

Overlooked Issues: Interactive and Interstate Gaming

By John Maloney

A fictitious American company named Betonit, Inc. (“Betonit”) wants to offer Random Number Generator (RNG) based interactive games to international players and multi-state bingo games to domestic players at tribal casinos. Betonit wants to maintain its servers and operations in the U.S. As more and more legitimate American companies become involved with interstate gaming and client-server games, inevitable questions arise regarding where such a company can and should base its operations. Are the servers gambling devices or gambling paraphernalia which are prohibited *per se*? Does the possession of the server, or support functions (i.e. payment processing, customer support, and so on) constitute the promotion of gambling in violation of the law? These are just two of many questions that organizations like Betonit must address.

Betonit’s games utilize a client-server model. In Betonit’s multi-state bingo games, players play at “dumb” client machines that have a video display; the client machines accept money and pay out prizes. The client is connected to the server via “wires.”¹ In modern multi-state bingo games, the server is often located away from the gaming facility and, in many cases, in a different state. The server is where the bingo game software resides, and the server is responsible for the randomly drawn game numbers. RNG based interactive games operate similarly. Players utilize personal computers, tablets, and cell phones as “dumb” clients. The client has a video display with software that the operator permits to accept electronic fund transfers and pay out prizes. The client is connected to the servers via the Internet through “wires.”

Analysis

The interactive gaming market in the US is currently very small. For companies only offering interactive gaming to the residents of the states of Nevada and New Jersey, the issues raised herein, at least with regards to most hardware, are simple: generally, for the time being, servers associated with interactive gaming aimed at New Jersey residents must reside in Atlantic City, and servers associated with interactive gaming aimed at Nevada residents must reside in the State of Nevada. However, what about organizations like Betonit that utilize the client-server model and don’t necessarily want to limit their operations to Nevada and New Jersey? Are their operations a violation of the law in the state where their employees and equipment are located?

Before addressing these issues it is worth noting that but for

recent developments with the Wire Act, this topic would be moot. Prior to the 2011 opinion issued by the Department of Justice, the Wire Act was the most obvious deterrent to organizations wanting to utilize interstate “wires” for gaming. As recently as 2007, courts were broadly interpreting the Wire Act to apply to all forms of Internet gaming, regardless of whether there was an exemption under state law. *See United States v. Corrar*, 512 F. Supp. 2d 1280, 1289 (N.D. Ga. 2007). In *Corrar* the court noted:

...[E]ven if internet gambling were permissible under state law, using interstate wire communication facilities to promote it would not be. This is why the Wire Act, unlike the Travel Act and 18 U.S.C. 1955, does not require an underlying violation of state law... This section was part of an omnibus crime bill that recognized the need for independent federal action to combat interstate gambling operations...

Since the 2011 Department of Justice opinion, federal courts have continued to recognize the limited applicability of the Wire Act, thus making articles such as this one relevant. *See United States v. Lyons*, 2014 U.S. App. LEXIS 950, 24-25 (1st Cir. Mass. Jan. 17, 2014) (“The Wire Act applies only to ‘wagers on any sporting event or contest,’ that is, sports betting.”)

First, it is important to discuss the issue of where the betting activity actually occurs within the interstate client-server model. This isn’t necessarily a new issue. People were busy tapping out bets on a telegraph more than one hundred years ago. In *Lescallett v. Commonwealth*, 17 S.E. 546, 547-548 (Va. 1893), the court noted:

A bet, like an ordinary contract, may be made by telegraph, and, when an offer to bet is accepted by telegraph, the acceptance, as in the case of a contract, takes effect when the message of acceptance is delivered to the telegraph company for transmission, and not when it is received by the other party. If, therefore, an offer to bet is telegraphed by a person in this city to another in New York, and the latter accepts by telegraph, the betting is done, not in Richmond, but in New York, because the offer, being accepted there, takes effect there. (footnotes and citations omitted)

If one were to believe that the betting activity occurred only at the servers, then a company like Betonit would need only to consider the laws of the state where the servers are located. The argu-

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ment that the betting activity occurs only where the operations are located has actually seen some limited success in the US, most notably, in *United States v. Truesdale*, 152 F.3d 443, 447 (5th Cir. Tex. 1998), which has since been distinguished in multiple cases (*See e.g. United States v. Cohen*, 260 F.3d 68, 2001 U.S. App. LEXIS 17000 (2d Cir. N.Y. 2001); *United States v. Ross*, 1999 U.S. Dist. LEXIS 22351 (S.D.N.Y. Sept. 16, 1999); *United States v. Kaczowski*, 114 F. Supp. 2d 143, 1999 U.S. Dist. LEXIS 22240 (W.D.N.Y. 1999)).

