

WEDNESDAY, NOVEMBER 2, 2011

GUEST COLUMN

## Will California take the lead in online gaming?

By Mitchell Kamin and Jessie Kornberg  
of Bird Marella

Online gambling is coming soon to laptops, iPads and PDAs near you.

Legislation to legalize various forms of online gambling is pending in Congress and state legislatures across the U.S., including two separate proposals in California. With politicians looking for creative

**FIRST IN A TWO PART SERIES** new revenue streams, the incentives are in place to pass such legislation. The only remaining questions are: Who will legalize and when? The answer matters because, as is often the case, the first guests to this party could reap the greatest rewards and also, set the rules for those who follow suit.

Researchers at H2 Gambling Capital estimate that there were 1.7 million active online poker player accounts in the U.S. this year, wagering some \$14 billion dollars. Other experts estimate that some 16 million Americans participate in all the various forms of online gambling. Rather

Native American casinos in California generated roughly \$7 billion last year, more than a quarter of gaming revenue nationwide.

than curtail this market, the recent high-profile federal prosecutions of poker sites Full Tilt, Absolute Poker and PokerStars have simply sent players to alternative online sites, many of them overseas. Facing this reality, Congress and a number of states, including California, are poised to adopt legislation legalizing online poker and perhaps other online gaming as well. The District of Columbia already has moved its lottery online and legalization in other states and perhaps even at the federal level appears likely to occur in the very near future.

Gambling is already big business and one of the most heavily regulated in-



Associated Press  
North Dakota Hospitality Association member Bill Shalhoob plays a hand of online poker at Pokerstars.com.

dustries in America. A disproportionate share of the activity is here in California. State and federal laws permit, license and regulate Indian gaming, race track betting, and card clubs in the state. California has more Native American-run gaming than any other state, with 43 tribes operating 66 casinos. Native American casinos in California generated roughly \$7 billion last year, more than a quarter of gaming revenue nationwide. Despite these impressive numbers, revenues were actually down for the second year in a row. Many Native American gaming interests blame the rise of online gaming for the decline and are directing their lobbying efforts toward the cause of online legalization.

Elsewhere in the United States, jurisdictions license these same activities, along with traditional casinos (as in Las Vegas and Atlantic City), sports books, off track betting, bingo halls, riverboat casinos and the peripheral investors and businesses that support these activities. Companies that do business in multiple jurisdictions — like those that own casinos domestically

and abroad, and others that sell gaming machinery and software all over the world — have to contend with widely varied regulatory regimes and a frustrating lack of coordination between jurisdictions.

Outside of the U.S., including in many European countries, online gambling (poker, other casino games and sports betting) is lawful, regulated and extremely



**Mitchell A. Kamin** is a principal of Bird, Marella, Boxer, Wolpert, Nessim, Drooks & Lincenberg PC in Los Angeles.



**Jessie Kornberg** is an associate at Bird, Marella, Boxer, Wolpert, Nessim, Drooks & Lincenberg PC in Los Angeles.

profitable. A leading European online gaming company, bwin.party Digital Entertainment, is listed on the London stock exchange and estimates revenues from online gambling in excess of 600 million in euros this year.

Online gambling providers have been successful despite a difficult regulatory regime, with a patchwork of laws and rules governing these activities. The European Union has allowed each member country to enact and enforce its own regulations. Britain and Italy have implemented industry-friendly licensing regimes, while other nations have prohibited online gambling entirely or limited it to state-controlled monopolies. The inconsistencies have been criticized by the EU's governing bodies and efforts to standardize regulation throughout the EU are underway.

Meanwhile, some providers have successfully challenged certain country's efforts to prohibit online gambling. One of the most remarkable turnarounds occurred in France, where in 2006 the founders and chief executives of bwin were arrested and charged with violating French gaming laws by entering into a sponsorship deal with a French soccer team. Then, in 2010 the country legalized online gambling.

