

Playing Your Cards Right in the Changing U.S. Online Gaming Market

By David J. Apfel
and Robert M. Crawford, Jr.

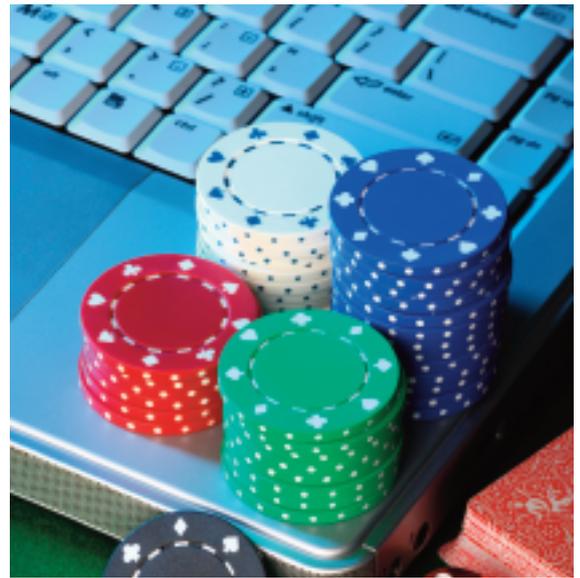
Over the past five years, global online gaming and gambling revenues have increased from just over \$20 billion in 2007¹ to more than \$35 billion in 2011.² Online poker alone generated revenue in excess of \$4.8 billion in 2009³ and is expected to rise to \$6.7 billion in 2012.⁴ These numbers are all the more remarkable when one considers that online gaming and gambling, including online poker, have always been prosecuted as if they were illegal in the United States. Notwithstanding state and federal legal prohibitions, and despite active and high profile prosecutions by the U.S. Department of Justice (“DOJ”) of several of the biggest and most successful international online gaming businesses, online gaming and gambling in the United States has continued to flourish.

It now appears that opportunities for entrepreneurs and investors to lawfully tap the multi-billion dollar online gaming and gambling market are poised to expand exponentially. On December 23, 2011, DOJ released a Memorandum Opinion (the “Opinion”) that reversed its long-standing position that the Wire Act prohibits all forms of Internet gambling, and all interstate wire transmissions of gambling-related communications no matter the nature of the gambling. While answering a specific question posed by Illinois and New York regarding their ability to use the

Internet and out-of-state transaction processors to sell lottery tickets to adults within their states, the Opinion found that DOJ’s prior view was “incorrect and the Wire Act prohibits only the transmission of communications related to bets or wagers on sporting events or contests.”⁵

The Opinion is just that, an opinion—it is not binding legal precedent. And, even as an opinion of DOJ counsel, it is narrow in scope, limited to the Wire Act and to the specific question posed by Illinois and New York concerning their proposed online lotteries. Nevertheless, many gaming experts, bloggers and, most importantly, states viewed the Opinion as opening the door not only to online, state-sponsored lotteries but to state authorization of intrastate non-sports Internet gambling, including online intrastate poker, operated by private businesses.

In the immediate wake of the Opinion, New York and Illinois moved forward with their proposed online lotteries. The Nevada Gaming Commission, which just prior to December 23, 2011, unanimously approved regulations authorizing private companies to apply for in-state Internet poker licenses, pushed forward with its plans, with more than twenty-five Las Vegas businesses, including MGM, Caesars



(in partnership with 888), Boyd Gaming (with bwin.party) and Bally Technologies, already having applied for licenses. In addition to Illinois, New York and Nevada, at least eighteen other states and the District of Columbia promptly responded to the Opinion with initiatives that would legalize or at least explore various forms of real-money Internet gambling within their borders.⁶

¹ Global Betting and Gaming Consultants, E-Gaming To Pass US\$30bn GGY in 2011, *Interactive Gambling Report*.

² Global Betting and Gaming Consultants, 2011 Global Gambling Revenues Passed US \$400 billion, *Global Gambling Report 6th Edition*.

³ Nathan Vardi, “Are the Feds Cracking Down on Online Poker?” *Forbes* (March 1, 2010).

⁴ Spectrum Gaming Group, “Internet Gambling Developments in International Jurisdictions: Insights for Indian Nations” *White paper: Prepared for the National Indian Gaming Association and Member Indian Nations and Tribes* (October 4, 2010).

⁵ Memorandum Opinion for the Assistant Attorney General, Criminal Division, by Virginia A. Seitz, Assistant Attorney General (September 20, 2011), at 3.

⁶ Judy Keen, “Illinois to become first state to allow online lottery sales,” *USA Today* (March 22, 2012).

