-designating-spaces-to-drug-dealers> [<https://perma.cc/CK3Z-28B9>].

289. *Betäubungsmitteln [BtMG] [Narcotics Act]*, July 28, 1981, BUNDESMINISTERIUM DER JUSTIZ [BMJ], as amended (Ger.).

290. U.N. OFF. OF LEGAL AFFS., COMMENT ON THE CONVENTION ON PSYCHOTROPIC SUBSTANCES DONE AT VIENNA ON 21 FEBRUARY 1971, at 392, U.N. Doc. E/CN.7/589, U.N. Sales No. E.76.XI.5 (1976).

291. *LSD Fast Facts*, NAT'L DRUG INTEL. CTR. (May 2003), <https://www.justice.gov/archive/ndic/pubs4/4260/index.htm> [<https://perma.cc/4AM2-GCKR>]. Despite the risks, the Department of Justice notes that LSD is not considered to be addictive. *Id.*

292. *See* BtMG, *supra* note 289.

293. Bateman, *supra* note 82.

analog, 1cP-LSD was not.²⁹⁴ Entrepreneur Carl Trump opened LSD Store to sell the analog after he “went to a lawyer and got a document written up stating it was legal.”²⁹⁵

3. Outcome

In July 2021, German law caught up to 1cP-LSD, officially banning it.²⁹⁶ However, enterprising chemists were already developing 1V-LSD—“a new lysergamide prodrug to replace 1cP-LSD,” which, because its novel compound is not (yet) on the schedule of banned narcotics, would not be illegal in Germany, as well as other countries “where there isn’t a blanket ban on psychoactive compounds.”²⁹⁷ LSD Store is currently selling 1V-LSD, claiming it is a “legal high.”²⁹⁸

J. PUFF BAR

Much like German narcotics laws, U.S. regulations are sometimes playing catch-up as shrewd²⁹⁹ entrepreneurs bring new versions of banned products to market more quickly than policymakers can address them.³⁰⁰

294. See *Donald Trump’s Apparent Distant Relative Opens Berlin’s First LSD Shop*, CANEX (Jun. 24, 2021), <https://canex.co.uk/trump-berlin-lsd-shop-1cp-lsd/> [<https://perma.cc/F9UL-A4GG>] (explaining that 1CP-LSD is “a ‘research chemical,’ which is yet to be banned in a lot of countries, including Germany”).

295. Bateman, *supra* note 82.

296. *1V-LSD – Introducing a New Legal LSD Prodrug for Germany and Most of the World. The New 1cP-LSD?*, CHEM. COLLECTIVE (Oct. 6, 2023), <https://chemical-collective.com/blog/1v-lsd-the-legal-1cp-lsd-replacement/> [<https://perma.cc/ED93-V2MY>].

297. *Id.*

298. LSD STORE, <https://lsd.store/en/> [<https://perma.cc/8YKK-RAC2>] (last visited Mar. 21, 2022).

299. Some would say “cunning.”

300. See Matt Stieb, *The Vaping Industry Has Gone Rogue*, N.Y. MAG. (July 12, 2022), <https://nymag.com/intelligencer/2022/07/the-fda-is-going-to-regulate-synthetic-nicotine-and-puff-bar.html> [<https://archive.ph/tO0xo>]. For instance, vape manufacturer Juul

launched in 2015 with mango and cucumber pods that experts said would attract teens; it took the FDA five years to ban all vape flavors except for menthol and tobacco. Juul reps told high schoolers on campuses that their vape was a safer alternative to cigarettes; it took at least a year for the FDA to tell them that message was illegal. But

And like LSD Store, some American loophole ventures remain in business even after their fundamental loopholes close. Vaping product maker Puff Bar, for example, has the distinction of being a triple-loophole entrepreneur—as one FDA loophole closed, the business revamps its product so as to exploit another one.³⁰¹ But unlike LSD Store, which could relatively easily alter a minute aspect of the chemical makeup of its lysergamide to evade the narcotics prohibition, Puff Bar had to make major changes to its product to keep it legal in the face of ever more stringent restrictions of an FDA determined to crack down on teenage vaping.³⁰²

1. General Law

The Tobacco Control Act (“TCA”) grants the FDA broad authority to regulate “tobacco products.”³⁰³ To combat vaping by children and teenagers, the FDA in 2020 ordered fruit-flavored e-cigarettes off the market by banning electronic nicotine delivery devices (“ENDS”) with flavors other than tobacco.³⁰⁴ Juul, which had first popularized vaping

the threat of enforcement didn’t matter. Soon enough, it seemed like everyone was pulling on a Juul.

Id.

301. See *infra* Parts II.J.2 and II.J.3.

302. U.S. regulators appear to be far more determined to crack down on fruit-flavored vaping than their German counterparts are to ban all psychedelic drugs in Berlin. See *supra* note 288 and accompanying text. This determination is driven, in no small part, by public opinion about preventing teenage vaping. See *infra* Part III.D (describing the relationship between public opinion and loophole fragility).

303. Family Smoking Prevention and TCA of 2009, Pub. L. No. 111-31, 123 Stat. 1776 (2009).

304. *FDA Finalizes Enforcement Policy on Unauthorized Flavored Cartridge-Based E-Cigarettes that Appeal to Children, Including Fruit and Mint*, FDA (Jan. 2, 2020), <https://www.fda.gov/news-events/press-announcements/fda-finalizes-enforcement-policy-unauthorized-flavored-cartridge-based-e-cigarettes-appeal-children> [https://perma.cc/53YZ-UTJT]; see ENFORCEMENT PRIORITIES FOR ELECTRONIC NICOTINE DELIVERY SYSTEMS (ENDS) AND OTHER DEEMED PRODUCTS ON THE MARKET WITHOUT PREMARKET AUTHORIZATION (REVISED)* (FDA 2020), <https://www.fda.gov/media/133880/download> [https://perma.cc/4VHU-L37Z]; see also Sheila Kaplan, *Teens Find a Big Loophole in the New Flavored Vaping Ban*, N.Y. TIMES (Jan. 31, 2020), <https://www.nytimes.com/2020/01/31/health/vaping-flavors-disposable.html#:~:text=When%20the%20Trump%20administration%20decided,allows%20menthol%20and%20tobacco%20flavors> [https://archive.li/liA2f].

among teenagers, succumbed to this regulatory pressure and withdrew most of its flavored ENDS from the U.S. market.³⁰⁵

2. Loophole

Puff Bar continued selling its fruity ENDS under a loophole in the FDA's ban, and when that closed, the company redesigned its product to exploit another loophole in federal law.³⁰⁶ The FDA's 2020 ban on fruit-flavored e-cigarettes included a footnote exempting single-use disposable products.³⁰⁷ This essentially created a loophole for Puff Bar (which produces such disposable, single-use devices), while competitors such as Juul (whose vaporizers are reusable, with refill cartridges of nicotine-containing e-liquid) were subject to the ban.³⁰⁸ As Puff Bar sales

305. Jennifer Maloney, *Puff Bar Stays Top Teen Vaping Choice, as Juul Slips*, WALL ST. J. (Oct. 6, 2022), <https://www.wsj.com/articles/puff-bar-holds-top-spot-among-vaping-teens-as-juul-slips-11665073650> [<https://archive.li/hDF3m>]; see Kaplan, *supra* note 304.

306. See *infra* notes 311–15 and accompanying text.

307. ENFORCEMENT PRIORITIES FOR ELECTRONIC NICOTINE DELIVERY SYSTEMS (ENDS) AND OTHER DEEMED PRODUCTS ON THE MARKET WITHOUT PREMARKET AUTHORIZATION (REVISED)*, *supra* note 304, at n.21 (“An example of products that would not be captured by this definition [of vaping products the FDA was regulating] include completely self-contained, disposable products.”); see Sophie Alexander & Angelica Lavito, *Upstart L.A. Company Pulls Back Puff Bar Single-Use Vaping Product After Outcry*, L.A. TIMES (Feb. 20, 2020, 1:01 PM), <https://www.latimes.com/business/story/2020-02-20/vaping-loophole> [<https://perma.cc/7RJU-7NQ2>] (“While regulators banned most flavored e-cigarettes this year, Puff Bar and its peers have proliferated thanks to a footnote that creates a safe space for devices meant to be used once and thrown away.”); but see Jim McDonald, *So Much for the Loophole: FDA Orders Puff Bar Off the Market*, VAPING360 (July 20, 2020), <https://vaping360.com/vape-news/104207/so-much-for-the-loophole-fda-orders-puff-bar-off-the-market/> [<https://perma.cc/2NLK-AKBG>] (claiming that the footnote did not actually create a loophole for Puff Bar).

308. *New E-Cigarette Ban Loophole Allows Teens to Switch to Disposable Devices*, P'SHIP TO END ADDICTION (Feb. 2020), <https://drugfree.org/drug-and-alcohol-news/new-e-cigarette-ban-loophole-allows-teens-to-switch-to-disposable-devices/> [<https://perma.cc/2C39-MRSY>] (“The new [FDA] ban on most flavored e-cigarettes contains a loophole that allows teens to use disposable devices Teens and school administrators told [the New York Times] that disposable e-cigarettes are popular among teens who formerly used Juul e-cigarettes.”). In 2019, before the ban went into effect, disposable ENDS represented 15% of the e-cigarette market; in 2023, they now account for more than half of the market. Jennifer Maloney, *Sweet and Fruity E-Cigarettes Thrive Despite Teen-Vaping Crackdown*, WALL ST. J. (June 23, 2023, 12:19 PM), <https://www.wsj.com/articles/sweet-and-fruity-e-cigarettes-thrive-despite-teen-vaping-crackdown-11687500000>

skyrocketed, and teenage vaping continued to surge, news media and anti-smoking advocates blasted the FDA's failure to ban Puff Bar.³⁰⁹ Additionally, 30 United States senators sent a letter to the FDA commissioner denouncing the loophole that so obviously undermined the FDA's stated intention to fight teenage vaping.³¹⁰ As a result of this media and congressional scrutiny, in July 2020, the FDA closed the disposable device loophole, issuing warning letters to Puff Bar "to remove their flavored disposable e-cigarettes and youth-appealing e-liquid products from the market because they do not have the required premarket authorization."³¹¹

Puff Bar, however, proved resilient. Because the TCA authorizes regulation of "tobacco products," the 2020 ban applies only to fruit-flavored ENDS containing *tobacco-derived* nicotine.³¹² Thus, after being forced off the market by the FDA, Puff Bar switched to using *synthetic* nicotine and began selling its products again in 2021.³¹³ Puff Bar's co-CEO said: "These loopholes have caused us to look for alternative ways to still provide to our consumers and customers with the products that

[//www.wsj.com/articles/sweet-and-fruity-e-cigarettes-thrive-despite-teen-vaping-crack-down-f2da676f?mod=Searchresults_pos1&page=1](https://www.wsj.com/articles/sweet-and-fruity-e-cigarettes-thrive-despite-teen-vaping-crack-down-f2da676f?mod=Searchresults_pos1&page=1) [<https://archive.li/o0hyB>].