Not always just a European gaming operation, before 2006, bwin.party conducted some business in the United States. A 2006 federal law, the Unlawful Internet Gambling Enforcement Act (UIGEA), made it illegal for banks and credit card companies to process online gaming payments and sent foreign gaming companies out of U.S. markets. However, neither UIGEA nor any other federal law makes it illegal for players to gamble on the Internet,

with the exception of sports wagering. Accordingly, UIGEA hasn't stopped a huge number of Americans from playing online poker. It has just sent them underground and overseas.

It is estimated that in 2011, Americans will wager more than \$6 billion on offshore websites. These sites are out of the reach of U.S. law enforcement and tax collection. It is easy to understand why many in business and government regard the online market as a missed opportunity. The Congressional Committee on Taxation has predicted that legal online gambling could generate \$42 billion in revenue over 10 years. The District of Columbia expects to collect \$14 million in additional revenue with the passage of its legalization measure.

Though increased tax revenues are an easy incentive for government action on the issue, there are consumer-protection and free market arguments in favor of legalization as well. Americans will continue to gamble online regardless of legalization. But because the activity is not permitted in the U.S., they will seek online gaming opportunities on sites that are unsecure, through payment processes that provide little protection, and with companies against which American consumers will have no recourse. That's precisely the story of Full Tilt's customers, who gambled millions online only to discover there was no way to collect their winnings. The unintended consequence of the Full Tilt prosecutions may well be the legalization, regulation, and taxation of online gaming. Indeed, in advocating for legalization measures, Massachusetts Congressman Barney Frank cited the abuses alleged in Full Tilt as support for his position.

Politicians and businesses are busy preparing for the arrival of online gambling, and the conventional wisdom among industry professionals, their lobbyists, and legislators is that online gaming, or at least online poker, is coming to the U.S. very soon. Most providers and regulators advocate for a federal, national regulatory framework, rather than a patchwork of potentially conflicting state rules — a critical advantage for online gambling providers, whose product knows no boundaries.

Two bills currently are pending in the House of Representatives. HR 1174, The Internet Gambling Regulation, Consumer Protection, and Enforcement Act, introduced by California Republican Tom Campbell, would create a federal regime for the licensing of internet casino games and poker. HR 2366, The Internet Gambling Prohibition, Poker Consumer Protection, and Strengthening UIGEA Act of 2011, by Joe Barton, a Texas Republican, would delegate significant responsibility to State and tribal regulators and allow the licensing of internet poker only.

Experts view this second proposal as more likely to pass because it is limited to poker, a game that combines chance and skill and is therefore somewhat less susceptible to criticism from conservative organizations opposed to the spread of gambling. At a recent gaming law conference, Barton said his bill might even be adopted by the congressional super committee established at the time of the debt ceiling crisis as a non-tax source of revenue. However, the chair of that committee recently said no internet taxes should be included in the deficit reduction bill and that proposals of this type need to be fully debated apart from the committee.

# Daily Journal

www.dailyjournal.com

THURSDAY, NOVEMBER 3, 2011

## GOVERNMENT

## Will California take the lead in online gaming?

By Mitchell A. Kamin and Jessie Kornberg

This year, California had two competing intra-state online gaming bills in the state Senate. Senate Bill 45 (Wright) would permit the state to license and regulate three internet gaming “hub” operators to offer various online “gambling games,” from which the state would receive at least ten percent of the operators’ gross revenues. Senate Bill 40 (Correa) would authorize existing licensees such as tribal governments

**LAST IN A TWO PART SERIES**

and card clubs to offer intrastate online poker; the first five licensees would have an exclusive until 2016 and pay up front license fees of \$250 million to the state along with other fees. Senate President Pro Tem Darrell Steinberg recently tabled both bills for reconsideration in the next legislative term, beginning with hearings in the Senate Government Oversight Committee in January 2012.

