

The Internet Café

A look at the latest gambling franchise pushing the boundaries of our gambling laws

By Marc Dunbar

In recent years, a new phenomenon of “convenience gambling” has spread across the country. Utilizing the speed and sophistication of networked computer technology, proprietors are offering the appeal of slot machine gambling in strip mall store fronts under the legal cover of laws drafted for lost leader commercial game promotions or sweepstakes designed in the 1970’s and ‘80s for Publisher’s Clearing House and the McDonald’s Monopoly game. However, unlike these games intended to drive sales of commercial products, these new gambling enterprises appear more focused on the typical casino goal of driving coin-in, rather than increased profits from an underlying business which has nothing to do with gambling. These new forms of gambling which operate under the innocuous moniker of “Internet Café” are pushing the boundaries of gambling laws and gambling regulation, and the communities in which they operate often are ill-equipped to deal with their oversight.

The term “Internet café” requires further explanation as it is a bit of a misnomer. On most occasions, patrons of an Internet café are not interested in accessing the Internet, nor are they enjoying the relaxing coffee-infused environment generally imagined when one fashions a mental picture of a “café.” Rather, the type of Internet café

at issue in this article, also known as an adult amusement arcade or convenience casino, is a place where people go to play electronic sweepstakes games that look and sound almost identical to slot machines found in regulated casinos around the world.

The reason these places are called “Internet cafés” is attributed to an attempt by their proprietors to adhere to state gambling laws. States in which these facilities operate have laws allowing a commercial business to conduct promotional sweepstakes in conjunction with the sale of a “good or service” to its customers. Generally speaking, the sweepstakes serves as a marketing aid to drive sales of the underlying commercial product. Some of the more widely used sweepstakes promotions operating under these statutory exemptions range from the well known “look under the cap” games of soft drink manufacturers, to code numbers on receipts which, when entered following an online consumer satisfaction survey, enter the customer into a drawing for a prize.

In contrast for Internet cafés, the good or service for sale is Internet or even long distance telephone time, and the game promotion in connection with the sale of this time is essentially an electronic pull tab ticket. The argument of Internet café operators is



that their operations are no different than the sweepstakes operated by companies such as McDonald’s, Coca-Cola or Home Depot. Counsel for a coalition of Internet cafes was recently quoted in Florida saying: “The sweepstakes is simply a marketing tool used to promote the Internet time and telephone time purchased at these cafes, the same type of sweepstakes offered at many checkout counters of large retailers that ask you to go online to complete a survey and the chance to win thousands in gift cards for that retailer.” Despite this justification in support of their legitimacy, many customers, and even media outlets, are entirely unaware that this “marketing tool” is not the underlying business and that Internet cafes are not casinos. That the games played so closely resemble slot machines and the names of the facilities, such as “Luxxor Casino” or “Lucky 777 Cafe,” further blurs the line as to what the underlying business actually entails. An article from the *New York Times* published in May, 2011, highlighted the gambling proceeds as the focus of these

businesses for the criminals, targeting them when it concluded “[t]hat these cafes are cash machines – and take in as much as \$100,000 per week – is no secret to robbers.” The article featured a series of burglaries, robberies and even fatal shootings at Internet cafes.

For lawyers attempting to advise clients relative to these businesses, a good bit of research should be undertaken into the evolution of state law related to gambling and gambling devices. From the early slot machines through the cases involving the latest type of convenience gambling, the Internet café, courts essentially proceed with the same basic analysis to determine whether gambling is inherent in the activity. Three basic elements typically guide the reviewing courts in their evaluations: prize, chance, and consideration. Each is fairly basic to understand but as evidenced by the various slot machine decisions rendered by state courts nationwide, game developers become more and more savvy and are willing to go to great lengths to hide these three elements in an effort to mask the underlying activity.

Within the context of the Internet café, prize and chance are essentially conceded by the operators; by its very nature, a sweepstakes game contains a prize which is awarded by chance. The critical element for lawyers, law enforcement and courts is to determine whether consideration is present or whether the sweepstakes somehow fits within a safe harbor statute or local ordinance which authorizes the activity. This evaluation is unique to every jurisdiction given the subtleties of each state’s gambling laws and the cases interpreting them.

Regulation of Internet cafes by the states is very disparate. Some states have very clear gambling laws or plenary gaming commissions with statewide oversight over all gambling ac-

tivities. Such states almost universally prevent the operation of such businesses; while others with very passive regulations and lack of a statewide regulator over state gambling laws allow for Internet cafes to claim legal legitimacy.

In these latter states, local governments and their law enforcement are often left with the task of deciding for themselves how to deal with these facilities.

One of the leading appellate cases analyzing the legality of Internet café business model is *Barber v. Jefferson County Racing Association* in which the Supreme Court of Alabama looked at this new type of enterprise and tested it against its gaming statutes and nearly one hundred years of its gambling common law. The case involved an activity advertised as “Megasweeps” which was operated at a greyhound track near Birmingham. The enterprise operated fundamentally the same as most Internet cafes currently in operation throughout the country today.