309. See Kaplan, *supra* note 304; see also Stanton A. Glantz, *Puff Bar Continues to Thumb Its Nose at FDA*, UNIV. OF CAL. S.F. CTR. FOR TOBACCO CONTROL RSCH. & EDUC. (May 5, 2020), <https://tobacco.ucsf.edu/puff-bar-continues-thumb-its-nose-fda> [<https://perma.cc/6Y27-8MPY>] (noting that Puff Bar's advertising specifically targeted teens stuck at home during Covid lockdowns, and calling on FDA to "use its authority immediately to enforce against Puff Bar and other e-cigarette companies who are flagrantly violating the law by marketing to kids").

310. Press Release, Senator Jeff Merkley, Merkley, Wyden Slam FDA E-Cigarette Policy Riddled with Loopholes for Kid-Appealing Flavors (Jan. 13, 2020), <https://www.merkley.senate.gov/news/press-releases/merkley-wyden-slam-fda-e-cigarette-policy-riddled-with-loopholes-for-kid-appealing-flavors-2020> [<https://archive.li/rC6cE>].

311. Press Release, FDA, FDA Notifies Companies, Including Puff Bar, to Remove Flavored Disposable E-Cigarettes and Youth-Appealing E-Liquids from Market for Not Having Required Authorization (July 20, 2020), https://www.fda.gov/news-events/press-announcements/fda-notifies-companies-including-puff-bar-remove-flavored-disposable-e-cigarettes-andyouth?utm_source=CTPTwitter&utm_medium=social&utm_campaign=ctp-enforcement [<https://perma.cc/9PCG-VA82>].

312. Nathaniel Weixel, *Congress on Verge of Closing Vaping Loophole*, THE HILL (Mar. 9, 2022, 2:01 PM), <https://thehill.com/policy/healthcare/597542-congress-on-verge-of-closing-vaping-loophole> [<https://perma.cc/U82L-MPM4>].

313. *Id.*

they need.”³¹⁴ He claimed that because Puff Bars were not “tobacco products,” they fell outside the scope of the FDA’s regulatory authority.³¹⁵ With competitors such as Juul limited to selling tobacco- or menthol-flavored ENDS, Puff Bar used the synthetic-nicotine loophole to capture impressive³¹⁶ market share—particularly among teenagers: according to a 2021 CDC report, 26.1% of high school e-cigarette users reported that Puff Bar was their usual brand.³¹⁷ And Puff Bar was the preferred choice among 30.3% of middle school users.³¹⁸

3. Outcome

While critics lambasted Puff Bar’s move as an “Oklahoma land rush going through a very wide loophole,” Puff Bar argued, apparently without evidence, that synthetic nicotine was safer than its tobacco-derived counterpart because synthetic nicotine contained fewer toxins and chemicals.³¹⁹ Medical groups and anti-smoking advocates, however, were quick to dispute this claim.³²⁰

In March 2022, Congress included a provision in the FY 2022 omnibus appropriations bill making clear the FDA’s authority to regulate

314. *How Companies Like Puff Bar Have Avoided FDA Regulation: “The Industry Can Innovate Around It”*, CBS NEWS (Dec. 15, 2021, 11:15 AM), <https://www.cbsnews.com/news/puff-bar-fda-regulation-loopholes/> [<https://perma.cc/RS3P-479K>].

315. *Id.* Beltran emphasized that he was not trying to “side skirt, you know, kind of laws,” and said that “if there’s a law that would order us off the market tomorrow, we would pull our products off the market tomorrow.” *Id.*; see also Stieb, *supra* note 300.

316. Though many would say appalling.

317. Eunice Park-Lee et. al., *E-Cigarette Use Among Middle and High School Students—National Youth Tobacco Survey, U.S., 2021*, 70 CTRS. FOR DISEASE CONTROL & PREVENTION MORBIDITY & MORTALITY WKLY. RPT. NO. 39 1387, 1387 (2021). R.J. Reynold’s Vuse trailed at a distant second with 10.8%. *Id.*

318. *Id.* Puff Bars have been especially “attractive to children and teenagers because of their vibrant colors and flavors, low cost, and ease of access.” Hannah Rosenthal et al., *Puff Bars: A Dangerous Trend in Adolescent Disposable E-cigarette Use*, 34(3) CURRENT OP. IN PEDIATRICS 288, 288 (2022).

319. *How Companies Like Puff Bar Have Avoided FDA Regulation, supra* note 314.

320. The American Lung Association, for example, noted that “[j]ust because synthetic nicotine is not made from tobacco does not mean that it is not harmful.” *What Is Synthetic Nicotine?*, AM. LUNG ASS’N: EACH BREATH (Aug. 18, 2022), <https://www.lung.org/blog/synthetic-nicotine> [<https://perma.cc/EXW9-U36D>]; see Rosenthal et al., *supra* note 318, at 288 (concluding that “Puff Bars present a significant danger to adolescents”).

synthetic nicotine as a “tobacco product.”³²¹ Under the law, e-cigarette manufacturers would have to submit premarket applications for products that were not commercially marketed in the United States as of February 15, 2007, containing nicotine from *any source*.³²² The FDA sent a Warning Letter to Puff Bar on October 6, 2022, stating, “FDA has determined that your firms receive and deliver new tobacco products lacking premarket authorization in the United States. All new tobacco products on the market without the statutorily required premarket authorization are marketed unlawfully and are subject to enforcement action at FDA’s discretion.”³²³

As it had done in the wake of the 2020 ban on fruit-flavored vapes, Puff Bar again changed its product, this time to eliminate nicotine altogether in a product branded Puff Plus Zero.³²⁴ As of January 2023,

321. Press Release, Senator Susan Collins, Collins, Colleagues Secure Omnibus Provision to Close E-Cigarette Loophole, Regulate Synthetic Nicotine (Mar. 14, 2022), <https://www.collins.senate.gov/newsroom/collins-colleagues-secure-omnibus-provision-to-close-e-cigarette-loophole-regulate-synthetic-nicotine> [<https://perma.cc/6QDD-LTEW>].

322. Warning Letter, EVO Brands, LLC and PVG2, LLC d/b/a Puff Bar, FDA (Oct. 6, 2022), <https://www.fda.gov/inspections-compliance-enforcement-and-criminal-investigations/warning-letters/evo-brands-llc-and-pvg2-llc-dba-puff-bar-643091-10062022> [<https://perma.cc/UR7Y-3C2N>]; see Celine Castronuovo, *Tobacco-Free Vapes to Linger on Shelves as FDA Grasps New Power*, BLOOMBERG L. (Apr. 22, 2022), <https://news.bloomberglaw.com/health-law-and-business/tobacco-free-vapes-to-linger-on-shelves-as-fda-grasps-new-power> [<https://perma.cc/G28R-7DRN>].

323. Warning Letter, *supra* note 322. The law had set a May 14, 2022, deadline for companies to file their applications with the FDA, and it ordered that all existing products that had not won agency approval must come off the market by July 13, 2022. Castronuovo, *supra* note 322. However, those deadlines proved overly ambitious, given that the FDA was “already suffering from extremely limited resources, which are progressively being dedicated to the thousands of pending applications from Juul and other producers of tobacco-based e-cigarettes.” *Id.* (internal quotation marks omitted).

324. PUFF BAR, <https://puffbar.com/collections/puff-plus-zero> [<https://perma.cc/S6XJ-WJX8>] (last visited May 25, 2023). Puff Bar’s mission statement on its website states,

We believe that innovation is the key to creating unforgettable experiences. And innovation is at the heart of what we do. Puff Bar provides adults with premium products to elevate life’s greatest moments. For us, offering consumers the best choice on the market isn’t just a mission—it’s a requirement.

Our Mission, PUFF BAR, <https://puffbar.com/pages/about-puff-bar> [<https://perma.cc/TKD4-P6YN>] (last visited Jan. 3, 2023).

Puff Bar’s website lists only vaping devices that are “nicotine free”—though in the same fruity flavors that have been proven to appeal to children and teenagers.³²⁵

K. REVEL

Like Puff Bar, rideshare startup Revel faced regulatory changes that would close the loophole on which its business depended.³²⁶ Whereas Puff Bar doubled down on its business model targeting teenage vaping (further provoking widespread indignation), Revel adopted practices that would cast it in a positive light with the public and with its regulator.³²⁷

1. General Law

Rideshare drivers in New York City are required to obtain a license from the city’s Taxi and Limousine Commission (“TLC”).³²⁸ Beginning in 2018, the TLC capped the number of new licenses it would issue for “for-hire vehicles” (a category that includes rideshare vehicles) in an attempt to relieve congestion on the city’s streets.³²⁹

2. Loophole

The TLC rules capping new for-hire vehicle (“FHV”) licenses included exemptions for wheelchair-accessible and electric vehicles.³³⁰ Seizing on the electric vehicle exemption, Revel (then a moped-sharing

325. PUFF BAR, *supra* note 324. Puff Bar persists in selling its products in fruity flavors, raising justifiable concerns that the company continues to market its products to children and teenagers. *Id.* Puff Plus Zero flavors include Aloe Mango Berry, Blueberry Ice, Cool Mint, Grape Ice, Lemon Razz, Mango Peach Watermelon, Sour Apple, Straw Watermelon, and Mystery. *Id.*

326. *See infra* Part II.K.3.

