

Bullion and Bandits: The Improbable Rise and Fall of E-Gold

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Kim Zetter

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MELBOURNE, Florida – In a sparsely decorated office suite two floors above a neighborhood of strip malls and car dealerships, former oncologist Douglas Jackson is struggling to resuscitate a dying dream.

Jackson, 51, is the maverick founder of E-Gold, the first-of-its-kind digital currency that was once used by millions of people in more than a hundred countries. Today the currency is barely alive.

Stacks of cardboard evidence boxes in the office, marked "U.S. Secret Service," help explain why, as does the pager-sized black box strapped to Jackson's ankle: a tracking device that tells his probation officer whenever he leaves or enters his home.

"It's supposed to be jail," he says. "Only it's self-administered."

Jackson, whose six-month house arrest ends this month, recently met with Wired.com for his first in-depth interview since pleading guilty last year to money laundering-related crimes, and to operating an unlicensed money transmitting service. His tale is one of countless upstarts and entrepreneurs who approached the internet with big dreams, only to be chastened by sobering realities. But his rise and fall also offers a unique glimpse at the web's frontier halcyon days, and the wilderness landscape that still covers much of the unregulated and un-policed web, where fraud artists prospect for riches alongside pioneers, and sometimes stake, and win, a claim on their territory.

Despite the shackle, Jackson's conviction isn't black and white. In a twist still unacknowledged by prosecutors, Jackson turned E-Gold for a time into one of law enforcement's most productive honey pots, providing information that helped lead to the arrest and conviction of some of the web's most wanted credit card thieves and hackers. He's now working with regulatory agencies to try to bring back E-Gold, steps he says he would have taken voluntarily years ago if authorities had given him a chance.

Following his story, the picture that emerges of Jackson is not a portrait of a calculating criminal. Rather it is one of a naive visionary who thought his dream was bigger than any financial regulations, who got in over his head, and who finally struggled, too late, to make up for his missteps.

"There was no indication at all that anyone had a problem with what he was doing," says Richard Timberlake, a former economics professor at the University of Georgia and author of several books on U.S. banking. Timberlake visited Jackson at his E-Gold office in 1997 and vouches for Jackson's innocent intentions. "He was always very honest and very forthright in what he was trying to do as a business. Even the Federal Reserve believed it was legitimate."

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The story of the first digital currency backed entirely by gold and silver began in 1995, while Jackson was still treating cancer patients. A longtime student of economic history, Jackson was convinced that gold was a superior currency to paper money, despite the consensus among professional economists that a gold-standard prevented governments from responding quickly to monetary crises; when an economy faltered, treasuries couldn't easily manufacture gold bars to stimulate it.

The United States dropped its reliance on gold in 1971, but Jackson doubted the wisdom of this move. "Many a paper currency has spun out of orbit in a calamitous trajectory," he once wrote. "There has never been an instance of gold or silver being discarded as worthless."

It was time, Jackson mused, for a radical rethink of money. Had he been born in another era, he could scarcely have acted on his beliefs. But the nascent internet changed everything. The international, 24-hour churn of e-commerce cried out for a monetary system that transcended borders and time zones. So in early 1996, Jackson began programming a back-end system for a new electronic currency, practicing medicine by day, and coding by night.

He hired a software engineer to create the user interface, and four months later launched E-Gold.

As Jackson envisioned it, E-Gold was a private, international currency that would circulate independent of government controls, and stand impervious to the market's highs and lows. Brimming with evangelical enthusiasm, Jackson proclaimed it a cure for the modern monetary system's ills and described it at one point as "an epochal change in human destiny" and "probably the greatest benefit to humanity that's ever been thought of."

Though E-Gold would fail to change the world, libertarians and privacy-conscious netizens liked the service, which allowed them to open accounts anonymously. And international sellers appreciated the ease with which they could transact across borders

Over the next few years, Jackson drained his retirement accounts, sold his medical practice and charged credit cards to raise more than \$1 million to nurture the fledgling venture. Cynics might have considered him just another internet hustler looking to strike it rich, but those who knew him say he was a true believer. "He truly thinks that having a gold-backed currency is what's needed in the world," says James Clement, a libertarian attorney who met Jackson in 2003. "I don't think anyone would have stuck with it ... other than that he thinks it's extremely important and somebody has to do this."

Jackson drew his inspiration from economist Vera Smith's influential 1936 treatise *The Rationale of Central Banking and the Free Bank Alternative*, which challenged the tenets of banking. "She wrote in the depths of the Depression, and poses some of the most compelling questions about central banking systems," Jackson says. "Central banks should attenuate monetary disorder and prevent fluctuations, but ironically they sometimes amplify it."