The owners of Jefferson County Racing Association proposed that they had found and exploited a “loophole” in the laws of Alabama. The trial court found that most of the customers were more interested in getting the sweepstakes entries than they were in accessing the Internet. The court further found that “the owners undertook the Mega-Sweeps to attract customers who wanted to gamble, or, at least, those who could be made to think that they were gambling.” Ultimately, the court found that the operations involved all three elements of gambling (prize, chance, and consideration) and further ruled that the Internet café model essentially was illegal slot machine operation under Alabama law.

The holding in Alabama serves as one of the most comprehensive court cases involving

“**These new forms of gambling which operate under the innocuous moniker of “Internet Café” are pushing the boundaries of gambling laws and gambling regulation, and the communities in which they operate often are ill-equipped to deal with their oversight.**”



Marc Dunbar
marc@penningtonlaw.com

Mr. Dunbar’s practice focuses on gaming and governmental law. Over the past decade and a half, he has established himself one of the Florida’s leading gaming attorneys. His gaming practice is Florida’s largest encompassing both lobbying and litigation for casinos, gaming suppliers, pari-mutuels, Indian tribes, sweepstakes and charities. Mr. Dunbar is regularly asked to appear before legislative and law enforcement panels to comment on changes to Florida’s gaming laws and provide assistance in drafting changes to Florida’s gaming rules and statutes. He served as lead counsel for the gaming company that joined with Florida’s Speaker of the House in successfully challenging the tribal gaming compact between Florida’s Governor and the Seminole Tribe of Florida.

Mr. Dunbar also teaches Gambling and Pari-mutuel Law at Florida State University College of Law and is regularly named one of the state’s top lawyers in the state by his peers in the annual Legal Elite Survey published by Florida Trend magazine, Florida’s premiere business publication. He is a regular media commentator on gaming issues, hosts a website www.floridagamingwatch.com dedicated to Florida’s gaming industry and is a monthly columnist to the gaming magazine Ante Up.

>> NEW DEVELOPMENTS IN JURISDICTIONS: ONLINE GAMING

Internet cafes in which the system of gaming, the statutes and case law are methodically analyzed in determining the legality of the enterprise. Unfortunately other jurisdictions have not experienced such in judicial depth analysis which is allowing pathways for talented software designers and game developers to ply their wares on the often underserved gambling public via the Internet café business model. The ability for the industry to explode on the scene in a state has led some legislatures to react in an effort to stem what they view as spreading illegal gambling within their state.

One such state with a growing Internet café problem is Georgia which attempted to pass legislation that would deem Internet cafes to be illegal lotteries by revising certain definitions of the Georgia statutes. Georgia SB 19, 2011, revised paragraph (4) of Code Section 16-12-20 to redefine the definition of "lottery" to the following:

a lottery shall also include the payment of cash or other consideration or the payment for merchandise and the option to participate in or play, even if others can participate or play for free, a no skill game or to participate for cash or noncash prizes by lot or in a finite pool on a computer, mechanical device, or electronic device whereby the player is able to win a cash or noncash prize.

SB 19 allowed for companies like Coca-Cola, McDonald's and The Home Depot to continue offering sweepstakes by additionally amending Section 16-12-38 so that the new definition of "lottery" would not mean a:

National promotion, contest, or sweepstakes conducted by any corporation or wholly owned subsidiary of such corporation, provided that, at the time of such

promotion, contest, or sweepstakes, such corporation: (i) Is registered under the federal Securities Exchange Act of 1934; and (ii) Has total assets of not less than \$50 million.

Although SB 19 passed both bodies of the Georgia legislature by a wide margin, the bill was ultimately vetoed by the Governor. In a press release detailing the rationale for the veto, the Governor's office provided this explanation:

Senate Bill 19 attempts to provide much needed clarity to a statute that often leads to murky interpretations and unintended results. On close review, this legislation would expand the reward categories for those who play Class A machines and attempts to clarify the term "gift certificate" that exists in current law. In addition, this legislation attempts to clarify for prosecutors that so-called internet sweepstakes cafes are illegal and subject to prosecution for violating Georgia's prohibition on gambling. I am vetoing this legislation because I do not believe SB 19 provides sufficient clarity or enforcement powers to shut down internet cafes and I also find that the modifications to the current Class A and Class B classifications of coin operated machines could lead to unintended consequences. I look forward to signing legislation in the near future that would more forcefully address these significant concerns. Accordingly, I VETO SB 19.

Even after vetoing the bill, the Governor wasted no time in enforcing existing laws in an effort to stem the growth of Georgia's Internet café industry by focusing the attention of the Georgia Attorney General's Office and

pushing for statewide law enforcement to "stamp out" Internet cafes.