327. *Id.*

328. 80 N.Y.C. TAXI & LIMOUSINE COMM’N § 80–11.

329. Clayton Guse, *TLC Approves Harsh Regulations on Uber and Lyft, Aims to Reduce Street Congestion in Manhattan*, N.Y. DAILY NEWS (Aug. 7, 2019, 7:26 PM), <https://www.nydailynews.com/new-york/ny-20190807-btuxcy5qkne5tgoamwas3ob7ly-story.html> [<https://perma.cc/8X5C-TQXR>].

330. Matt McFarland, *Revel Saw a Loophole as an Opportunity for a New Ridehail Service. New York City Is Absolutely Livid*, CNN BUS. (May 3, 2021, 2:07 PM), <https://www.cnn.com/2021/05/03/cars/revel-ridehail-nyc/index.html> [<https://perma.cc/4Y9A-KNNQ>].

startup) announced plans to launch a rideshare service in Manhattan with a fleet of 50 Tesla Model Ys.³³¹ In March 2021, Revel submitted its application for FHV licenses to the TLC.³³²

3. Outcome

After Revel announced its plans, the TLC issued a statement explaining that “[t]he electric battery exemption exists to encourage already-licensed cars to go green, not to flood an already saturated market. . . . [Revel’s] ride-share scheme deviates from the spirit of those rules.”³³³ In June 2021, the TLC voted 5-1 in favor of an emergency rule change to remove the exemption for electric FHV—a move that “was widely perceived as a snub toward Revel.”³³⁴

Revel responded by playing the role of the “good guy,” differentiating itself from Uber and Lyft. Principally, Revel emphasized its climate-friendly fleet, comprising exclusively Electric Vehicles (“EV”s).³³⁵ The company emphasized that the purpose of the EV exception was to promote a transition away from fossil fuel-powered cars, and Revel’s business did nothing to undermine that goal.³³⁶ Revel’s business model also differed from Uber and Lyft in other significant, socially beneficial ways.³³⁷ “Revel’s drivers [would] be employees with benefits”—not independent contractors—“and [would] drive Revel-owned electric vehicles rather than their own gas-powered cars.”³³⁸ Revel’s CEO touted this business model as favorable for the city: “This is as much of a slam dunk for the city administration and the [TLC] as it can be In terms of city administration goals and TLC goals, and what they’d like rideshare companies to do, we’re doing everything.”³³⁹ In the event, one month after closing the EV loophole, the TLC approved

331. *Id.*; Andrew J. Hawkins, *New York City Votes to Block New Licenses for Electric Taxis, Snubbing Revel’s Tesla Plans*, THE VERGE (June 23, 2021), <https://www.theverge.com/2021/6/23/22546955/nyc-tlc-electric-vehicle-license-taxi-vote-reveltesla> [<https://perma.cc/5HDA-CE4C>].

332. Valeria Ricciulli, *Everything We Know About Revel’s New Rideshare Teslas*, CURBED (Aug. 6, 2021), <https://www.curbed.com/2021/08/revel-tesla-cabs-manhattan-nyc.html> [<https://perma.cc/QQ5V-LECY>].

333. McFarland, *supra* note 330.

334. Hawkins, *supra* note 331.

335. McFarland, *supra* note 330.

336. *Id.*

337. *See id.*

338. *Id.*

339. *Id.*

Revel's licenses, purportedly because Revel had submitted its application months before the rule change.³⁴⁰

III. LESSONS FOR ENTREPRENEURS, LAWYERS, POLICYMAKERS, AND THE PUBLIC

The case studies above have described a variety of loophole entrepreneurial ventures. These stories reveal at a high level the nature and complexity of this phenomenon. This Part discusses six lessons about loophole entrepreneurship suggested by the case studies. First, they underscore the fact that legal loopholes can provide opportunities for entrepreneurs. Second, although all entrepreneurship carries some danger of failure, loophole entrepreneurship is especially risky. Third, notwithstanding these risks, loophole entrepreneurship can yield distinct competitive advantage. Fourth, a loophole entrepreneur's success often depends on the strength of the loophole. Fifth, loophole entrepreneurship can function as a de facto regulatory sandbox. And finally, loophole entrepreneurship must be judged on a case-by-case basis.

A. LOOPHOLES ARE A SOURCE OF ENTREPRENEURIAL OPPORTUNITY

Entrepreneurship involves the discovery, evaluation, and exploitation of a business opportunity; such opportunities may take the form of new technology, changes in culture or public policy, or simply an empty storefront.³⁴¹ For many entrepreneurs, the law is incidental and exogenous to the opportunity being exploited, and entrepreneurs often grudgingly hire lawyers to develop legal strategies to guide them through whatever legal conflict might emerge from their business plans.³⁴²

340. Theo Wayt, *Revel to Launch Tesla Taxis in NYC After Row with City Regulators*, N.Y. POST (July 26, 2021, 1:57 PM), <https://nypost.com/2021/07/26/revel-to-launch-tesla-taxis-in-nyc-after-row-with-city-regulators/> [<https://perma.cc/TD2H-87QG>].

341. See Zoltan J. Acs et al., *The Knowledge Spillover Theory of Entrepreneurship*, 32 SMALL BUS. ECON. 15, 15–19 (2009) (identifying sources of entrepreneurial opportunities); see also Greg Clydesdale, *Entrepreneurial Opportunity: A Framework for Teaching*, 15 J. ENTREPRENEURSHIP EDUC. 19, 23 (2012) (“Opportunities emerge from a complex pattern of changing conditions including technological, economic, political, social, and demographic conditions.”).

342. See Jack Wroldsen, *Creative Destructive Legal Conflict: Lawyers as Disruption Framers in Entrepreneurship*, 18 U. PA. J. BUS. L. 733, *passim* (2016) (discussing legal

But as the case studies indisputably show, entrepreneurial opportunity may also be found in the law itself—specifically, in a legal loophole. Each of the entrepreneurs discussed above saw a chance to form a viable business in a discrete gap in the law. Though some of these were abortive (Bluseed), and others were short-lived (UGotPosted and Aereo), many have proven successful (FanDuel, DraftKings, Revel, I-71 shops, and craft brewers)—and even revolutionary (Southwest).³⁴³ Aspiring entrepreneurs, and their lawyers, would do well to understand legal loopholes as a potential untapped wellspring of viable business models.

B. ENTREPRENEURSHIP IS RISKY—LOOPHOLE ENTREPRENEURSHIP IS EVEN MORE SO

A loophole entrepreneur runs the risk that the loophole at the core of its business may close.³⁴⁴ While all entrepreneurs face some danger that future laws may bear unfavorably on their businesses, only loophole entrepreneurs (and, even more so, regulatory entrepreneurs³⁴⁵) form their businesses in the shadow of an expression of political will that runs contrary to their business model. The enactment of a general law or regulation reflects a resolve on the part of a policymaker to restrict or control a given activity. The TCA, for example, signaled Congress's desire for the FDA to reduce underage smoking.³⁴⁶ Puff Bar's exploitation

strategies of six entrepreneurial case studies: Tesla, Uber, self-driving cars, equity crowdfunding, Netflix, and Napster).

343. See *supra* Part II.

344. As one website providing tips to entrepreneurs explains:

Some external risk, although it can't be controlled, can be foreseen. For example, if you are thinking about starting a business that takes advantage of a regulatory loophole it is foreseeable that at some point that loophole might get closed. If it does and you didn't plan for that, it's still on you. It's fine if your plan was to just exit the business as soon as the loophole closed—that is a plan. If you find yourself going bankrupt however, when the loophole closes because you just didn't think the good times would ever end, that is on you.

Matt, *External Business Risks – What They Are, How to Spot Them*, CAPFORGE (Nov. 6, 2015), <https://capforge.com/external-business-risks-what-they-are-how-to-spot-them/> [<https://perma.cc/4EY2-9D9B>].

345. See *supra* Part I.B.1.

346. See *supra* Part II.J.3.

of a loophole to evade the FDA's crackdown on fruit-flavored vaping products militated against the political will that led to the enactment of this law. In this case, Congress's resolve was steadfast, and the loophole was closed.³⁴⁷ Thus, a strong political will behind a general law may not permit any activity discordant with that general law's intended purpose. In other words, the political will prompting enactment of a general law may not tolerate loopholes.

Risk also abides in the ambiguity common among most loopholes. Many laws are unclear on the margins,³⁴⁸ but loopholes may be ambiguous at their core.³⁴⁹ This inherent ambiguity means that policymakers, enforcement authorities, or courts may close a loophole with relative ease. As one Florida state senator remarked, amidst the debate over the Busch Gardens exception, "If I were operating a business on a loophole, I'd be nervous . . . [the craft breweries are] vulnerable to being put out of business at the whim of a regulator or new governor."³⁵⁰ The introduction of SB 1714 made clear to the craft brewers the inherent fragility of a loophole, so they mobilized support for a change in state law that would explicitly allow bottle sales at breweries without the need to rely on the "promote tourism" exception.³⁵¹ As one state senator commented, "I'm afraid this industry is working in a lot of ambiguity, and

347. *Id.*

348. The classic example of statutory ambiguity is H.L.A. Hart's "no vehicles in the park" hypothetical: "A legal rule forbids you to take a vehicle into the public park. Plainly this forbids an automobile, but what about bicycles, roller skates, toy automobiles? What about airplanes? Are these, as we say, to be called 'vehicles' for the purpose of the rule or not?" H.L.A. Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593, 607 (1957); see Sanford Schane, *Ambiguity and Misunderstanding in the Law*, 25 T. JEFFERSON L. REV. 167, 191 (2002).

349. See *supra* note 18 and accompanying text. Though not all loopholes are necessarily ambiguous: the FDA's LDT loophole, for example, is reasonably clear. See *supra* Part II.C.2.