His commitment started to pay off in 2000, when some 50,000 transactions suddenly passed through his system in just two months – more than the previous three and a half years combined. By that November, E-Gold, now with 20 employees, had processed 1 million transactions, and Jackson's business reputation was growing. He was invited to

speak at the prestigious World Gold Council conference in Rome, the gold mining industry's leading event. In 2001, the growth continued, with customer accounts expanding from 134,000 to nearly 288,000, holding about \$16 million in value.

Initially, Jackson stored the company's reserves of sovereign coins and ingots in safety deposit boxes in banks around town. When this proved inconvenient for auditing, the company bought an office safe to hold the gold and platinum. "The silver was just stacked around the office," Jackson says. Ultimately, he converted the sovereigns and ingots to bars and moved them to bank vaults in London and Dubai. At E-Gold's peak, the currency would be backed by 3.8 metric tons of gold, valued at more than \$85 million.

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Despite the sudden burst of success, the venture was plagued with setbacks. E-Gold's servers buckled under the growing traffic load, hanging transactions and frustrating users. Copycat entrepreneurs erected their own gold-backed systems – e-Bullion, GoldMoney and OSGold – and poached E-Gold customers. When Jackson finally scaled up his infrastructure in 2003, solving the performance problems, cyber scammers entered the scene, launching a sortie of phishing attacks against users, tricking thousands of them into disclosing their E-Gold passwords, then draining the accounts.

Eventually Jackson deployed an anti-phishing remedy, and business rebounded in September 2004. A year later, customer accounts numbered about 3.5 million in 165 countries, with 1,000 new accounts opening every day. Millions of dollars were zipping through E-Gold's system 24-hours-a-day, bouncing between the U.S. and Europe, South America and Asia. E-Gold collected 1 percent of every transaction, with a cap at 50 cents.

E-Gold was now second only to PayPal in the online payment industry. At last, Jackson says, he felt relief.

"We had been stuck year-in and year-out on whatever crisis-du-jour required our immediate attention," he says. Now "we felt like we'd finally achieved a turning point."

But E-Gold's increasing popularity with customers drew less-welcome attention as well.

The federal government began to take notice in 2003, when the Secret Service launched an undercover operation against a website called Shadowcrew – a legendary forum for "carders" who trafficked in stolen credit and debit card numbers. Cyber crooks in Eastern Europe were stealing millions of card numbers in phishing and skimming scams, then passing the data to accomplices around the world. The low-end cashers coded the numbers onto blank cards, then siphoned money from ATMs and transmitted the bulk of proceeds back to the former Soviet bloc.

When authorities monitored the criminals' communications, they discovered that E-Gold was among the carders' preferred money-transfer methods, because the system allowed users to open accounts and transfer funds anonymously anywhere in the world.

When the Shadowcrew investigation wrapped in October 2004 with the shuttering of the site – and the arrest of more than a dozen members – the Justice Department turned its sights on E-Gold. Its goal was to force the service to comply with regulations governing money-transmitting services like Western Union and Travelex. Federal regulations required those businesses to register with the Treasury Department's Financial Crimes Enforcement Network (FinCEN), to be licensed in states that required it, to diligently authenticate the identity of customers and to file suspicious activity reports on shady-looking customers. But E-Gold wasn't doing this.

Jackson believed E-Gold was exempt from regulation because it was a payment system not a money transmitter. And although it did transfer money, customers could park balances in their accounts, as with a bank.

But Jackson insisted E-Gold wasn't a bank, either. It was something new – something the world and the U.S. government hadn't seen before. He wasn't alone in this view. Many internet-based payment services, including PayPal during its early years, believed they were exempt from regulation. They mostly flew under the radar of prosecutors until something brought them into the spotlight.

Jackson says he got the first inkling of the rampant, organized crime in his system when he read a June 2005 New York Times story about the growth of the carding forums. "To my horror ... E-Gold is mentioned in this ghastly, horrible way of it being, you know, the bitch of criminals," he says.

He concedes he knew that Ponzi schemers and other scammers sometimes used his system, but he'd always responded to government subpoenas for information about suspicious customer accounts. So he contacted the Secret Service to ask why the agency hadn't sought his help to track the crooks in the *Times* story. The agency, which was already secretly targeting E-Gold, ignored him. (The Secret Service didn't respond to interview inquiries for this story.)

The hammer dropped on E-Gold around 5 p.m. on a mild day in mid-December 2005. A herd of Chevy Suburbans wheeled up to Jackson's house and expelled more than a dozen FBI and Secret Service agents. Simultaneously across town, the Justice Department's "Operation Goldwire" unfolded with more agents raiding the offices of Gold and Silver Reserve, the company that operates E-Gold. A third group descended on a co-location facility in Orlando where E-Gold Limited, a holding company for E-Gold's assets, racked its database servers.