Like Georgia in the face of an onslaught of Internet café openings, the Virginia Legislatures acted decisively in recent legislative sessions. Virginia passed HB 1584 and SB 1195 which amended its gambling statutes in an attempt to shutter Internet cafes in that state. The passage of the bills in 2011 led many operators to close down in advance of the new law taking effect; others decided to wait until the last day to shut down, and some decided to stay open resulting in raids by police and SWAT teams statewide.

Similarly, North Carolina undertook a comprehensive review of its gaming laws and decided to outlaw Internet cafes statewide. North Carolina's legislators approached the issue in a different manner than Virginia which warrants comment. Rather than changing the definition of what constitutes illegal gambling, the North Carolina Legislature chose to adopt an entirely new provision in its gambling code with a sole purpose of eliminating what legislators considered illegal game promotions. In the two pieces of legislation enacted by the North Carolina Legislature, the state attempted to provide clear mandates for its law enforcement, the first measure codified at N.C. Gen. Stat. § 14-306.3 stated that:

(a) It is unlawful to promote, operate, or conduct a server-based electronic game promotion.

(b) It is unlawful for any person to possess any game terminal with a display that simulates a game ordinarily played on a slot machine... or a video gaming machine... for the purpose of promoting, operating, or conducting a server-based electronic game promotion.

The follow-up measure took a head-

on approach to Internet cafes. The Act provided additional definitions to clarify the technologies at issue. N.C. Gen. Stat. § 14-306.4 further added that:

it shall be unlawful for any person to operate, or place into operation, an electronic machine or device to do either of the following:

(1) Conduct a sweepstakes through the use of an entertaining display, including the entry process or the reveal of a prize.

(2) Promote a sweepstakes that is conducted through the use of an entertaining display, including the entry process or the reveal of a prize. ...

(c) It is the intent of this section to prohibit any mechanism that seeks to avoid application of this section through the use of any subterfuge or pretense whatsoever.

In addition to legislative approaches discussed above, a look at Massachusetts offers another example of how states are using the power of the executive branch to confront a rapidly expanding Internet café industry. Like other states with little or no regulated casino gambling industry, Massachusetts has experienced rather robust growth in its Internet café industry in the past three years. Almost daily, Massachusetts newspapers, magazines and television news stations would detail the opening of a new facility or issues surrounding an existing one. The news media even chronicled at least one Massachusetts politician who joined in the ranks of Internet café proprietors.

In response to increasing concerns, Massachusetts Attorney General Martha Coakley used her authority to regulate unfair and deceptive trade practices in trade and commerce to enact emergency regulations to deal with unlawful gambling establishments which she believed posed “an unacceptable risk

to the public health, safety and welfare.” By enacting the regulations, numbered 940 CMR 30.00 and relating to Illegal Lotteries, Sweepstakes and De Facto Gambling Establishments, the Attorney General was clear in her intention to shut down Internet café operations in the State of Massachusetts.

In addition to legislative and regulatory measures taken at the state level, local governments have also taken action. In Florida, a state lacking regulatory oversight or legal clarity at the state level, two counties have taken divergent approaches in dealing with the rapid growth of these businesses in their jurisdictions. Seminole County, located just north of Orlando, banned Internet cafes by outlawing “simulated gambling devices” within its jurisdiction. The ordinance which passed in January of 2011 is currently facing a Federal court challenge which is widely expected to result in the first comprehensive federal court opinion involving Internet cafes and their technologies. Duval County, which encompasses the Jacksonville area, took a different approach, and using its constitutional home rule authority, the county passed an ordinance that regulates “electronic game promotions” in a manner that controls the number of Internet cafes in the county, requires each operator to apply for a permit and adds other regulatory and financial restrictions. Although a challenge to this ordinance was brought in county court as to the county’s ability to limit the number of locations and enforce the ordinance’s limitations, the ordinance

was upheld by the trial judge. This divergent treatment emphasizes the need for Internet café proprietors and their lawyers to be very familiar with state and local laws and court opinions prior to opening these gambling operations.



The Internet café craze poses interesting questions for law enforcement, local governments and state legislatures. Are the devices slot machines? Is the game promotion really an illegal lottery? Should these facilities be regulated and taxed or banned altogether?



The Internet café craze poses interesting questions for law enforcement, local governments and state legislatures. Are the devices slot machines? Is the game promotion really an illegal lottery? Should these facilities be regulated and taxed or banned altogether? Depending on the state and local jurisdiction, as discussed above, the answer to these questions varies greatly depending upon where in the country the question is

being asked and what the desire is within a particular local community. In more liberal jurisdictions, perhaps the Internet café is an acceptable boost to a local economy. In contrast, communities like Seminole County, Florida, or the State of North Carolina, a state that proudly boasts its anti-gambling history back to the 1700’s, Internet café operations are seen as destructive to the morality of the citizenry. Internet café operators should be mindful of where they find themselves as their location is the principle driver of the success or failure, legality or impropriety, of their operations, and lawyers representing companies offering any type of game promotion would be mindful to closely monitor the legislative activities in their state and local governments as well as the judicial opinions analyzing these electronic game promotions. ♣