

Online Gambling: The Geolocated Road Ahead



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Law360, New York (April 24, 2012, 3:50 PM ET) -- Much has been made of the recent public release of a legal opinion by the United States Department of Justice that reversed its long-held stance that the federal Wire Act outlaws almost all forms of Internet gambling. The DOJ opinion was prompted by the plans of New York and Illinois to sell lottery tickets delivered to computers or mobile phones using the Internet, to adults within their state borders, using out-of-state transaction processors. These states' inquiries gave the DOJ a chance to publicly reverse its long-held view and instead opine that the Wire Act covers only sports-related gambling, betting and wagering and that a lottery is not a "sporting event or contest."

Does the DOJ opinion clear the way for online gambling? No, but it represents a clear step toward liberalizing online gaming in the United States. Although the DOJ opinion is not binding law, as a practical matter it would be difficult for the DOJ to bring a prosecution action under the old interpretation of the Wire Act. In the meantime, the opinion clears the way for states to decide, on a state-by-state basis, whether they wish to allow online gambling unrelated to sporting events or contests within their borders.

While online gaming may have been liberalized, it still carries political risk. Congress could conceivably pass preemptive federal legislation that expressly outlaws some or all forms of online gaming. Future administrations could revert to the older DOJ interpretation of the Wire Act. State laws that legalize online gambling but discriminate against out-of-state, non-U.S. service providers may raise free trade issues.

Most importantly, there are additional steps that must be taken for widespread legal online gambling to become a reality. Individual states must legalize online gambling within their borders, or (and less likely) Congress must pass comprehensive federal legislation legalizing online gambling. By implementing regulations for online poker, Nevada has charged fully ahead and, by virtue of its head start, could be the regulatory model for other states to follow.

Federal Gambling Laws

As a practical matter, the Wire Act was the only federal law that, as formerly interpreted, directly prohibited online gambling. Other federal laws that criminalize aspects of gambling require a violation of some other federal law or a violation of state law before being triggered.

For example, the Unlawful Internet Gambling Enforcement Act (UIGEA) prohibits accepting credits, fund transfers or other payments from anyone "engaged in the business of betting or wagering, in connection with the participation of another person in unlawful Internet gambling." The UIGEA defines "unlawful Internet gambling" as "to place, receive, or otherwise knowingly transmit a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made."

On April 15, 2011 (known as Black Friday in the online poker world), the DOJ unsealed indictments of the then three largest online poker companies and their executives. They were charged with bank fraud, money laundering and violating the UIGEA. Those defendants have either entered into plea bargains or their prosecutions are, as of this date, continuing. Notably, the DOJ did not charge the defendants with violating the Wire Act.

The Illegal Gambling Businesses Act (IGBA) is another federal gambling law. The IGBA makes it illegal to "conduct, finance, manage, supervise, direct, or own all or part of an illegal gambling business." It defines an "illegal gambling business" as any "gambling business which (i) is a violation of the law of a State or political subdivision in which it is conducted; (ii) involves five or more persons who conduct, finance, manage, supervise, direct, or own all or part of such business; and (iii) has been or remains in substantially continuous operation for a period in excess of thirty days or has a gross revenue of \$2,000 in any single day." Thus, like UIGEA, the IGBA prohibits gambling only if it is made illegal by virtue of some other law.

Finally, the federal Travel Act prohibits, in relevant part, a person or entity from using "any facility in interstate or foreign commerce" with the intent to "(1) distribute the proceeds of any unlawful activity; or ... (3) otherwise promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on, of any unlawful activity," and thereafter performing or attempting to perform such conduct.

Unlawful activity is defined to include "any business enterprise involving gambling" in violation of state or federal laws. The Travel Act may be violated whenever the Internet (an interstate facility) is used to place or receive a bet in a jurisdiction where gambling is prohibited. The Travel Act thus covers, for example, the case where an offshore operator of an online gambling business accepts bets originating from the U.S. if those bets otherwise violate federal or state law.

If online gambling unrelated to sports betting is not covered by the Wire Act, then neither the UIGEA nor the Travel Act would apply unless, as a threshold matter, such online gambling violates state law.

State Gambling Laws

Every state and the District of Columbia have some form of gambling or lottery statutes. These statutes apply to gambling, whether conducted in person or over the Internet. The laws vary from state to state, but generally outlaw or at least regulate lotteries. They generally define lotteries as games that include three basic elements: (1) something of value is wagered (the "consideration"), (2) for a reward of value (the "prize"), (3) on a game or contest of chance or where the bettor has no control over the outcome.

The element of consideration is satisfied by whatever a bettor chooses to risk, whether it takes the form of money or some other source of commercial value. Rules of promotional contests often specify that "no purchase is required" in an effort to avoid triggering the element of consideration.

The prize element is what a bettor hopes to win through his or her wagers. Although any prize could conceivably have subjective value, courts seldom find that rewards of only intangible value (e.g., a sense of personal accomplishment) satisfy the prize element. In general, the greater the ease with which a reward may be liquidated or used as currency outside a game, the more likely the reward is to meet the "prize" element. Publishers of online video games and social games often limit a player's ability to cash out his game winnings partly in an effort to avoid the element of "prize."

The third element — whether the game in question is one of skill or chance — is where much of the debate over whether poker is a form of gambling occurs.

While some may debate whether poker is predominantly a game of skill, no state views slot machines, blackjack, craps, roulette or other games commonly found on casino floors as anything but games of chance. Moreover, many states expressly outlaw poker and slot machines. In addition to prohibiting wagering on games of chance, some states, including Arizona, Iowa, Louisiana, Maryland, Montana, South Dakota and Tennessee, also arguably prohibit wagering on games of skill.

