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Legislative Approaches to Internet Sweepstakes Cafes

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Executive Summary

In less than a decade, Internet sweepstakes cafes—establishments where patrons can play computer games that mimic casino-style games—have proliferated across the United States. According to current estimates there are more than 5,000 sweepstakes cafes in operation throughout the U.S., as part of a business that has grown into an industry worth $10bn in annual revenues.

In many states the legality of these cafes is under debate. Cafe owners and operators argue that their businesses operate, legally, under state sweepstakes and promotional laws. Those who oppose the cafes consider them de facto gambling houses that are evading state gaming regulations.

Debate over Internet sweepstakes cafes is set to continue, in multiple states, during 2013. In South Carolina, for example, legislation to prohibit the machines has already been filed. In Florida and Ohio, how to approach the legality of the machines is under legislative debate. In both states, lobbying associations have been formed by the cafes ahead of potential regulatory or prohibitory legislation. At the national level, gaming industry associations are starting to weigh in.

This white paper looks at different approaches select states have taken in determining whether to regulate or prohibit the cafes. Generally speaking, states have taken one of three approaches: (1) state-level prohibition; (2) state-level regulation; (3) no legislative action.

Each approach brings with it specific issues and concerns. In states that prohibit the machines, legislators and law enforcement must keep pace with rapid technology changes. In North Carolina, where a prohibition recently came into effect, cafe owners are in the process of adjusting the technology behind their sweepstakes terminals. On the other hand, in some states, municipalities have created workable regulatory regimes. The "sweepstakes cafes have been no problem to regulate," one Florida official told GamblingCompliance in December.

Thus far, only a select few states have taken legislative action specific to sweepstakes cafes. Legislation prohibiting or severely limiting the cafes was passed in at least three states in 2012. As legislative and legal debate over the sweepstakes cafe industry continues, more states are likely to consider addressing the proliferation of sweepstakes cafes through legislative action.

Current Overview

A search for "Internet sweepstakes cafe" on Google Maps turns up more than 5,000 results across the U.S.[1] Estimates from 2011 state that in Florida alone there are between 600 and 1,000 cafes generating a marketplace worth upwards of $1bn annually.[2] In Ohio, 820 sweepstakes cafes filed paperwork with the attorney general in June 2012, following a moratorium on the operation of new cafes.[3] According to James Mecham, managing director of SweepsCoach, a California-based company that provides consulting services to sweepstakes cafes, a terminal in a typical cafe can gross between $1,000 and $5,000 a month.[4] Based on this, Mecham estimates Internet cafes in the U.S. represent a $10bn to $15bn industry.[5]

In many states, the cafes have caught the ire of local law enforcement and community officials. These cafes generally operate under state game promotion, or sweepstakes, statutes. These statutes were originally passed to carve out an exemption from state gambling prohibitions for consumer promotions, such as the popular McDonalds® Monopoly game. Those opposed to the cafes argue that the primary draw for consumers, and the primary revenue generator, is the promotional games.

In other words, opponents contend the products sold at the cafes, such as calling cards and Internet access time, are ancillary to the promotional games and therefore the activity should be considered gambling. Expert testimony provided during litigation over the legality of the cafes in Pennsylvania referred to the selling of phone and Internet time as a "sham process," stating, "[p]eople are going in for the simulated gaming activity."[6]

Cafe owners and operators, conversely, argue that their businesses legally operate within state sweepstakes laws. According to Laurie Lee, a sweepstakes attorney with Brennan, Manna and Diamond in Jacksonville, Florida, the cafes are legal.

> *Businesses have offered sweepstakes for decades—but most of them were big businesses who could afford the cost of development. Now, with the advance of technology and the creation of electronic sweepstakes, even small businesses can benefit from the marketing technique. The sweepstakes technology allows for all kinds of ways to reveal the results of the sweepstakes. Customers can choose to see entertaining video displays while their entry is being "read" by the computer. Most of the video displays simulate some type of game, even games traditionally seen in casinos, even though the display has no connection to the sweepstakes result. The video screens have often caused confusion as to the legality of the sweepstakes. Sweepstakes statutes don't typically address the way the results are communicated to the customer. They mostly address the fairness of the system and making sure that all prizes are awarded. As long as a business is offering a legitimate consumer product at market value, and the statutory requirements are followed, the sweepstakes is legal.*[7]