350. Walsh, *supra* note 267. We must also add "courts," since, after all, the judicial branch was responsible for closing loopholes in the case of UGotPosted and Aereo. See *supra* Parts II.B and II.D.

351. James Rosica, *Craft Brewers Turn to 'Crowdfunding' for Legal Fight*, NAPLES DAILY NEWS (Jan. 19, 2015), <https://www.naplesnews.com/story/news/blogs/political-fix-florida/2015/01/19/craft-brewers-turn-to-crowdfunding-for-legal-fight/86042640/> [<https://perma.cc/2GEX-D88P>]. The craft brewers have their own trade group, the Florida Brewers Guild. The brewers also organized a crowdfunding campaign to fund their "legal defense, legal offense, and lobbying." *Id.*

I don't want a growing industry in the state of Florida working in an area that is not clear."³⁵²

The consequences of loophole closure for a loophole entrepreneur may extend beyond the demise of one venture and affect the entrepreneur's future business opportunities. For example, when New York's Cannabis Control Board declared that marijuana "gifting" was illegal under New York law, one cannabis attorney said that he advised his clients to stop any gifting businesses, lest they face criminal charges that would render them ineligible to obtain a legitimate cannabis business license from the Board in the future.³⁵³ In addition to such legal repercussions that could blot an entrepreneur's proverbial copy book, the financial consequences of a business failing when a loophole closes may thwart future entrepreneurial efforts. Any personal investment in the loophole business would have been lost, and banks or other investors may (understandably) be loath to provide additional loans or investment funding to an entrepreneur who has previously failed.³⁵⁴

Risks may persist even if a loophole does not close. For instance, a loophole entrepreneur may face crippling litigation from established interests that understandably resent a startup evading regulations they are compelled to endure. Southwest Airlines, for example, was mired in legal challenges from Braniff and TI for four years before its first flight took off.³⁵⁵ When investors were ready to give up, Southwest's attorney, Herb Kelleher, offered to work for free and pay all legal costs out of his own pocket.³⁵⁶ Ultimately, the strategy paid off, but very few corporate lawyers would be willing to make such a sacrifice on behalf of a loophole entrepreneurial client.

Operating in a loophole may also limit future business growth. For example, to continue benefiting from the LDT loophole, Theranos would have been prohibited from selling its testing devices to other labs—thus

352. *Florida Senate Passes Rules for Craft Brewers*, PALM BEACH POST (Apr. 30, 2014), <https://www.palmbeachpost.com/story/news/state/2014/04/30/florida-senatepasses-rules-for/7821688007/> [<https://perma.cc/DSS9-2F7W>].

353. Fanelli, *supra* note 12.

354. *See, e.g.*, Susan Ward, *Challenges of Getting a Small Business Loan*, THE BALANCE (Oct. 11, 2020), <https://www.thebalancemoney.com/small-business-loan-2947070> [<https://perma.cc/6U2G-CA6H>] (noting that lenders may be unlikely to provide loans to people with negative items in their personal or business credit reports).

355. This ruthless strategy ultimately not only failed, but Braniff was hoist on its own petard when a federal grand jury indicted the company for antitrust violations in its effort to kill Southwest. Fallows, *supra* note 122.

356. *Id.*

closing off a potentially lucrative market.³⁵⁷ Similarly, had Congress not deregulated the airline industry, Southwest never could have expanded beyond Texas without CAB approval, which was unlikely given that CAB had approved none of the dozens of applications that it had received during its forty-year history.³⁵⁸

Finally, while loophole entrepreneurship is not inherently bad,³⁵⁹ stigma may nevertheless attach to “exploiting a loophole,” which can affect a startup’s reputation.³⁶⁰ For example, Puff Bar has been roundly criticized as using a loophole to “sidestep” or “skirt” the FDA’s efforts to curb teen vaping.³⁶¹ One Illinois congressman complained that the FDA is “getting punked by two 27-year-olds” (referring to Puff Bar’s young co-CEOs).³⁶² As the case study above explains, this negative perception led to a legislative backlash that closed the loophole on which Puff Bar had built its business.³⁶³

C. DESPITE ITS RISKS, LOOPHOLE ENTREPRENEURSHIP CAN YIELD DISTINCT COMPETITIVE ADVANTAGES

By basing a business on a legal loophole, an entrepreneur gains a competitive advantage over firms operating outside the loophole by reducing (or, in some cases, eliminating) regulatory compliance costs. For example, Bluseed would have enjoyed a considerable edge over land-based startup incubators in Silicon Valley because it could attract foreign entrepreneurial talent without the need to gamble on the H-1B visa

357. See CARREYROU, *supra* note 90, at 121.

358. Dempsey, *supra* note 125, at 115. CAB received more than six dozen applications between 1950 and 1974 for new carriers to enter the market—it did not approve a single one. See generally Robert L. Thornton, *Deregulation: The C.A.B. and Its Critics*, 43 J. AIR L. & COM. 641 (1977); see also Edward M. Kennedy, *Airline Regulation by the Civil Aeronautics Board*, 41 J. AIR L. & COM. 607 (1975).

359. See *infra* Part III.F.

360. This appears to be a kind of irregular verb: I “profit from an opportunity,” you “exploit a loophole,” they “subvert the democratic will of the people.”

361. CBS NEWS, *supra* note 314.

362. *Id.*

363. See *supra* Part II.J. That said, Puff Bar appears to have responded by shifting to “zero-nicotine” vaping devices. See *supra* notes 324–25 and accompanying text. It is possible that Puff Bar’s popularity at the time of this shift could have established enough of a reliable customer base that it will survive and possibly thrive notwithstanding closure of the loophole on which it initially built its business.

lottery.³⁶⁴ Similarly, Southwest had a significant advantage over its competitors in Texas (Braniff, TI, and Continental) that were hamstrung by strict CAB oversight, which inflexibly regulated routes and fares.³⁶⁵ And, for better or worse, Puff Bar was able to continue selling fruit-flavored ENDS after an FDA regulation effectively banned similar products from industry leader Juul.³⁶⁶

This competitive advantage persists at least as long as the loophole remains open and the general law remains in place. And even if the loophole should close, a company may be able to use its established reputation to pivot its business while capitalizing on the market share and reputation gained during its loophole period.³⁶⁷ Puff Bar adopted this strategy twice when the FDA closed favorable loopholes—first Puff Bar switched to synthetic nicotine, and then it introduced nicotine-free vaping devices.³⁶⁸ After each change in its product, Puff Bar was able to continue to remain popular among teenagers, in part because of the reputation (Puff Bar had grown to be considered a “status symbol” among teens³⁶⁹) and market share it had gained while operating in a loophole.³⁷⁰

In some instances, the loophole may expand, or the general law may disappear, bestowing further benefits on the loophole entrepreneur. Again, Southwest is a case in point.³⁷¹ Prior to deregulation, the airline had an opportunity to hone its low-cost business model while enjoying operational freedom that its larger, established carriers lacked.³⁷² After 1978, Southwest entered the newly deregulated interstate airline market with a finely tuned system that reduced costs and allowed it to undercut

364. See *supra* Part II.F.

365. See *supra* Part II.A. When Southwest began serving the Rio Grande Valley, in direct competition with TI, the latter pleaded with the CAB to be allowed to withdraw from that market because it could not beat Southwest’s fares, but the CAB rejected TI’s request, suggesting that a loophole entrepreneur’s competitors may recognize the loophole advantage. See Fallows, *supra* note 122.

366. See *supra* Part II.J.

367. On the other hand, as we’ve seen, loophole closure may prove to be insurmountable, as it was for Aereo and UGotPosted. See *supra* Parts II.B and II.D.

368. See *supra* Part II.J.

369. See *How Puff Bar Became the Most Popular Vape for Kids*, WALL ST. J. (Nov. 18, 2021), <https://www.wsj.com/podcasts/the-journal/how-puff-bar-became-the-most-popular-vape-for-kids/bb6d71d1-3837-4104-82b0-2fb5da30c353> [<https://perma.cc/WTN7-S3RD>].

370. See Rosenthal et al., *supra* note 318, at 288 (noting that Puff Bars “have skyrocketed in popularity recently”).

371. See *supra* Part II.A.

372. See *id.*

its competitors' fares and still turn a profit.³⁷³ Within a decade, Southwest recorded a billion dollars in annual revenue.³⁷⁴ Braniff, by contrast, declared bankruptcy and ceased airline operations in 1982,³⁷⁵ while TI—on the verge of insolvency—merged with Continental.³⁷⁶

Similarly, DraftKings and FanDuel were well positioned to achieve first-mover advantage in the legal sports betting market following the Supreme Court's invalidation of PASPA in 2018.³⁷⁷ The two companies had built sizable customer bases, nationwide name recognition, and technological infrastructure that allowed them quickly and successfully to enter the newly legal market and in short order become its largest players.³⁷⁸

And while operating in a loophole carries a high risk of litigation, these challenges may actually benefit the business by making it stronger. For example, the corporate culture of creativity and cost-cutting at the core of Southwest's success was engendered during the airline's loophole era, when it was operating on a proverbial shoestring budget and engaged in relentless legal battle with its CAB-regulated competitors.³⁷⁹ At one point, during what became known as the "\$13 War," Southwest halved the price of a one-way ticket on its Dallas-San Antonio route to \$13 to boost passenger volume and undercut Braniff.³⁸⁰

As a result, Southwest's passenger traffic spiked, and the airline turned what had been a \$40,000 monthly loss into a profitable route.³⁸¹ Braniff could not afford to match Southwest's price on that route, so it

373. See 1980-1989, SW. AIRLINES, <https://southwest50.com/by-the-decades-80s/> [<https://perma.cc/2SZB-FT83>] (last visited June 23, 2023).

374. *Id.*

375. *Braniff Declares Bankruptcy, Cancels Most Flights*, L.A. TIMES (Sept. 28, 1989), <https://www.latimes.com/archives/la-xpm-1989-09-28-fi-421-story.html> [<https://perma.cc/836Q-UPJR>].

