INTER-STATE GAMING AGREEMENTS

Finding common ground, by **Rachel Hirsch**, Attorney at Ifrah PLLC.

The US iGaming industry is still very much in its infancy. Currently, three states have legalized Internet gaming within their borders – Delaware, Nevada, and New Jersey. And while all three states have gone live with intra-state gaming, they have done so to mixed results. For all three states, having enough players to sustain an online game is a top concern. Inter-state gaming agreements are often touted as the solution to player liquidity concerns. Yet with vast differences in approach taken by states with respect to Internet gaming, finding enough common ground to forge a "model" agreement will not be an easy task.

The need for inter-state agreements

Given the difficult terrain states will need to traverse to forge reciprocal agreements, it begs the question as to the purpose of inter-state iGaming agreements. There are varying incentives for states to enter inter-state agreements, some of which are closely linked to the states' population and gaming regulatory frameworks.

Considerations for uniformity in standards

Delaware, Nevada, and New Jersey are not the only states to consider the merits of inter-state iGaming agreements. Indeed, there is a growing recognition among other state lawmakers and regulators that inter-state gaming agreements are a necessity. The National Council of Legislators from Gaming States (NCLGS), a non-partisan organization, recently announced that it will launch efforts to build a policy framework for states enacting and considering inter-state Internet gaming. Any state or organization considering a "model" inter-state agreement will need to consider uniform standards for, among other things, licensing, taxation rates, revenue distribution models, and player disputes.

Licensing standards

Legalized iGaming in the US is tied to land-based casinos – meaning that, in states like Nevada and New Jersey, operators and Internet service providers must be licensed to the same strict standards as a land-based casino operator and/or gaming manufacturer. Licensure is also required of purveyors of certain services such as geolocation and information technology, but the process is not as extensive.

Nevada and New Jersey both adhere to strict licensing requirements which share some commonalties but even more distinctions. In Nevada, for example, servers for iGaming operations must be located in Nevada unless the Chairman of the Nevada Gaming Board permits otherwise. New Jersey also requires servers to be located within the state, but, unlike Nevada, there is no discretion given to the gaming authority to waive that requirement. Nevada and New Jersey also differ in other aspects of licensure – most notably, in the types of games offered. Unlike Nevada, which offers online poker only, all "authorized" games may be offered in New Jersey, including all table games and slot machine games. The other notable difference between Nevada and New Jersey legislation is their suitability requirement. Nevada's law contains a "bad actor" clause barring entry for five years to certain persons who owned or operated interactive gaming facilities in the US in violation of the Unlawful Internet Gambling Enforcement Act of 2006. New Jersey's law, however, does not contain a "bad actor" clause.

Given the varying licensing requirements implemented by these states, any inter-state agreement will need to account for these differences and determine which state's licensing regimes will take precedence. From the perspective of current legalized states, the implementation of an inter-state agreement could prove difficult. For instance, will New Jersey allow its players to wager on a site that was licensed in Nevada but not in New Jersey, or will New Jersey insist on Nevada operators being licensed in New Jersey as well? Will Nevada preclude player pooling with an entity it considers a "bad actor," and, if so, which state investigates "bad actor" status? Similarly, will a state like Nevada rely on New Jersey's technology requirements, or will systems need to be approved by each state?

These questions not only impact the three states that have legalized iGaming, but they also impact other states that have some form of gaming within their borders that may permit iGaming in the future. As for these states, the question becomes whether they will rely on the practices and procedures of their own gaming regulatory body or surrender to the super-regulatory hub of New Jersey or Nevada. These types of questions will need to be resolved before any form of model inter-state agreement can be reached. And these licensing questions will change as new states come online that may not have any gaming or regulatory experience.

Tax considerations

Even assuming that iGaming providers are willing to go through the licensing process

in each state, there is still the issue as to how individual states will tax online gaming that results from shared player pools. Any inter-state iGaming agreement will need to examine the possibilities of how to source the gaming activity for taxation purposes. Will the gaming activity be sourced on the location of the player or on the location of the operator?

Sourcing the activity based on the location of the player seems to be the most straightforward approach. With multiple states' iGaming tax regimes potentially being applied to activity taking place on the same tables, operators could be subject to paying tax to more than one state for the same activity. A player-based model, however, would dispense with that problem. Alternatively, states could take the approach of sourcing the activity based on the location of the operator. This approach would mean that all gaming activity on the operator's site would be subject to tax in the state where the operator is located. The application of this approach, however, could have significantly different tax consequences for states depending on whether the operator is located in only one state or more than one state pursuant to an inter-state agreement. If the operator is located in more than one state, sourcing activity based on player location would be the best approach.

Revenue sharing

The same considerations apply to a revenue sharing model. How much does each state share in revenue generated as a result of an inter-state agreement? Will the revenue sharing model be based on the location of the player or the location of the operator? Other revenue sharing considerations include whether a state with a smaller population agrees to pay a high revenue share in order to access a greater pool of customers. Common sense dictates that these smaller states would, indeed, be willing to pay a higher share to obtain a revenue stream they would not otherwise have. Of course, the real winners here would be gaming operators who have casinos in numerous jurisdictions of varying sizes.

Impediments to "compacting"

Although forging a "model" inter-state agreement may be conceptually difficult, it is not legally impossible. Once thought to be the biggest obstacle to inter-state or international transmission of money related to online wagers, the Federal Wire Act of 1961 no longer poses a threat to the possibility of inter-state gaming agreements. In December 2011, the DoJ reversed its long-held position that the Wire Act prohibited all forms of Internet gambling, including poker, holding that the Act applies only to sportsbetting.

Another perceived impediment to inter-state "compacts" is the lesser known Compact Clause of the US Constitution. The term "compacts" has been used to describe gaming agreements between states. The Compact Clause prohibits a state from entering into any "Agreement" or "Compact" with another state without the consent of Congress. Nevertheless, the Compact Clause has been interpreted narrowly by the Supreme Court to apply only to agreements that tend to increase the political power of states, which may encroach upon the supremacy of the federal government. Under the Supreme Court's test, inter-state Internet gaming agreements do not implicate the Compact Clause because the sole purpose of the agreements is to facilitate commerce between licensees and a larger pool of customers. The agreements would not export any state's regulations or apply any state's laws to any out-of-state resident or company. For example, Illinois could always enact a statute providing that its residents are permitted to access games from New Jersey licensees, and New Jersey could do the same for its residents and Illinois licensees. That would not impair any federal interest because Internet poker is lawful under every applicable federal law as long as it is also lawful under state law. Thus, while use of the term "compacts" to describe gaming agreements may trigger certain implications under the Compact Clause, such inter-state agreements are not constitutionally prohibited because they do not expand the states' power at the expense of the federal government.

For both online operators and players, expanded player pools under inter-state gaming agreements will result in a more consumer-friendly experience, increased participation, bigger payouts, and increased profits. As the US market continues to take shape, it may be some time before the industry can agree to a "model" inter-state agreement. But with state lawmakers and regulators recognizing the importance of player liquidity, an inter-state agreement may come sooner than we expect.

Rachel Hirsch is an attorney at the Washington, DC-based law firm of Ifrah PLLC. Ms Hirsch focuses her practice on complex litigation and transactions, with a particular emphasis on iGaming and Internet marketing and advertising. Her clients have included PokerStars, Full Tilt Poker, and Microgaming. Ms Hirsch graduated with honors from the University of Maryland School of Law and practiced at Venable LLP prior to joining Ifrah Law. rhirsch@ifrahlaw.com.