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Authorizing Online Poker in California

LEGISLATIVE ANALYST'S OFFICE

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Hon. Isadore Hall III, Chair

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Federal Law Allows States to Authorize Intrastate Online Gambling

- Under the Federal Unlawful Internet Gambling Enforcement Act (UIGEA) of 2006, it is generally unlawful now to place or receive gambling bets through the Internet.

- However, UIGEA allows states to authorize online, intrastate gambling under certain conditions. For example, the type of bet or wage must be authorized by state law and cannot violate certain federal laws. In addition, rules and regulations must be adopted to prevent minors and nonstate residents from participating in online gambling.

- In recent years, there have been various bills introduced in Congress to legalize online gambling across all states, which would likely impact the revenues that states could generate from intrastate, online gambling.

- Currently, Nevada, Delaware, and New Jersey have launched intrastate, online gambling.

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Overview of Nevada Online Gaming

☑ ***Types of Games Offered.*** Nevada launched online poker in April 2013.

☑ ***Regulatory Authority.*** The Nevada Gaming Commission and the Nevada State Gaming Control Board share regulatory, licensing, enforcement, and adjudicatory authority over online gaming activities in the state.

☑ ***Operator Licenses.*** Statute restricts operator licenses to resort hotels that already possess certain gaming licenses that allow them to operate within the state. Operators must currently pay an initial two-year license fee of $500,000 and a subsequent one-year renewal fee of $250,000.

☑ ***State Tax Revenues.*** The state receives 3.5 percent, 4.5 percent, or 6.75 percent of total gross revenue received by a licensed operator, depending on the amount of gross revenue the operator generates monthly. Nevada anticipates annual revenue totaling around $3 million.

☑ ***Player Protections.*** Operators are required to maintain a reserve backed by a federally insured financial institution and/or a bona fide insurance carrier, equal to the total amount of funds held across all player accounts. Additionally, operators are required to contract with an independent certified public accountant to review the maintenance of the reserve.

☑ ***Problem Gaming Requirements.*** Operators must provide links to a responsible gaming website and a website to allow individuals to "self-exclude" themselves from future play. Additionally, operators must ensure that players have the ability to set limits on losses, deposits, tournament entries, buy-ins, and play time through their gaming account.

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Overview of Nevada Online Gaming *(Continued)*

☑ ***Number of Websites and Operators.*** Nevada currently has three websites operated by three licensed operators: Real Gaming operated by South Point Hotel and Casino, Ultimate Poker operated by a subsidiary of Station Casinos, and World Series of Poker operated by Caesars Entertainment Corporation.

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Overview of Delaware Online Gaming

- ***Types of Games Offered.*** Delaware launched online gaming in November 2013. Authorized games include poker, blackjack, roulette, and slots.

- ***Regulatory Authority.*** The Delaware State Lottery Office has regulatory, licensing, enforcement, and adjudicatory authority over online gaming activities in the state.

- ***Operator Licenses.*** The State of Delaware does not license private entities to serve as online gaming operators in the same manner as Nevada and New Jersey. Instead, the state controls all gambling and licenses agents to serve on its behalf.

- ***State Tax Revenues.*** The state receives 43.5 percent of online slots revenue and 29.4 percent of revenue from all other games, excluding payments made to players. In addition, the state receives the first $3.75 million of proceeds each fiscal year. The Delaware State Department of Finance initially estimated $7.75 million in first-year revenues. However, the state now anticipates $3.75 million in revenues.

- ***Player Protections.*** The State Lottery Office maintains a separate bank account to hold funds that are deposited into authorized gaming accounts.

- ***Problem Gaming Requirements.*** Individuals may submit a request to exclude themselves for one year, five years, or a lifetime. Violation of the exclusion constitutes a misdemeanor. Every licensed agent is also required to have a link to the self-exclusion page of the State Lottery website.

- ***Number of Websites and Operators.*** The state operates online gaming websites designed by 888 Holdings through its three racetrack casinos—Delaware Park, Dover Downs, and Harrington Raceway.

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Overview of New Jersey Online Gaming

☑ ***Types of Games Offered.*** New Jersey launched online gaming in November 2013. Authorized games include poker, blackjack, roulette, and slots.

☑ ***Regulatory Authority.*** The New Jersey Office of the Attorney General's Division of Gaming Enforcement and the New Jersey Casino Control Commission share regulatory, licensing, enforcement, and adjudicatory authority over online gaming activities in the state.

☑ ***Operator Licenses.*** Statute restricts the issuance of operator licenses to casinos based in Atlantic City and requires that nearly all associated personnel and equipment be housed within the casinos. Operators must currently pay a license issuance fee of at least $400,000 and a renewal fee of at least $250,000. The amount paid depends on the actual cost of regulation. Licensed operators must also pay $250,000 annually for problem gaming programs and services.

☑ ***State Tax Revenues.*** The state receives 15 percent of gross revenues from online gaming. Additionally, operators must either reinvest 2.5 percent of gross revenues for community and economic development projects or pay a tax consisting of 5 percent of gross revenues. New Jersey initially anticipated revenues of $160 million to $180 million annually. However, the state now anticipates annual revenues of $35 million to $50 million.