376. Mary Jo Nelson, *Continental, TI Airlines to Finish Merger Oct. 31*, THE OKLAHOMAN (Oct. 7, 1982), <https://www.oklahoman.com/story/news/1982/10/07/continental-ti-airlines-to-finish-merger-oct-31/62870819007/> [<https://perma.cc/6CVU-7698>].

377. See Brett Smiley, *Exclusive: FanDuel Has Absolutely Dominated Virginia Sports Betting Market So Far*, SPORTSHANDLE (July 21, 2021), <https://sports.handle.com/virginia-market-numbers-fanduel-leader/> [<https://perma.cc/A6E6-SH55>].

378. *Id.* (noting the importance of FanDuel's valuable "first-mover advantage" in the Virginia sportsbook market, and DraftKings following on its heels).

379. See *supra* Part II.A.3.

380. *A Tiny Line Takes on Braniff in a Price War*, N.Y. TIMES, Feb. 11, 1973.

381. *Id.*

retaliated by cutting its Dallas-Houston fares from \$26 to \$13.³⁸² Southwest responded by saying that it would match Braniff's \$13 fare, but that if a passenger were to pay the full \$26 fare, Southwest would throw in a fifth of whisky.³⁸³ Because so many of Southwest's passengers were businessmen traveling on expense accounts, they gladly paid the regular fare and enjoyed the whisky.³⁸⁴ It was a knight's move—unconventional, unanticipated by its rivals, and effective.³⁸⁵

As the story of the \$13 War suggests, the unrelenting assault from Braniff, TI, and Continental helped Southwest by keeping it vigilant and compelling it to devise imaginative tactics for staying in business.³⁸⁶ In a 1975 interview, Southwest CEO Lamar Muse reflected:

Harding Lawrence [Braniff's CEO] is probably the best chief executive officer of a trunk line in the United States. But he just got a hard-on about Southwest Airlines. It didn't make any difference to him whether it made economic sense to fight Southwest. He was just going to do us in The funny thing is, every one of his tricks backfired on him. If he had just let us alone from the very beginning, we'd probably have gone under by now.³⁸⁷

Finally, while the negative connotation of “exploiting a loophole” may bring reputational harm, it may also allow an entrepreneur to reap reputational benefits. Aereo and Theranos, for example, were touted as occupying the technological vanguard prior to their downfalls.³⁸⁸ Notwithstanding the gripes from the TLC and established taxi and

382. *Id.*

383. *Id.*

384. *Id.*

385. While the promotion was in effect, Southwest became the largest liquor distributor of Chivas, Crown Royal, and Smirnoff in Texas. *1972 to 1977, SW. AIRLINES MEDIA*, <https://swamedia.com/pages/1972-to-1977> [<https://perma.cc/EU58-AJR7>] (last visited June 23, 2023).

386. *See supra* notes 379–85 and accompanying text.

387. Fallows, *supra* note 122. In another interview, Muse said, “Harding hasn't spoken to me since 1971 Some people are calling our competition a war, but I really still love Harding. He's really helped Southwest.” *A Tiny Line Takes on Braniff in a Price War*, *supra* note 380.

388. *See supra* note 211 (detailing positive media coverage of Aereo); *see also* Noah Kulwin, *Theranos CEO Elizabeth Holmes's Five Best Cover Story Appearances, Ranked*, VOX (Oct. 26, 2015), <https://www.vox.com/2015/10/26/11620036/theranos-ceo-elizabeth-holmes-five-best-cover-story-appearances> [<https://perma.cc/53JK-T4ZG>] (describing the conspicuous, widespread praise lavished on Theranos as a “do-gooder techie venture that is bound to get you lots of favorable media attention”).

rideshare companies, Revel enjoyed positive media coverage focusing on the socially beneficial aspects of its business model, such as its zero-carbon fleet and its better treatment of drivers.³⁸⁹

D. ASSESSING LOOPHOLE STRENGTH

As these lessons have explained, loophole strength is often the determining factor in whether an entrepreneur will fall victim to the risks, or reap the rewards, of loophole entrepreneurship. Some legal loopholes seem lined with titanium, while others collapse under the weight of an unyielding general law. But how can a prospective entrepreneur tell the difference?

The case studies suggest that loophole strength often depends on the general policy trend surrounding the loophole. The cannabis “gift” loophole in Washington, D.C.’s I-71 is a useful example.³⁹⁰ The strength of the gifting provision may seem surprising given the ambiguity of the loophole. Some legal experts and law enforcement officials opined that cannabis gifting shops were actually illegal under the loopholes³⁹¹ though little—if anything—was done to crack down on these businesses.³⁹² Although the D.C. Police Department claimed that “[t]he U.S. Attorney’s Office has successfully prosecuted these cases [of marijuana gifting businesses],” the Department did not provide examples and deferred to

389. Valeria Ricciulli, *Everything We Know About Revel’s New Rideshare Teslas*, CURBED (Aug. 6, 2021), <https://www.curbed.com/2021/08/revel-tesla-cabs-manhattan-nyc.html> [<https://perma.cc/8ABQ-UZ27>] (noting that Revel’s model is “a significant departure from the gig-economy model that leaves many Uber and Lyft drivers on the verge of poverty”); see Maria Merano, *Revel COO Explains How Tesla Model Y Fleet Can Help Familiarize Commuters to EVs*, TESLARATI (Aug. 3, 2021), <https://www.teslarati.com/tesla-model-y-new-york-taxi/> [<https://perma.cc/Q2FK-PSXD>].

390. See *supra* notes 1–12 and accompanying text.

391. A D.C. Police Department official said, “We view any company that advertises that they provide marijuana for any type of payment as illegal. That would include ones that advertise other services in exchange for a marijuana ‘gift.’” Barber, *supra* note 23. Of a similar loophole in Michigan, Wayne County Sheriff Benny Napoleon said in 2019, “I personally believe the law is clear: that you cannot distribute marijuana without a proper license.” Breana Noble, *Gift of Pot? Marijuana Businesses Work in Michigan Law’s Gray Area*, DETROIT NEWS (Jan. 3, 2019), <https://www.detroitnews.com/story/business/2019/01/03/gifting-marijuana-businesses-michigan/2382096002/> [<https://perma.cc/UVZ8-9ZPW>].

392. Barber, *supra* note 23.

D.C.'s Office of the Attorney General.³⁹³ But a spokesperson for that office said he was aware of only one such prosecution.³⁹⁴ The activity at issue in that case, in which the owner of a group called Kush Gods pled guilty to selling marijuana to an undercover officer, differed from the I-71 shops.³⁹⁵ Rather than ostensibly selling non-cannabis products and providing cannabis as an accompanying gift, Kush Gods did not offer any non-cannabis product.³⁹⁶ Instead, the group would “give away” marijuana and then accept a cash “donation” from the recipient.³⁹⁷ Likewise, although some policymakers proposed closing the loopholes, these efforts were ultimately unsuccessful.³⁹⁸

What could account, then, for the unlikely strength of this loophole? One explanation is the overall policy trend vis-à-vis marijuana, which for the last decade has been decidedly in the direction of fewer restrictions and greater freedom.³⁹⁹ In 2012, Colorado and Washington state became the first states to legalize recreational use of marijuana.⁴⁰⁰ Since then, nineteen other states, as well as Washington, D.C. and Guam, have enacted similar measures.⁴⁰¹ These legislative trends track significant changes in public opinion about marijuana.⁴⁰² A 2015 Pew Research

393. *Id.*

394. *Id.*

395. *Id.*

396. *Id.*

397. *Id.*

398. See Austermuhle, *supra* note 102 (describing the D.C. city council's failed effort to close the I-71 loophole). The city's Alcoholic Beverage Regulation Administration, which regulates medical marijuana dispensaries, announced that it would begin requiring inspections of gifting stores for health code, fire safety, and tax violations beginning in September 2022. Martin Austermuhle, *D.C. to Start Inspecting Marijuana Gifting Stores for Health Code and Tax Violations*, NPR (Aug. 9, 2022), <https://www.npr.org/local/305/2022/08/09/1116516128/d-c-to-start-inspecting-marijuana-gifting-stores-for-health-code-and-tax-violations> [<https://perma.cc/Z22B-AGBA>]. But subjecting gifting stores to a basic inspection regime does not undermine the legality of the businesses—if anything, it legitimizes the businesses by treating them in the same way the city treats any other business in the city.

399. See Claire Hansen et al., *Where Is Marijuana Legal? A Guide to Marijuana Legalization*, U.S. NEWS (Sept. 27, 2022), <https://www.usnews.com/news/best-states/articles/where-is-marijuana-legal-a-guide-to-marijuana-legalization> [<https://archive.li/35SLU>] (listing other states that have legalized marijuana).

400. *Id.*

401. *Id.*

402. See *In Debate over Legalizing Marijuana, Disagreement over Drug's Dangers*, PEW RSCH. CTR. (Apr. 14, 2015), <https://www.pewresearch.org/politics/2015/04/14/in->

national survey showed that 53% of respondents believed marijuana should be legal, with 30% saying they have always felt that way, while 21% said they used to think it should be illegal but had changed their minds.⁴⁰³ Among the 44% who believed marijuana should be illegal, only 7% said they had changed their minds, suggesting that the tide of public opinion was flowing in the direction of legalization.⁴⁰⁴ Indeed, by 2022, more than 88% of Americans said they believe marijuana should be legal (59% supporting both recreational and medical use, and 30% supporting medical use only), while a mere 10% said it should not be legal.⁴⁰⁵ Given these trends in both legislation and public opinion, it is unsurprising that I-71's gifting loophole has proved durable—despite its ambiguity.