The states of Illinois, Indiana, Louisiana, Oregon, South Dakota, Washington and Wisconsin explicitly prohibit online gambling. While not all of the online gambling prohibitions use the term "online gambling," these statutes generally define the concept of "online gambling" as the use of the Internet to place wagers or to transmit information for placing or receiving wagers. Some states also outlaw receiving, recording or registering bets or wagers, or of selling pools of bets or wagers (i.e., bookmaking and or pool selling).

Although several states (including California) are considering online gambling as a potential source of new revenue, as of the date of this publication, only Nevada has explicitly legalized certain forms of online gambling (currently only for online poker).

Nevada: The Model for eGaming Regulation?

During its 2011 session, the Nevada legislature passed a law allowing qualified persons and entities to become licensed to conduct in-state "interactive gaming" and "mobile gaming." The day before the DOJ opinion was made public, the Nevada Gaming Commission adopted regulations drafted by the Nevada Gaming Control Board to implement Nevada's new interactive gaming laws for online poker. While a full review of the Nevada legislation and accompanying regulations is beyond the scope of this article, certain provisions require operators to have effective, and virtually foolproof, geolocation and player authentication capabilities, and are therefore worth noting.

The regulations direct the chairman of the board to adopt and publish minimum internal control standards that "interactive gaming operators" must follow concerning such matters as system security; authorized player identification and registration; the confidentiality of player accounts; precautions against the use of automated software programs (sometimes called "bots") that interface with websites to calculate odds and process wagers more rapidly, and other automated, nonhuman player software programs; the prevention of player collusion; periodic system testing; the adoption of self-exclusion programs and protecting players' personally identifiable information (as rather narrowly defined in the regulations).

While delegating to the board chairman broad authority to define and mandate certain licensing mechanics, minimal internal controls and a variety of other matters, the commission took care to include in the regulations themselves specific provisions concerning player registration procedures. Recognizing that authenticating the identity of online gamblers is perhaps the greatest technological

hurdle to be overcome, the regulations reflect an effort to shift the risk of "getting it wrong" to those players who misrepresent their age, location or identity.

Before allowing any "wagering communication" over the Internet (or other specified media), an interactive gaming operator must obtain a host of information from the individual, including an acknowledgment that if the operator "is unable to verify the information provided by the individual" within 30 days of registration, then any winnings attributed to the individual "will" be retained by the operator and the individual will have no rights to any winnings.

Pending "verification" of the information provided, the individual may not deposit more than \$5,000 into his or her interactive gaming account or withdraw any funds from his or her interactive gaming account. The regulations also state that the operator "shall verify the information provided by the individual" within 30 days of registration and "must record and maintain" the "physical location, by state or foreign jurisdiction, of the authorized player while logged in to [his or her] interactive gaming account."

Importantly, the operator's obligation here is not to use its commercially reasonable or best efforts to geolocate the authorized player; the obligation is an absolute one. Likewise, the regulations mandate that the operator "shall ensure" that the "individual registered as an authorized player holds only one interactive gaming account with the operator." Thus, regardless of imperfections in available technology for geolocating a person and confirming his identity, if the operator unintentionally engages in a wagering communication with someone located in a state where online gambling remains illegal, then that communication could violate state law and, in turn, trigger a violation of the IGBA, the Travel Act or, if related to sports betting, the UIGEA.

The penalties for noncompliance with Nevada's interactive gambling requirements can be severe. Under the regulations, the commission "may limit, condition, suspend, revoke or fine any license, registration finding of suitability or approval given or granted under this regulation on the same grounds as it may take such action with respect to any other license, registration, finding of suitability or approval."

As for the risk of underage players, the Nevada law states that "a debt incurred by a patron at an interactive gaming system of an establishment licensed to operate interactive gaming is valid and may be enforced by legal process." Thus, minors who misrepresent their age are still "patrons" whose gambling debts are valid and enforceable, rather than minors who otherwise lack the capacity to contract and whose contractual commitments are therefore voidable.

The Road Ahead

Given the variety and inconsistency in states' approaches to regulating gambling activities, Sen. Harry Reid, D-Nev., and others have urged Congress to pass overriding federal legislation that spells out where and when online gambling should be legal. There is irony in these calls for a federal online gambling law because the DOJ's pivot around the Wire Act may reflect its growing comfort with emerging technologies that can be used to quickly locate would-be online gamblers and block transactions from individuals located outside participating states' boundaries.

Even absent federal legislation, prospective online gambling operators aiming to position themselves to compete in online gambling markets would be wise to secure access to best-of-breed geolocation technology services to meet the standards set forth in Nevada's interactive gaming regulations.

In view of the fundamental (though perhaps not unexpected) shift in the DOJ's view on the federal regulation of online gambling unrelated to sporting events, gaming companies have already commenced making substantial investments to position themselves to compete in the anticipated online gambling marketplace.

As of this writing, various manufacturers, operators and service providers, including Caesars Entertainment, International Game Technology (IGT), Fertitta Interactive, South Point and Boyd Gaming, have already submitted proposals to obtain interactive gaming licenses from the Nevada Gaming Control Board. Caesars bought a 51-percent interest in Israeli social game developer Playtika for \$90 million in June of 2011 and purchased the remaining 49 percent in December of 2011.

On Jan. 12, 2012, IGT announced that it purchased the social game developer Double Down Interactive for up to \$500 million, including an earnout. We can expect to see more mergers, collaborations and cross-licenses between developers of free-to-play, virtual good-filled, social games played on mobile phones, tablets and computers, on the one hand, and casino and casino equipment owners and operators, on the other hand. These collaborations require special attention to structuring for, and documenting, the unique strengths that each of the participants will bring to their unions and how, going forward, the new online gambling legal requirements will be met.

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