The feds carted away more than 100 boxes of electronic records and paper files, including birth certificates, photos and a deed to the Jackson family burial plot. The gold and silver reserves remained safe overseas, but the government froze the company's domestic bank accounts. Jackson's venture was dissolving around him.

Jackson wasn't sure what the feds hoped to find in all those records; once E-Gold got its systems back online he turned to his database for answers.

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He scoured the system for suspicious transactions using key words like "cvv," "dumps" and "cob," and the names of carders he'd read in the *Times*. He quickly discovered the disturbing truth about what his libertarian dream had become. "I found out there was quite a bit of stuff going on which law enforcement knew about, but wasn't asking us about," he says. "I found, holy smokes, there is a continuing pattern of these so-called carders. There's, like, a ring that I can distinguish."

One user named "Segvec" received more than half a million dollars from four others, including a Ukrainian named "Maksik" who sent a rapid stream of cash totaling \$300,000. In the "memo" field of the transactions – where the sender can state a reason for the payment – Maksik noted that \$17,000 was "for beer." Another three transactions totaling \$89,000 sent over a week's time were supposedly for Sony Vaio computers.

A New York account-holder named "Potluck" had a pattern of buying \$6,000 in postal money orders twice a month, then exchanging them for e-Gold to send to Ukraine. Over a year, he'd transmitted about \$150,000.

Jackson had uncovered a constellation of shady accounts doing business with one another. He watched in amazement as the criminal activity expanded before his eyes, and balances in several accounts ballooned, with no sign that the account holder intended to move it out. Segvec alone amassed more than \$700,000 in digital gold.

"They weren't just using us as a good vehicle to trade their data, they were parking value in our system," Jackson says. E-Gold had unwittingly become banker to the underworld.

Because users could sign up for E-Gold with aliases, there was no easy way for Jackson to determine the real identity of many of his suspects. But the criminals became vulnerable the moment they converted their virtual currency to local cash. This required them to do business with an E-Gold money exchanger – the online equivalent of currency exchangers at international airports – who'd ask for valid ID and contact information. Sometimes the criminals wanted their cash loaded to a debit card and mailed to a drop address, or wired to a traditional bank account; exchangers would have this data, too.

Jackson reached out to about a dozen exchangers in Europe and elsewhere with the account names he was tracking. Some criminals had provided the exchangers with fake credentials, but a surprising number had given their real names or addresses. Jackson

soon had the identities of some of the most wanted figures in the underground.

One money exchanger in Northern Ireland revealed that "Segvec" routinely had packages sent to a Tokyo remailer, who forwarded them to a "Stephen Ceres" in Miami. The same exchanger also sold "Stephen Ceres" a Card One debit card with a daily load limit of \$9,500. Jackson obtained a list of transactions on the card that linked it to a slew of ATM withdrawals in Miami suburbs. A storm of withdrawals during one five-minute period yielded the cardholder \$8,000 in cash.

Jackson, who had been snubbed by the Secret Service and FBI, took the information he uncovered to the U.S. Postal Inspector Service, providing investigators with names, addresses and transaction histories. The postal inspectors passed the information to overseas allies, the FBI, and eventually to the Secret Service as well.

It was a devil's bargain. Once the feds got a taste of what Jackson could provide, the postal agents began peppering him with requests for more data on other accounts, promising Jackson they'd follow up with a formal court order or subpoena later. He cooperated fully, despite the fact that it violated his user agreement with customers. "We never did get any legal cover whatsoever," he says ruefully. "We never got our trap-and-trace. We never got our pen register."

In March 2006, inspectors asked him for information on a carder named "Jilsi," whom Jackson traced to a money exchanger in the United Kingdom. The exchanger gave him a real name – Renu Subramaniam – a 2-year-old confirmed phone number and the time and location of deposits Subramaniam had made to two London banks. Jackson passed the information to inspectors who told him that the phone number, if correct, would be "the break in the case we have been waiting for, for quite a long time."

It wasn't long before carders were being taken down. In May 2007, Markus Kellerer, aka Matrix 001, was arrested in Germany. In July 2007, Subramaniam, who had been an administrator on a carding site called DarkMarket, was arrested in Britain. That same month, authorities in Florida arrested Julio Lopez, aka Blinky, who was connected to a ring of Cuban carders. And last year in Miami, authorities arrested Albert Gonzalez, aka Segvec, allegedly one of the masterminds behind the hack of TJX and other businesses. Jackson had provided authorities with information on all of them.

An FBI agent who was involved in the arrest of a number of carders, but asked not to be identified because he wasn't authorized to speak, acknowledged that information Jackson provided was "instrumental in helping track people down."

A year after he began his probe, Jackson began blocking the accounts responsible for the suspicious activity, preventing suspected crooks from getting their loot. E-Gold was on its way to becoming clean, relatively speaking.