By contrast, public policy and public opinion on teenage smoking and vaping have grown more restrictive and determined.⁴⁰⁶ Between 2012 and 2015, 93 localities raised the minimum age to buy tobacco products to 21.⁴⁰⁷ On December 20, 2019, President Trump signed into law an amendment to the Federal Food, Drug, and Cosmetic Act, which raised the age for sale of tobacco products (including e-cigarettes) to 21.⁴⁰⁸ These legislative changes have corresponded to similar swings in public opinion.⁴⁰⁹ A 2019 poll by the Kaiser Family Foundation found that “[a]mid concerns about flavored vaping products being marketed to teens, eight in ten (81%) Americans think teenagers who would otherwise not smoke cigarettes are using flavored e-cigarettes.”⁴¹⁰ The poll also found

debate-over-legalizing-marijuana-disagreement-over-drugs-dangers/ [https://perma.cc/QY4G-QQBC].

403. *Id.*

404. *Id.*

405. Ted Van Green, *Americans Overwhelmingly Say Marijuana Should be Legal for Medical or Recreational Use*, PEW RSCH. CTR. (Nov. 22, 2022), <https://www.pewresearch.org/fact-tank/2022/11/22/americans-overwhelmingly-say-marijuana-should-be-legal-for-medical-or-recreational-use/> [https://perma.cc/7ED3Y4AW].

406. Dorie E. Appollonio & Stanton A. Glantz, *Minimum Ages of Legal Access for Tobacco in the U.S. from 1863 to 2015*, 106(7) AM. J. PUB. HEALTH 1200 (July 2016), <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4902755/> [https://perma.cc/9D4Q-PVE2].

407. *See id.*

408. *Tobacco 21*, FDA, <https://www.fda.gov/tobacco-products/retail-sales-tobacco-products/tobacco-21> [https://perma.cc/442K-PTY3] (last visited June 6, 2023).

409. *See* Lunna Lopes et al., *Data Note: Public Views on Vaping and E-Cigarettes*, KAISER FAM. FOUND. (Oct. 17, 2019), <https://www.kff.org/other/issue-brief/data-note-vaping-and-e-cigarettes/> [https://perma.cc/6LLY-KKXJ].

410. *Id.*

that a majority of Americans (52%) support a ban on flavored e-cigarettes.⁴¹¹ Scholars, medical authorities, and the media have cast teenage vaping as a public health crisis.⁴¹² In light of this movement towards greater restrictions on, and growing concern about, teenage vaping, the closure of the disposable device and synthetic nicotine loopholes should have come as no surprise.

Although none of us can foretell the future and know which loophole will close and which will not, the contrast between the I-71 and Puff Bar case studies supports the reasonable assumption that public opinion and policy trends may be gauges of loophole strength.⁴¹³ Of course, while public opinion may bear on a legislature's or regulatory agency's approach to a loophole, these concerns will likely carry less weight among federal (and many state) courts, which are by design unaccountable to the public, and therefore insulated from vicissitudes in public opinion.

Aereo, for example, was an increasingly popular service, and the Court's closure of the loophole incited backlash and public criticism.⁴¹⁴ Whereas a legislature would likely have been loath to act in opposition to public sentiment, Supreme Court justices need not face re-election and are less swayed by popular opinion.⁴¹⁵ That said, courts in some instances

411. *Id.*

412. See, e.g., *Don't Be Fooled: Teen Vaping is Still a Public Health Crisis*, WASH. POST (Oct. 16, 2022), <https://www.washingtonpost.com/opinions/2022/10/16/teen-vaping-health-risks-fda/> [<https://perma.cc/7HVV-7SFZ>] (citing FDA studies, the article concludes that “[t]een vaping continues to be a public health crisis”); *Teen Vaping is a Public Health Crisis: What You Need to Know*, CHILD.'S HOSP. PHILA. (Feb. 4, 2020), <https://www.chop.edu/news/health-tip/teen-vaping-public-health-crisis-what-you-need-know> [<https://perma.cc/DF8J-E8J5>] (“Vaping among preteens and teens has reached a crisis point, . . . and it threatens to undo years of public health efforts that had led to a decline in nicotine use.”); Gretchen Newsom, *Big Tobacco Wants Your Teen to Vape. We Must Do More to Stop It*, SAN DIEGO UNION-TRIB. (Oct. 28, 2021), <https://www.sandiegouniontribune.com/opinion/commentary/story/2021-10-28/teen-vaping-ecigarette-tobacco-nicotine> [<https://perma.cc/Q8AR-ZD6G>] (“Despite all the kid-friendly flavors that make them seem like candy and less like addictive tobacco products, they truly are harmful and addictive.”); *Under the Influence: NIH Research Shows Teen Vaping, Social Pressure on the Rise*, NIH MEDLINE PLUS (Nov. 5, 2020), <https://magazine.medlineplus.gov/article/under-the-influence-nih-research-shows-teen-vaping-social-pressure-on-the-rise> [<https://perma.cc/T2FS-LKK2>] (quoting the Director of the National Institute on Drug Abuse, “[t]he vaping studies have worried us enormously”).

413. See *supra* notes 1–12 and accompanying text; see also Part II.J.

414. See *supra* notes 210–11.

415. See, e.g., Stephen Jessee et al., *The Supreme Court Is Now Operating Outside of American Public Opinion*, POLITICO (July 19, 2022), <https://www.politico.com/news/magazine/2022/07/19/supreme-court-republican-views-analysis-public-opinion->

may nevertheless consider the social implications of the business activity in question.⁴¹⁶ Given the reprehensible nature of UGotPosted, for example, it beggars belief that a judge would have taken no account of the prevailing view that revenge porn violates societal norms.⁴¹⁷ In such a case, the public may, at least in part, have motivated the judge to search for a reasonable interpretation of Section 230 that would find UGotPosted outside of the loophole's protection.⁴¹⁸

E. LOOPHOLE ENTREPRENEURSHIP AS A REGULATORY SANDBOX

In providing this opportunity for demonstrating, testing, and evaluating marginal innovation, loophole entrepreneurship functions as a de facto “regulatory sandbox”—a relatively isolated space where a business can reveal to policymakers and the public what would happen if a law or regulation were changed or eliminated.⁴¹⁹ In a typical regulatory sandbox, “a regulator grants a temporary variance to a startup to experiment with new technology in a live environment.”⁴²⁰ As Seth Oranburg explains, regulatory sandboxes are often touted as “a promising way for regulators to partner with startups in experimenting with more efficient regulations.”⁴²¹ But in practice, Oranburg argues, this approach

00046445 [<https://perma.cc/T4U2-ELH3>] (noting, “The justices are not popularly elected, and the Supreme Court was designed in large part so that the justices, with their lifetime appointments, would be insulated from political pressures, including the ups and downs of public opinion”).

416. See Christopher Casillas et al., *How Public Opinion Constrains the U.S. Supreme Court*, 55(1) AM. J. POL. SCI. 74, 74 (2011) (arguing that “the influence of public opinion on Supreme Court decisions is real, substantively important, and most pronounced in nonsalient cases”); but see Bryan Calvin et al., *On the Relationship Between Public Opinion and Decision Making in the U.S. Courts of Appeals*, 64(4) PUB. RSCH. Q. 736 (2011) (concluding that public opinion has limited effects on courts of appeals decision making).

417. See *supra* Part II.B.

418. See Kashmir Hill, *This Guy Hunts Down the Men Behind Revenge Porn Websites*, FORBES (Apr. 23, 2014), <https://www.forbes.com/sites/kashmirhill/2014/04/23/this-guy-hunts-down-the-men-behind-revenge-porn-websites/?sh=3e1a34716c7b> [<https://perma.cc/9MAM-WSEV>] (noting the “shift in public opinion [that] is helping to shut these sites down” and that there is a “societal norm that says it’s not okay to post a naked photo of someone without their permission”).

419. Seth C. Oranburg, *Encouraging Entrepreneurship and Innovation Through Regulatory Democratization*, 57 SAN DIEGO L. REV. 757, 797 (2020).

420. *Id.*

421. *Id.*

has been beset by limitations.⁴²² First, to the extent it has been used at all, it has mostly been confined to financial technologies.⁴²³ Additionally, regulators enjoy broad discretion to approve or reject sandbox proposals.⁴²⁴

Loophole entrepreneurship, as a *de facto* regulatory sandbox, addresses both of these issues. First, such sandboxes are available in any industry where creative entrepreneurs can identify and exploit a regulatory loophole.⁴²⁵ Rather than having discretion to prospectively reject a sandbox proposal, regulators can generally shut down a loophole sandbox only *after* it has already formed.⁴²⁶ By that point, a savvy entrepreneur will have employed some of the strategies discussed above to ensure that the loophole stays open and the sandbox remains active.

By functioning as a regulatory sandbox, loophole entrepreneurship can reveal to policymakers and regulators important lessons about the (mal)functioning of a general law. Southwest Airlines is a case in point, as it exposed inefficiencies in the ossified regulatory scheme established by the 1938 Civil Aeronautics Act.⁴²⁷ When Southwest was founded in 1968, commercial air travel was heavily regulated by the CAB, which oversaw nearly every aspect of interstate airline operations—routes, fares, and (most importantly for entrepreneurs) market entry.⁴²⁸ Southwest exploited a loophole by flying only *intrastate* routes in Texas, thereby avoiding CAB oversight.⁴²⁹

Southwest quickly became a customer favorite, offering low fares, efficient service, and innovations that were impossible for its CAB-regulated competitors to match.⁴³⁰ Lawmakers took notice, and in the ensuing congressional debate about airline deregulation, Southwest was cited as an example of the positive results that would follow from loosening the regulatory fetters and allowing freer competition in the

422. *Id.*

423. *Id.*

424. *Id.* at 799.

425. *See supra* Part II (describing loophole entrepreneurship in a variety of industries).

426. *See supra* Part II.B–Part II.E (showing after-the-fact efforts to shut down loophole sandboxes).

427. *See Khan, supra* note 90.

428. CAB received more than six dozen applications since 1940 for new carriers to enter the market; it did not approve a single one. *See supra* note 358.

429. *See supra* Part II.A.2.

430. *See Fallows, supra* note 122; *see also Khan, supra* note 90.

industry.⁴³¹ In this way, Southwest—through loophole entrepreneurship—revealed actual (not merely theoretical) problems inherent in the interstate airline regulatory scheme and the potential for value creation outside of those regulations.