Truesdale involved a company operating as World Sportsbook ("WSB"). WSB purportedly based its operations in the Dominican Republic and Jamaica, and it maintained payment processing and support functions in Dallas, Texas. The court acknowledged WSB's operations in Jamaica and the Dominican Republic as legal, and bettors from the US placed bets by contracting with WSB's Jamaican and Dominican offices, where those offices accepted and processed the bets.

WSB and its employees were initially successfully prosecuted under 18 U.S.C. 1955 and 1955(b)(1)(i) based on the government's charge that the employees were guilty of "bookmaking," under Texas Penal Code 47.01(2)(A)-(C). However, the United States Court of Appeals for the Fifth Circuit reversed the convictions based on what the Court deemed to be insufficient evidence that the defendants engaged in bookmaking under Texas law merely by accepting bets from Texas. The Court's holding was based upon its conclusion that the bookmaking actually occurred in the Dominican Republic and Jamaica where it was legal. The Court's ruling was based on a very narrow reading of Texas' bookmaking law, and the court noted that the outcome may have been different had the defendants been charged in connection with a different portion of Texas' Penal Code. It is also worth noting that the New Jersey Legislature voluntarily adopted a variation of this theory as part of its interactive gaming law; however, the legislature only adopted this theory to achieve a very limited and specific purpose.

The alternative and more widely held theory is that the bet actually occurs where the client is located. The generally accepted conflict of laws principle is that a gambling transaction occurs in the country where the bet or wager is accepted. *Dacey & Morris, The Conflict of Laws 1468* (1993). This theory, at least as it relates to the Internet age, first gained prominence in *People v. World Interactive Gaming Corp.*, 185 Misc. 2d 852, 858 (N.Y. Misc. 1999). *World Interactive Gaming Corp.* involved a company that operated an offshore betting website ("WIGC"). WIGC argued that that the company and its servers were located in Antigua; thus the betting activity took place offshore and there was no violation of New York law. The New York County Supreme Court however ruled:

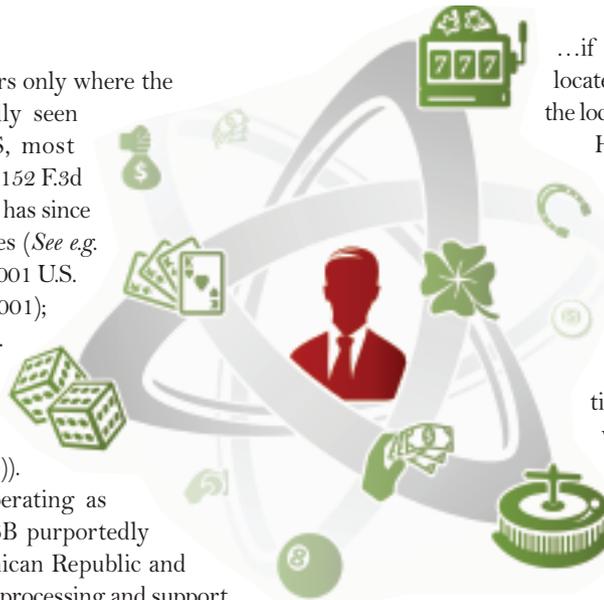
...if the person engaged in gambling is located in New York, then New York is the location where the gambling occurred.

Here, some or all of those funds in an Antiguan bank account are staked every time the New York user enters betting information into the computer. It is irrelevant that Internet gambling is legal in Antigua. The act of entering the bet and transmitting the information from New York via the Internet is adequate to constitute gambling activity within New York State.