As far as the feds were concerned, however, it was too late. A few months later, in April 2007, the Justice Department wrapped up its four-year-long investigation by indicting Jackson and his colleagues on federal charges of money laundering, conspiracy and operating an unlicensed money transmitting business.

"Douglas Jackson and his associates operated a sophisticated and widespread international money remitting business, unsupervised and unregulated by any entity in the world, which allowed for anonymous transfers of value at a click of a mouse," said U.S. Attorney Jeffrey A. Taylor for the District of Columbia in a press release. "Not surprisingly, criminals of every stripe gravitated to E-Gold as a place to move their money with impunity. As alleged in the indictment, the defendants in this case knowingly allowed them to do so and profited from their crimes."

Clement, the attorney, disputes the government's depiction of Jackson. "They automatically assume that E-Gold somehow made it easy for these people involved in money laundering, or [sought criminals] as clients," says Clement. "But that's completely the opposite of Doug's attitude toward any kind of illegal behavior. It would be crazy for somebody to seek out that kind of business."

Jackson, who'd hocked his future to start E-Gold, now faced the potential of a federal prison term. He was frustrated and confused.

"It never crossed my mind that anyone could seriously want people like us in prison," he says. "But I guess my bigger fear was that we would go bankrupt, and there would be a train wreck of people that had trusted value to us who couldn't get their money."

Timberlake, the economics professor, is convinced that Jackson's radical dream, his goal of upsetting the economic status quo and overturning the government's monopoly on money, is what really got E-Gold targeted.

"No matter how innocent a person is you can always find a law that government agents can use to convict him of something," Timberlake says, "And this is a perfect example of it. Any time anybody tries to produce money, the federal government is going to be on their tail."

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After a year-and-a-half of court wrangling and negotiations, Jackson pleaded guilty last year to conspiracy to operate an unlicensed money transmitting service and conspiracy to commit money laundering. In November he was sentenced to 36 months of supervised released – including six months of house arrest and electronic monitoring, and 300 hours of community service. In addition to forfeiting about \$1.2 million to the government, his two companies – Gold and Silver Reserve and E-Gold Limited – were fined \$300,000, to be paid in \$10,000 monthly installments beginning last month.

The plea agreement is conditional on Jackson revamping his business to comply with regulations governing money-transmitting services – a goal that, Jackson concedes, faces many hurdles. To begin the process of compliance, he suspended the creation of new accounts. Existing customers are now required to submit a government-issued photo ID and proof of residence to authenticate their name, address and other details, and are limited to \$1,000 to \$3,000 a month in transactions until they pass muster. Customers in high-risk countries – such as Nigeria, Russia and Ukraine – are suspended from making any transactions at all for now. Their money is locked indefinitely in E-Gold's servers.

Jackson, who always considered himself one of the good guys, acknowledges today that he might have done a better job of policing his system from the start. "In hindsight there's any number of things that would have been a smarter or better way of approaching things," he says.

Back in his Melbourne office, the blinds are drawn against the harsh sun, and a wall calendar serves as the room's sole decor. A belt and freshly dry-cleaned dress shirt, still swathed in plastic wrap, hang from a metal shelf. A one-pound plastic jug of protein powder on Jackson's desk serves as a reminder of the weight he's lost since his legal troubles began. When asked what toll the trouble has taken on his family – Jackson and his wife are currently living in different states – there's a long silence before he clears his throat.

"It's been a source of distress," he says finally. "Ten years ago I was an affluent physician."

Although E-Gold was occasionally profitable, Jackson only drew a salary, like his employees. The two upscale homes he once owned with his wife are long gone. Now his wife and 12-year-old son occupy half a duplex in Pennsylvania near her family, and Jackson lives in a one-bedroom apartment in Melbourne with his 17-year-old son, while the latter finishes high school, and Jackson and his staff attempt to rebuild the business.

Jackson has finally registered E-Gold with FinCEN, and has begun applying to states for money transmitting licenses. The company is also blocking people who appear on the Treasury Department's list of Specially Designated Nationals and plans to follow bank procedures for verifying customer income and sources of transmitted funds. There are other plans in works to clean up the system as well.

There's a daunting hill to climb before E-Gold will be operational again, and it remains to be seen whether there will be a market for a scrubbed-down, government-compliant E-Gold. But Jackson seems relieved to be headed in this direction.

"One of the biggest results of this is that we're getting to the place we wanted to be anyway, which is to have some sort of an explicit set of standards to build against," he says.

He maintains that he would have done what authorities now want him to do, if they'd just worked with him to devise a plan, instead of treating him like a criminal.

Now, after all of E-Gold ups and down, Jackson hasn't lost his optimism for the venture, or his knack for florid prose. As he wrote on his blog last year, he looks forward to transforming E-Gold from a marginal player to a respected institution – one, he says, that will serve to "advance the material welfare of mankind."

(Photos by Chris Livingston)