But loophole entrepreneurship can reveal not only when regulations ought to be loosened (as in the case of airline regulation), but also when they should be tightened. For example, the Theranos debacle highlighted the dangers of lax FDA oversight of certain types of diagnostic testing equipment, leading to widespread calls for the agency to close the loophole on which Theranos built its business.⁴³² Thus, loophole entrepreneurial case studies can provide empirical, real-world evidence about the relative inefficiencies and inequalities of free(r) markets and strict(er) regulatory regimes, highlighting both what a regulation gets right and what it gets wrong.

Of course, one problem with loophole entrepreneurship as a regulatory sandbox is the inherent difficulty—or even impossibility—of keeping the testing environment isolated from the market. For even if public or political will exists to close a loophole after assessing the effects of the loophole business in the “sandbox,” practical difficulties may keep the loophole open. Moreover, regulators and enforcement agencies have limited resources, so even if policymakers were to close a loophole, enforcement may prove challenging.⁴³³ This was one of the concerns with closing the I-71 loophole: if D.C.’s local government were to make gifting marijuana illegal, how would D.C.’s police department stretch its already

431. See Khan, *supra* note 90; see also Kennedy, *supra* note 358, at 611–12.

432. Though as of this writing, the loophole in question remains open. See Parkins, *supra* note 185.

433. Of course, this would then change the character of the activity from loophole entrepreneurship to regulatory entrepreneurship, given that the crucial distinction between the two—whether the activity is *de jure* legal—would have changed. See *supra* Part I.B.1. But from the entrepreneur’s perspective, would this matter? The business would remain active, carrying on much the same as it had when its activity was *de jure* legal. It is possible, though, that the entrepreneur may have ethical reservations about doing something that is *de jure* illegal, even if there is little threat of enforcement. So, too, might ethical qualms lead the business’s customers to retreat. This topic is important, though largely beyond the scope of the present paper. Daniel Ostas and Elizabeth Pollman have already written about it (see *infra* note 451), and I hope that future scholarship will explore this topic further, specifically as it relates to loophole entrepreneurship (see *infra* notes 451–55 and accompanying text).

strained budget to shut down the scores of I-71 shops that have opened?⁴³⁴ Similarly, the FDA has faced challenges in enforcing its oversight of flavored vaping products due to its underfunded enforcement arm.⁴³⁵

The more successful a loophole entrepreneur is, the more difficult it will be to shut down the activity, even if the loophole closes. The “FDA is now basically trying to put the genie back in the bottle,” according to a legislative aide to Senator Dick Durbin, who helped write the legislation closing the synthetic-nicotine loophole.⁴³⁶ Because the loophole has allowed demand for the product to grow, entrepreneurs—either Puff Bar or others—will find ways to meet that demand. Many counterfeits have formed in the wake of Puff Bar’s popularity, so even if the FDA were effectively to take action against Puff Bar, there would still be other manufacturers (often based in China) making and selling similar products.⁴³⁷ Like the mythological Lernaean Hydra,⁴³⁸ if the FDA stops one supplier of flavored vapes, two others will likely emerge to take its place. Thus, effective enforcement will require more—and more expensive—resources.

434. Adam Eiding, the author of I-71 who believes that the gifting businesses are illegal under the law, noted that D.C.’s police had not actively enforced the law. Barber, *supra* note 23. “Police have kept it a low priority and they don’t think it needs to be prioritized,” according to Eiding. *Id.* “It is still illegal but there are a lot of other more serious things going on.” *Id.*

435. See Stieb, *supra* note 300 (noting that the FDA reportedly has only “a small number of enforcement officers” to ensure that stores are not selling banned vaping products); see also Maloney, *supra* note 308 (explaining that “[t]he FDA can conduct surveillance and issue warning letters but can’t follow-up with legal action in court without the cooperation of the Justice Department. The Justice Department and the FDA haven’t always agreed on enforcement priorities.”). As a result of these limitations on the FDA’s enforcement capabilities, stores continue to sell illegal products despite an FDA order that they cease doing so. See *id.*

436. Stieb, *supra* note 300.

437. *Id.* According to Stanford professor Robert Jackler, “If you want to start a cigarette company and have a billion dollars, you probably can’t do it But if you want to start a vaping company and have \$100,000, you’re in business. It’s really easy.” *Id.*

438. See CHRISTINA SOLOWEY, *Labor II: The Lernean Hydra*, in THE OXFORD HANDBOOK OF HERACLES 45 (2021) (describing the Lernean Hydra as a “creature [with] multiple appendages ending in snake heads, which, when cut or destroyed, regenerated themselves and multiplied”).

F. JUDGING LOOPHOLE ENTREPRENEURSHIP

Although “loophole” has assumed a pejorative connotation,⁴³⁹ loophole entrepreneurship is neither inherently bad nor inherently good. From a socio-political standpoint, there are two types of consequences that can flow from loophole entrepreneurship: benign effects (i.e., unanticipated positive consequences) and perverse effects (i.e., unanticipated negative consequences).⁴⁴⁰ These are best thought of as ends of a spectrum rather than as mutually exclusive categories, and where the effects of a particular loophole entrepreneur fall on that spectrum can be a matter of debate that often may depend on an individual’s subjective views on an issue. For instance, those who support legalizing recreational marijuana would understandably see the effects of I-71’s gifting loophole as positive. Anti-drug advocates, by contrast, would regard the effects as detrimental.

This divergence in opinion over the I-71 loophole stems from disagreement about ends. The two sides in the example above differ in their views on whether the public policy goal should be to allow or to restrict access to marijuana. But even where people agree on a general goal, they may disagree about whether loophole entrepreneurship is the best means to achieve it. If the goal, for instance, were to facilitate immigration of skilled workers and ease the strictures of the H-1B program, some might see Blueseed as accomplishing that goal. But others might see Blueseed as a band-aid that alleviates the problem only in San Francisco.⁴⁴¹ In so doing, it may end up undercutting efforts to achieve a national solution if, say, California voters or the state’s congressional delegation were to lose interest in supporting a comprehensive, nationwide solution—or even oppose it, finding that seasteading gives California-based businesses a competitive advantage. In short, whereas a

439. See, e.g., Richard Esenberg, *Coulee Catholic: Of Loopholes and Legislating*, MARQUETTE UNIV. L. SCH. FACULTY BLOG (July 23, 2009), <https://law.marquette.edu/facultyblog/2009/07/coulee-catholic-of-loopholes-and-legislating/> [<https://perma.cc/EXD7-SXDF>] (noting, “People use the term ‘loophole’ in connection with judicial decisions to imply that the principle of decision is either unimportant or not intended for the purpose to which it has been put.”)

440. See Frith, *supra* note 19; see also Burk, *supra* note 19.

441. Blueseed’s effects would likely be limited only to the Bay Area. And similar ventures would not be possible in landlocked states (and likely not all coastal states—it is difficult to imagine a successful seasteading venture in Florida’s hurricane-prone coastal waters, or the frigid, turbulent seas of New England).

San Franciscan may regard Blueseed as a means to solving the immigration problem, a Minnesotan could see it as a means to *thwarting* a solution.

Relatedly, competing policy goals may lead to different perceptions of a loophole entrepreneur. Revel, for example, highlighted the clash among three public policy issues: reducing traffic congestion in New York City, reducing fossil fuel emissions by transitioning to electric vehicles, and improving compensation and benefits for rideshare workers. One's opinion about Revel's exploitation of the EV loophole likely depends on how one ranks those policy goals in terms of priority.

Yet some loophole businesses may appear objectively good or bad when judged in terms of widely held public values, such as economic efficiency, public health, or individual privacy. From an economic efficiency perspective, a loophole business may seem beneficial if it reveals and helps to combat unfair, wasteful, or otherwise pernicious aspects of a law or regulation. The "Busch Gardens loophole" yielded the unexpected benefit of exposing the inherent inefficiency in Florida's three-tier beverage law.⁴⁴² Similarly, Southwest's upending of the airline industry yielded benefits for the flying public.⁴⁴³ Southwest understood—well before any of the legacy airlines—that with the demise of CAB regulation, the airline market would grow fiercely competitive. To win market share, Southwest adopted a model focused on creating value for customers.⁴⁴⁴ As one commenter noted, Southwest "brought the old-school retail mindset to the once staid and heavily regulated world of air travel. [Its] competitors struggled to keep up."⁴⁴⁵

On the other hand, LSD Store and Puff Bar may appear objectively detrimental in terms of public health.⁴⁴⁶ Both businesses reveal perverse

442. See *supra* notes 277–79 and accompanying text.

443. See *supra* Part II.A.3.

444. For instance, unlike its CAB-regulated competitors Southwest empowered front-line employees to "help resolve customer complaints, even if the airline wasn't at fault and even if doing so cost the carrier money" (such as allowing gate agents to authorize hotel vouchers for passengers whose flights were canceled or delayed). Loren Steffy, *How Herb Kelleher Made the World a Whole Lot Smaller*, TEX. MONTHLY (Jan. 4, 2019), <https://www.texasmonthly.com/news-politics/herb-kelleher-southwest-airlines-made-world-smaller/> [<https://perma.cc/XPX3-UVW3>].