Other states are getting into the game as well. U.S. jurisdictions have either already legalized intrastate online gaming (Washington D.C.) or are considering legislation to do so (Florida, New Jersey, North Dakota and Iowa). The Nevada Gaming Board and Commission are planning to adopt online

When it comes to new regulatory regimes, it has often been the case that where California goes, the nation will follow.

poker regulations no later than January 2012. Rather than immediately implement intrastate Internet poker, however, Nevada plans to initiate a dialogue with the U.S. Department of Justice about appropriate next steps because the casino industry has opposed intrastate gaming in Nevada, arguing instead for federal regulation of online gaming. Moreover, the Nevada Legislature previously enacted enabling legislation in 2001, but the governor stopped short of signing it after the Justice Department opined that the law violated the Wire Act of 1967.



Associated Press

Casino industry representatives and exhibitors watch an online poker game during the industry’s G2E conference on Oct. 4, in Las Vegas.

European providers are said to be entering into strategic alliances with established U.S. gambling organizations like Wynn Resorts and preparing to enter the U.S. market. There is hope that the U.S. has the opportunity to overtake Europe as the leader in online gaming. These predictions are balanced against concerns about entering the U.S. if states create a patchwork of regulation, as members of the European Union have. Potentially, having to contend with a range of different standards will tilt the cost-benefit analysis against coming to the U.S.

The California market might be big enough to tip the scales. According to the proponents of SB 45, “over 1.5 million Californians participate in illegal online gambling on more than 600 unregulated gambling Internet Websites every week.” With a population comparable to many EU jurisdictions, California is an attractive market. And when it comes to new regulatory regimes, it has often been the case that where California goes, the nation will

follow. Pro-legalization interests hope that attractive licensing and regulatory structures may be developed in California to be replicated elsewhere.

The benefits of legalization — consumer protection, economic growth, tax revenue — are significant. Former California State Finance Director Tim Gage has reported



**Mitchell A. Kamin** is a principal of Bird, Marella, Boxer, Wolpert, Nessim, Dooks & Lincenberg PC in Los Angeles.



**Jessie Kornberg** is an associate at Bird, Marella, Boxer, Wolpert, Nessim, Dooks & Lincenberg PC in Los Angeles.

that the authorization and regulation of online poker could generate more than 1,300 new jobs and \$1.4 billion in new state revenue over the next 10 years.

One concern remains the application of federal law to a California-only licensing regime. Despite a 2002 ruling by the 5th U.S. Circuit Court of Appeals that the Federal Wire Act of 1961 applies only to sports betting and not to games of chance such as poker, the Bush administration took the position that the Wire Act prohibited all forms of online gambling. Under President George W. Bush, the Justice Department was able to convince North Dakota and Nevada Legislatures not to legalize online gambling, despite broad easy passage in those states' legislatures. Since then, Congress passed Unlawful Internet Gambling Enforcement

Act (UIGEA), 31 USC Sections 5361 et seq., which prohibits financial transactions associated with online gambling, but only if the gambling activity is itself prohibited by state law. So a California-authorized online gaming operation which was limited to people actually in California would not fall within the purview of UIGEA.

Meanwhile, several states claim that the Justice Department under President Barack Obama has given tacit and even explicit consent to intra-state legalization. The administration has issued no comment on the Washington D.C. legalization effort and several state legislators in other states claim to have obtained consent letters from the Justice Department for their own legalization measures.

In addition to clarifying the application

of the federal Wire Act and UIGEA, state regulators confront a number of other challenging issues, including how to exclude out-of-state gamblers, minors, criminals who would exploit access to online gaming to launder funds, and problem gamblers who would otherwise abuse permission to gamble. Customer data security will be another major area of ongoing concern.

Many believe the potential benefits of legalized online gambling outweigh these risks. And it is fitting, as the gaming industry is increasingly driven by cutting edge technological innovations, that California should be an early adopter of a legal licensing regime. Whatever happens here, the stakes are high. California's efforts will inform and influence this industry for years to come.