☑ ***Player Protections.*** Operators must maintain a New Jersey bank account—separate from all operating accounts—for funds deposited into gaming accounts. The amount in this account must be greater than or equal to the total amount that can be withdrawn from the operator's gaming accounts. Operators are also required to contract with an independent firm to conduct annual system and security assessments.

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Overview of New Jersey Online Gaming *(Continued)*

- ***Problem Gaming Requirements.*** Individuals may exclude themselves for one year, five years, or a lifetime. Websites must include a prominent message directing problem gamblers to appropriate resources and operators must provide links to responsible gaming websites and a self-exclusion application. Additionally, operators must ensure that players have the ability to set limits on deposits, spending, and play time through their gaming account.

- ***Number of Websites and Operators.*** New Jersey currently has around a dozen distinct websites operated by seven licensed operators.

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How Much Revenue Could Actually Be Generated in California?

☑ Our analysis indicates that the actual level of state revenue that could be generated from authorizing online poker in California would depend heavily on a variety of factors. These factors include:

- Possible legal issues regarding tribal-state compacts.
- How legal poker websites would be implemented in California.
- The number of people that would play online poker, as well as the amount wagered, on legal websites.
- The extent to which the legal websites are able to capture monies that are currently being wagered on illegal websites.

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Possible Legal Issues Regarding Tribal-State Compacts

- The existing tribal-state compacts that have been ratified by the Legislature require the tribes to make payments to various state accounts. For example, some ratified compacts require tribes to make annual payments to the General Fund. (The Governor's proposed budget for 2014-15 estimates that the General Fund will receive approximately $330 million in revenue from these tribes in the current year.)

- However, the Ninth Circuit Court of Appeal decided in the *Rincon Band v. Schwarzenegger* case that the state could not require tribes to make payments to the General Fund. While the compacts requiring these payments still stand, these tribes will likely no longer make such payments when they are renegotiated.

- Existing compacts also contain provisions limiting the state's ability to authorize certain types of gambling that could compete with the tribal casinos. For example, if the state authorizes certain types of competing gambling enterprises, these compacts may allow the tribes to stop making payments to state accounts, such as those that support nongaming tribes, regulatory bodies, problem gaming resources, and local mitigation.

- There could be legal challenges that legal poker websites violate the above provisions in tribal-state compacts if online poker is approved in California. If such challenges were upheld, the state could lose hundreds of millions of dollars in revenue annually. Thus, the Legislature should work closely with the Office of Legislative Counsel and other legal experts to assess these risks if it wishes to consider proposals in this area.

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How Legal Poker Web Sites Could Be Implemented in California

- ***State Share of "Gross Revenues."*** One of the primary factors in how much revenue the state would generate is what portion of gross revenues it would receive from the legal website operators. One goal could be to maximize the benefit from these activities to the state. On the other hand, if the state were to require too large a share, such operators may not retain sufficient funds to effectively compete with the operators of illegal websites (such as for marketing and incentives to retain players).

- ***State Regulations.*** The state would incur regulatory costs to prevent unauthorized users from playing on legal poker websites. In addition, it is not clear what specific steps individuals in California would need to take to be able to play on legal poker websites (such as providing proof of residency, location verification, and paying registration fees). If these requirements were extensive, however, they could be a barrier to player participation.

- ***Number of Websites.*** Although the existence of multiple legal poker websites within California could promote competition, having too many sites could result in each site not having sufficient players to facilitate poker games, as sometimes occurs on illegal websites. This seems to be an issue facing the three states currently operating online gaming.

- ***Tax Revenue.*** The website could be designed to make it easier to collect income taxes on net winnings. Currently, players using illegal websites have little incentive to report gambling winnings for tax purposes. The state could require that such websites report such information to the state. However, this could deter some players from using legal websites. The state would also collect taxes from the operators of legal poker websites as well as their employees.

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Various Factors Could Impact Player Participation in Legal Online Poker

- ***Cost to Play.*** If the cost of playing on legal poker websites was greater than the cost of playing on illegal websites, due to taxes and fees paid by the players, there could be a fiscal disincentive to play and wager similar amounts on legal sites.

- ***Security and Regulation.*** Unlike illegal poker websites, the legal websites would be able to provide players with a greater sense of security and comfort in that they would know that they are not engaging in an illegal activity.

- ***Incentives to Retain Players.*** Many of the existing illegal websites offer financial incentives to retain players. For example, some sites offer bonuses to players that they can collect only after playing a predetermined amount of time. This could make it more difficult for new California online websites to capture a share of the market in the near term. The state could allow similar incentives for its games.

- ***Games Offered.*** Legal poker websites would have to compete with existing illegal websites that have little or no limits on the types of games offered.

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Two Potential Sources of State Gaming Revenues From Online Poker

☑ State Revenues From Redirecting Wagering From Illegal Websites

- Several studies estimate that illegal websites receive roughly $300 million to $400 million in gross revenue from Californians participating in online poker.
- While it is not known how many current California players would switch from illegal websites, these potential gambling activities could generate new revenues for the state.

☑ State Revenues From Generating More Wagering

- Revenue generated from (1) existing players betting more than they otherwise would or (2) individuals that currently do not play online poker would be offset, to an unknown extent, by a reduction in existing state revenues.
- This is because individuals would generally spend less consuming other goods and services because more of their income would be spent on online gambling.