Recently, gaming industry stakeholders have begun to consider the effect sweepstakes cafes might have on their respective businesses. In late 2012, the American Gaming Association (AGA) adopted a formal position on Internet sweepstakes cafes. Calling them "rogue businesses," the AGA takes the position that the cafes are a "threat to existing state-licensed [gaming] businesses." In fact, a 2004 study by the Texas Lottery Commission found that illegal gambling machines in the state were siphoning money away from legal gambling industries.[8]

"Sweepstakes cafe proprietors claim that these under-the-radar businesses don't constitute gambling and would like to continue to operate without the accountability of normal gaming establishments, but if they aren't controlled, states, existing gaming businesses and consumers all stand to lose," said Frank J. Fahrenkopf, Jr., president and CEO of the AGA. The National Indian Gaming Association (NIGA) has not yet adopted a formal position on the cafes. In January, NIGA told GamblingCompliance the issue is actively being discussed among its members.[9]

The North American Association of State and Provincial Lotteries (NASPL) has not yet adopted an official position. David Gale, NASPL's executive director, told

What is an Internet Sweepstakes Cafe?

Typically the cafes have computers and sell Internet access time or long distance phone cards to patrons. By purchasing these items patrons also receive points to participate in a promotion. At most sweepstakes cafes, no purchase is necessary to obtain promotional points, but the cafe usually places a limit on promotional plays daily. There are generally two ways to use the promotional points, "quick reveal" and "game display." Although both options produce the same result, as pre-determined by the sweepstakes software, they are revealed differently. "Quick reveal" is when a patron can determine if he or she won immediately—either by asking a sales associate or selecting the instant reveal option on one of the cafe's computers. The "game display" option allows the user to play computer simulated casino-style games. Prizes can consist of cash, non-cash prizes, or more chances to play the sweepstakes games, with some cafes offering prizes up to $5,000.

GamblingCompliance: "NASPL will be addressing this issue during our upcoming Executive Meeting in February. It is likely that we will adopt a similar position as the one approved by the AGA."[10]

With the relatively recent growth in the industry and questions over its legality, the topic of Internet sweepstakes cafes is being discussed in state houses across the U.S. In 2012, Georgia, New Hampshire and Pennsylvania all passed laws to either prohibit or severely restrict sweepstakes cafes. Other states, such as Massachusetts and North Carolina, have also passed laws to address sweepstakes cafes. In Virginia, prohibitory legislation was passed in 2011 after an attorney general's opinion found that, at least in one circumstance, the cafes were not violating existing gambling laws. Approximately a dozen state attorney generals have weighed in on the legality of sweepstakes cafes in their respective states.

On a state-by-state basis, various legislative approaches have developed to address the issues surrounding Internet sweepstakes cafes. These approaches can be separated into three general classifications: (1) state-level prohibition; (2) state-level regulation; (3) no legislative action.

State-Level Prohibition
The first legislative approach involves creating specific acts, or amending current statutes, to directly prohibit the playing of sweepstakes machines throughout the state. For example, in 2012, New Hampshire amended the definitions of "gambling" and "gambling machine" to specifically include sweepstakes terminals. The law imposes a fine of $5,000 a day, per device, for violations and empowers local authorities to shut down sweepstakes game locations. In some states, laws seeking to outlaw sweepstakes machines have been the subject of legal challenges. In Pennsylvania and North Carolina, laws were challenged as violations of the First Amendment Free Speech Clause. In both cases, court rulings upheld the laws banning the machines.

State-Level Regulation
Another option is for state-level regulation, though no state has yet to fully embrace this method. In some states, for example Florida, legislation to regulate the cafes has been proposed. In Ohio, there is currently a moratorium on new Internet cafes opening, while the legislature takes time to consider whether they wish to regulate or prohibit the cafes. In Georgia, the sweepstakes law does provide for some regulations, although it essentially outlaws the cafes.

Generally, regulatory legislation would charge the cafes license fees and the state would then establish rules and regulations for these types of machines, including payout requirements, age restrictions, equipment testing and auditing. Proponents believe that state legislation would provide for adequate controls and uniformity, which are currently lacking.