445. *Id.*

446. See, e.g., American Addiction Centers, *Effects of Acid (LSD): Short-Term, Long-Term, and Side Effects*, DRUGABUSE.COM (Jul. 7, 2023), <https://drugabuse.com/drugs/hallucinogens/lsd/effects-use/> [<https://perma.cc/BLV4-7RBG>] (discussing dangers of LSD); American Medical Association, *E-Cigarettes and Vaping: A Public Health Epidemic*, <https://www.ama-assn.org/delivering-care/public-health/e-cigarettes->

effects of regulation—closing a loophole to outlaw one product incentivized the development of others that may be more harmful or less easy to regulate.⁴⁴⁷ Similarly, from a privacy or ethical standpoint, it is unlikely that anyone could reasonably argue that UGotPosted’s business model of revenge porn and extortion yielded any social benefits.⁴⁴⁸

Some policymakers understandably may have a “knee-jerk reaction” to loophole entrepreneurship and rush to close the loophole. They may see loophole entrepreneurship as inimical to the policy goals they set in enacting the general law. Similarly, the public may also be wary of loophole entrepreneurship, especially in a democracy where lawmakers are (at least in theory) carrying out the public will. After all, loophole entrepreneurship has in some cases fostered revenge porn and teen vaping, so policymakers have a duty to respond swiftly in the interest of public welfare. However, it would be worthwhile for politicians and regulators not to paint with too broad a brush, but rather to adopt a more judicious, individualized approach to loophole entrepreneurship and to discern lessons from it that may lead to better, more effective regulations. Likewise, the public may be better served by loophole entrepreneurs than by zealous regulators or self-interested politicians who are often swayed by powerful special interest groups.⁴⁴⁹ In sum, the benefits or detriments of loophole entrepreneurship depend on specific facts and circumstances, so the policy response should likewise be determined on a case-by-case basis.

and-vaping-public-health-epidemic [<https://perma.cc/U29S-HZRZ>] (last visited Nov. 12, 2023) (“The rise of e-cigarettes and vaping has raised concerns that another generation may become dependent on nicotine.”).

447. See *supra* notes 320 and 412.

448. See Goldman, *supra* note 161 (noting “[m]ost folks are cheering [Bollaert’s] arrest for understandable reasons: revenge porn is odious, especially when victims must pay to remove content”).

449. Public Choice Theory maintains that politicians act primarily for their own benefit, and that special interest group influence pervades legislation and regulation. See Steven P. Croley, *Theories of Regulation: Incorporating the Administrative Process*, 98 COLUM. L. REV. 1 (1998); see also Peter L. Kahn, *The Politics of Unregulation: Public Choice and Limits on Government*, 75 CORNELL L. REV. 280 (1990); but see Matthew Wansley, *Virtuous Capture*, 67 ADMIN. L. REV. 419 (2015) (arguing that regulatory capture by interest groups can be a virtue).

CONCLUSION

Loophole entrepreneurship is one way in which the law both shapes and adapts to entrepreneurial activity; thus, it is an ideal subject for the field of law and entrepreneurship.⁴⁵⁰ Yet the topic remains understudied, and the scope of this Article has been limited. This Article has sought to define loophole entrepreneurship, to establish a conceptual framework for understanding it as a distinct phenomenon (one that differs in important ways from regulatory entrepreneurship and regulatory arbitrage), to present a variety of case studies illustrating the phenomenon, and to discern from these some preliminary lessons. In doing so, this Article provides a foundation on which, it is hoped, future scholarship will build.

The ethical implications of loophole entrepreneurship are one area warranting further study.⁴⁵¹ While loophole entrepreneurship is less ethically problematic than regulatory entrepreneurship,⁴⁵² ethical issues arguably inhere in knowingly engaging in activity that flouts the “spirit” of a law, even though it conforms with the “letter” of the law.⁴⁵³ On the other hand, to exploit a loophole is technically to obey the law. As Ludwig von Mises famously asked, “What is a loophole? If the law does not punish a definite action or does not tax a definite thing, this is not a loophole. It is simply the law.”⁴⁵⁴ For Mises, then, there would seem to be no ethical distinction between technical compliance and purposive compliance with a law. Similarly, Leo Katz has argued that loophole exploitation is nearly analogous to skillful persuasion, and that the “loophole-exploiting lawyer no more deserves to be criticized, sanctioned, or otherwise frustrated in his efforts than does the shrewd

450. See Ibrahim, *supra* note 13, at 84.

451. Several scholars have already explored the ethical implications of business and entrepreneurial activity falling either in legal gray areas or outside the law entirely. See, e.g., Elizabeth Pollman, *Corp. Disobedience*, 68 DUKE L.J. 709 (2019); Ostas, *supra* note 18; Daniel T. Ostas, *Cooperate, Comply, or Evade? A Corporate Executive’s Social Responsibilities with Regard to Law*, 41 AM. BUS. L.J. 559 (2004). While this scholarship has not focused explicitly on loophole entrepreneurship, it offers a useful analytical lens for assessing the ethical dimension of the phenomenon. See *id.*

452. See *supra* Part I.B.1.

453. See generally Ostas, *supra* note 18; Ostas, COOPERATE COMPLY OR EVADE, *supra* note 451; see also ØYVIND KVALNES, LOOPHOLE ETHICS, IN MORAL REASONING AT WORK (2d ed. 2019), https://doi.org/10.1007/978-3-030-15191-1_10 [<https://perma.cc/A2NQ-DC4Y>].

454. Salerno, *supra* note 95.

parliamentarian.”⁴⁵⁵ Why should the same not be said of a loophole-exploiting entrepreneur?

A second area deserving further study is the political-economic implications of loophole entrepreneurship,⁴⁵⁶ and future scholarship might assess loophole entrepreneurship from different political-economic perspectives. For example, loophole entrepreneurship may be considered beneficial under public choice theory, as it can expose rent-seeking and provide a counterweight to powerful entrenched interests.⁴⁵⁷ Loophole entrepreneurship might also prove favorable under a Schumpeterian analysis.⁴⁵⁸ After all, loophole entrepreneurs bring about a form of “creative destruction” that may have been improbable, if not impossible, had it not been for the exploitation of a loophole.⁴⁵⁹ CAB’s stringent oversight of all aspects of interstate airlines, for example, effectively suppressed any creative-destructive forces in the industry.⁴⁶⁰ Only through Southwest’s exploitation of a loophole in CAB’s authority was the status quo under the forty-year-old regulatory scheme challenged, and the industry revolutionized.⁴⁶¹ By contrast, advocates of central planning

455. Leo Katz, *A Theory of Loopholes*, 39 J. LEGAL STUD. 1, 27 (2010) (“In the end then, loophole exploitation and skillful persuasion turn out to differ only by a hair, and inasmuch as we never felt too uneasy about the latter, we have one more reason not to feel too uneasy about the former.”).

456. Walter W. Heller is alleged to have quipped that “An economist is a man who, when he finds something works in practice, wonders if it works in theory.” WALL ST. J., June 3–4, 2023, at C8.

457. See *supra* notes 283 and 449 and accompanying text.

458. See JOSEPH SCHUMPETER, CAPITALISM, SOCIALISM, AND DEMOCRACY (3d ed. 1950).

459. Joseph Schumpeter described capitalism as a continuous process of “creative destruction,” as new, more productive techniques, more powerful technologies, more desirable consumer goods, and more efficient forms of economic organization destroy older methods. See *id.* Entrepreneurs are essential to this process. *Id.*

460. See *supra* Part II.A.1.

461. See *supra* Part II.A. During the airline deregulation debate in the 1970s, almost all interstate carriers strongly opposed and lobbied against deregulation. *Airline Deregulation: When Everything Changed*, *supra* note 141. As William Zink explains, “Nearly all of the trunk carriers opposed the notion of deregulation. The major concerns of the airlines were based on the intensive fear of competition and the drastic reduction in fares brought about by low cost entrants.” William Zink, *The Political Motivation of Aviation Deregulation*, 3 J. OF AVIATION/AEROSPACE EDUC. & RSCH. 19, 20 (1999) (noting these carriers had reason to be fearful, as the future history of the airline industry would show; innovative budget carriers would thrive, whereas within the first five years

would likely decry loophole entrepreneurship as a deviation from regulatory intent. The premise of central planning, after all, is that government planners alone are capable of managing a “rational economy,” and any attempt to find or exploit loopholes in the planners’ scheme would amount to defiance of this enlightened and beneficent system.⁴⁶² These questions reveal that loophole entrepreneurship is fertile ground for political economists as well as scholars of law and entrepreneurship.

Future scholarship might also address practical drafting considerations for policymakers. How, for example, might a law be worded so as to encourage beneficial loophole entrepreneurship? Or to prevent loophole entrepreneurship altogether? While an instinctive response might be to create ever-more detailed regulations that address every possible behavior covered by a law, Øyvind Kvalnes has argued that the more comprehensive the rules, the more incentive they create to find loopholes.⁴⁶³ But would more open-ended regulations necessarily reduce those incentives? A study of statutory and regulatory language that has given rise to (or inhibited) loophole entrepreneurship may reveal a relationship between legislative drafting and loophole entrepreneurial activity that would prove instructive to policymakers.

It is also hoped that this Article will spur focused, comparative surveys of loophole entrepreneurship. The case studies presented here represent only a sampling of loophole entrepreneurial activity in a handful of industries. Future scholarship might attempt a more systematic and extensive survey of the phenomenon and a comparison across different industries. Such a study may reveal what (if any) features may make an industry more or less conducive to loophole entrepreneurship.⁴⁶⁴ Likewise, a global comparison of loophole entrepreneurship in different political and economic systems could show in which countries a loophole entrepreneur is more or less likely to succeed.

after deregulation, 20 carriers filed for bankruptcy—including Southwest’s principal competitors in Texas, Braniff, and Continental).

462. See, e.g., Rexford Tugwell, *The Principle of Planning and the Institution of Laissez Faire*, 22 AM. ECON. REV. 77 (1932) (advocating for centralized planning of the national economy).

463. KVALNES, *supra* note 453, at 94.

464. A study such as this would likely reveal important lessons about the effect on loophole entrepreneurship of different degrees and sources of regulation. For example, there may be differences between highly regulated industries and lightly regulated ones (healthcare vs. tech) or industries regulated at the federal level and state/local level (airlines in the early 1970s vs. ride-hail services today).

Finally, while this Article has taken a theoretical approach to loophole entrepreneurship, a future study might provide practical advice that current and prospective loophole entrepreneurs can use to ensure their businesses are successful. The case studies here have suggested some means by which a business might shift the odds in its favor, but entrepreneurs and their lawyers would surely welcome a more deliberate approach to providing pragmatic considerations.

These are only some of the many potential topics for future study in this area. Given the inevitability of legal loopholes—and their exploitation by entrepreneurs—an understanding of loophole entrepreneurship will yield not only academic fodder for scholars, but also practical benefits for policymakers, entrepreneurs, and the lawyers who advise them.