Even if one accepts that the relevant betting activity takes place in the state where the client is located

and that the server merely helps to make the bet possible, there are still a number of issues that must be considered. Betonit needs servers and other hardware to make its games work. Are these components illegal gambling equipment prohibited *per se*? Gray market operators are constantly pushing the definition of what constitutes gambling equipment. For this reason, in many states laws related to gambling devices and equipment are extremely broad. For example, Hawaii Revised Statutes 712-1220(5) defines a gambling device as "any device, machine, paraphernalia, or equipment that is used or usable in the playing phases of any gambling activity, whether that activity consists of gambling between persons or gambling by a person involving the playing of a machine." Section 47.01 of the Texas Penal Code defines "gambling paraphernalia" in relevant part as any instrument or apparatus "by means of which bets have been or may be recorded or registered." In many places gaming equipment is contraband; regardless of whether or not such equipment is actively being used in connection with illegal bets. *See e.g. State v. Container Mfg. Co.*, 364 S.W.2d 20, 26 (Mo. Ct. App. 1963); *Playboy Hotel of Chicago, Inc. v. Chicago*, 147 Ill. App. 3d 984, 987-988 (Ill. App. Ct. 1st Dist. 1986). While our research did not locate any opinions specifically holding that a server which processes bets made by people in another jurisdiction as a gambling device, the current debate over Internet cafés or the future expansion of servers dedicated to interactive gaming may result in such a ruling.

Betonit requires customer service, technical support, and payment processing functions. Could these functions constitute the promotion of gambling in violation of the law? Courts in New Jersey and Pennsylvania have dealt with similar issues relatively recently. In *United States v. 734,578.82 in United States Currency*, 286 F.3d 641, 656-657 (3d Cir. N.J. 2002), money held by a company in New Jersey which was involved with the processing of payments for an interactive gaming operator based in England were seized in connection with 18 U.S.C. 1955. While the companies involved



may have been involved with taking bets from people in the US, the Court noted that the money would have been subject to seizure even if the companies had not taken bets from people in the US in violation of US law:

Although Claimants' argument has some appeal, it ignores the text of New Jersey's statute. That statute prohibits "conduct, which materially aids any form of gambling activity," ... Therefore, even if we accept Claimants' argument that the gambling occurred outside of New Jersey where it is legal, their activity inside of New Jersey was nevertheless illegal because it promoted a gambling enterprise... We reiterate: the "innocence of the owner is irrelevant" in a civil forfeiture proceeding. Therefore, the legality and/or licensure of the businesses in England is simply irrelevant to the issues raised in the instant forfeiture proceeding. (citations omitted)

In 2005, a court in Pennsylvania reached a similar conclusion. In *United States v. Atiyeh*, 402 F.3d 354, 371 (3d Cir. Pa. 2005) the court held that:

the mere custodianship of gambling-related funds is sufficient to constitute a violation of 18 U.S.C. § 1955, because such custodianship is considered to be "gambling" under state law even though it may not appear to fit within "gambling" as defined in § 1955(b)(2). (citations omitted)

Conclusion

There are fifty states and each state interprets its own laws differently. While it can now be argued that the Wire Act targets sports betting, there are numerous Federal laws that can be triggered when a state law is violated. A violation of any of these laws while engaged in interstate gaming can trigger investigations, indictments, and seizures. The complexity of state laws or the lack thereof requires an understanding of how such laws will be interpreted. The many laws and courts interpreting such laws regarding client-server based gaming will continue to challenge even the most seasoned gaming lawyers. Furthermore, bank accounts are an easy target for ailing governments that choose to utilize legal uncertainties to fill financial gaps. The vaguely, poorly written, politically motivated laws that target the gaming industry are truly a gaming law minefield. ♣

John K. Maloney is the principal attorney of the Law Offices of John K. Maloney. He splits his time working out of the firm's Henderson, Nevada and Sacramento, California, offices. John specializes in the area of gaming regulatory law. Prior to establishing his firm, John spent eight years with the State of Nevada Gaming Control Board in the Investigations Division and four years with the Casino Control Division in Queensland, Australia. John is also a founding member of the International Masters of Gaming Law (IMGL). John is listed in The Best Lawyers in America (Woodward/White, Inc.) in the Gaming Law Section and The Chambers Guide. John is an author and frequent speaker on many gaming law issues and a member of the California and Nevada State Bar Associations.

¹ See 18 U.S.C. 1084



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