Next Steps: Our Top 10 Recommendations

For those who wish to take advantage of the new opportunities in the online gaming and gambling market, we recommend the following ten steps:

1. Relationships

Establish (or reestablish and further develop) appropriate relationships in states that have already legalized or are actively considering legalizing online gaming. Nevada and other states following Nevada's model will require site operators to partner with licensed land-based casinos to be eligible for a license. Other states, like California, may only issue gaming licenses to establishments licensed under existing law, in which case partnering with licensed cardrooms and casinos will be vital.

2. Start-Up Money and Reserves

Consider all options to finance your operation and the payment of initial non-refundable licensing fees (which are likely to be very steep), including debt or equity securities, small business loans, state economic incentives, tax breaks and other non-monetary incentives. In addition, online gaming companies must plan to maintain a cash, credit, or bond reserve equal to the sum of all of the funds in players' accounts.

3. Patent Protection

Protect your proprietary technology by (i) utilizing professional conduct investigations to ensure your product is new and would not infringe anyone else's patents, and (ii) filing patent applications with the U.S. Patent and Trademark Office to cover your technology prior to disclosure outside the company. Any patent application should cover preferred implementations of the game rules, user interfaces and back-end processing, as well as intersections with other fields such as computing, mobile communications, social media and advertising.

4. Branding

Distinguish your products and services by (i) working with your marketing team to identify strong and distinctive trademarks, (ii) having a professional conduct a search to ensure that no one else is already using the same or a confusingly similar mark, and (iii)

filing "intent to use" trademark applications with the U.S. Patent and Trademark Office before you go to market.

5. Know When to Hold 'Em

When discussing your proposed project with potential partners and investors, you will be asked to share information about your intellectual property and technology, which is likely to include confidential information, trade secrets and even attorney-client privileged information. Make sure that you enter into appropriate non-disclosure agreements in advance. Even then, limit the information you share to that which is necessary, and consult with your legal advisers before sharing trade secrets or privileged information.

6. \$\$\$

Develop an organized and secure system to process players' money, as player-to-player transfers and credit accounts will likely be out of bounds. In Nevada, for instance, player deposits can include cash at brick and mortar locations, checks, wire transfers, casino transfers and debit or credit cards. Other states may broaden or narrow these restrictions, so it will be necessary to develop sophisticated, secure methods to process funds. These processes will likely need to pass stringent suitability tests.

7. Know Your Players

Control player registration by developing secure and confidential player registration and accounts. Site operators must prove that they have an effective way to verify that their users are of age and located in the applicable state while playing. Operators will also be required to verify each player's identity, ensure they are not blacklisted and determine that they are actual individuals, as opposed to automated "bots."

8. Policies and Disclosures

Be prepared to provide easily accessible information to players. For instance, Nevada requires that online gambling sites provide links to the State Gaming Control Board's site, information on problem gambling and a self-exclusion option. Legislation being considered elsewhere

requires online gaming sites to develop and post clear policies on items such as dispute resolution, house gaming rules, privacy and data security, and terms of use for registered users of online games.

9. Security

Guarantee that you have a secure platform and be prepared to prove it. Player information must be kept confidential and funds must be segregated and secure. Policies and procedures must be developed to avoid money laundering, collusion and other cheating. Policies should also be in place to alleviate concerns that the company might deduct money from player deposits before it is earned.

10. In-State Support Services

Consider hiring employees who will help support a 24-hour gaming site. Legislation, such as the bill proposed in California, will likely require that operators be on hand all day, every day, to address site errors or player concerns. These operators will need to be located in the state in which the operating site has received a license, or in which it has partnered with a licensed entity. Licensees should determine who they will hire to provide these services, develop the requisite contracts and ensure that their support service arrangements abide by all applicable legal requirements. ♣

David Apfel and Bob Crawford are attorneys in the Gaming, Gambling & Sweepstakes Practice of Goodwin Procter LLP, a national Am Law 50 law firm. The Practice brings together an interdisciplinary team with specialized knowledge of federal and state gambling, gaming, lottery and sweepstakes laws and regulations, as well as Native American tribal laws. Its attorneys represent entrepreneurs and investors seeking opportunities to establish or grow their presence in online gaming, land-based casinos and gaming establishments, virtual markets and currencies. It also assists entities seeking to promote their products and services through online and offline sweepstakes, contests, games and raffles, as well as operating companies. For more information, please contact David Apfel (dapfel@goodwinprocter.com) or Bob Crawford (rcrawford@goodwinprocter.com).