No Legislative Action: Local Regulation and Enforcement
A third approach that states have taken has been to forgo legislative action. In states without specific legislation, which currently accounts for the majority, regulation and enforcement approaches are varied. In some states, such as California and Texas—where officials are trying to enforce general gambling bans and shut down cafes—law enforcement is struggling in the face of unclear legal standards and practical constraints. In South Carolina, magistrate judges across the state have come to divergent conclusions on the legality of sweepstakes machines, leaving the industry in a state of flux. Yet, in other states, such as Florida, municipalities have stepped in where state regulation has not, passing ordinances regulating or prohibiting the cafes. Those municipalities that have chosen to allow the cafes charge license fees to establishments who wish to operate sweepstakes gaming terminals.

Moving Forward

As we move into 2013, more state legislatures are likely to review Internet sweepstakes cafes. In South Carolina, legislation to make clear that sweepstakes machines are considered illegal gambling machines has been filed. Legislation is also expected in Ohio. In December, outgoing Ohio Senate President Tom Niehaus (R) was quoted saying there is more support among his caucus for regulation than prohibition.[11] In Florida, legislators are undergoing a holistic two-year review of the state's gaming industry, at the end of which recommendations for gaming legislation will be made. Nonetheless, legislation to prohibit sweepstakes devices has been pre-filed in Florida for 2013.

While states continue to debate what actions, if any, to take regarding sweepstakes cafes, a varied approach to the industry will continue. In December, the California Bureau of Gambling Control issued an advisory to law enforcement stating that the cafes are "illegal gambling operations," yet they are opening with "increasing frequency."[12] Meanwhile, Ohio Attorney General Mike DeWine has advocated requirements he would like to see in sweepstakes regulation.[13] The Internet Sweepstakes Association of Ohio was recently formed and in Florida there is a similar lobbying organization, in anticipation of increased legislative debate.

The following section of this paper contains seven state case studies highlighting varying policy approaches to Internet sweepstakes cafes. The final section of this paper consists of a state summary reference chart describing different laws, regulations and opinions relevant to Internet sweepstakes cafes in 20 states.

Selected Case Studies

Florida

Florida does not have a law that specifically addresses Internet sweepstakes cafes. The operation of sweepstakes cafes in the state, therefore, falls under the general gaming laws and the game promotion statute. A game promotion, "means, but is not limited to, a contest, game of chance, or gift enterprise, conducted within or throughout the state and other states in connection with the sale of consumer products or services, and in which the elements of chance and prize are present."[14] Promotions relating to bingo and sports wagering are specifically excluded by statute. Customers must not be required to purchase goods or services, or pay an entry fee, to take part in the promotional game. In addition, the game promotion law sets out various rules that promotional operators must follow when operating their sweepstakes.

One concern of Florida law enforcement is whether or not the game promotion statute allows for consumer goods or services that are incidental to the sweepstakes. The statutory language provides that the promotion must be "in connection with the sale" of consumer goods and the case law on the subject may be considered inconclusive.[15] In 1998, prior to the proliferation of the cafes, an attorney general's opinion found that machines which dispensed telephone calling cards that also had a sweepstakes ticket attached to the cards violated Florida law. The opinion seemed to reason that the telephone card purchase was "incidental" to the gambling purpose of the machines; however this was not the main holding of the opinion.[16]

An official in charge of regulating sweepstakes machines told GamblingCompliance that the regulation has had an overall "positive impact" on Duval County.

Enforcement of the state's gaming laws, as they apply to the cafes, is being undertaken at the local level. Municipalities have either ignored the issue or taken one of three approaches:

- Taking enforcement action against the cafes via raids and prosecutions based on the general gambling law, although it has been acknowledged that the applicable state laws regulating the cafes is ambiguous.[17]
- Enacting a state or county ordinance to prohibit the cafes. For example, in 2011, Seminole County enacted an ordinance banning Internet sweepstakes cafes through a prohibition on simulated gambling devices.[18]
- Regulating the cafes. For example, Duval County issues permits for electronic game promotion machines.[19] There are 47 sweepstakes cafes in the county. A sweepstakes cafe is a location with more than 10 machines. The machines may also be located in other locations, such as bars. The cafes must pay a $2,000 annual fee and a $50 per machine fee, along with a $500 permit renewal application fee.[20] According to data from Duval County, licensing fees assessed for some 3,500 gaming machines totaled nearly $400,000 in 2012. An official in charge of regulating sweepstakes machines told GamblingCompliance that the regulation has had an overall "positive impact" on Duval County.[21]

Ambiguous state law and the variation in approaches to the cafes at the municipal level have sparked concern among state lawmakers. "Internet cafes are cropping up by the hundreds all over Florida, and local governments are struggling with it," Senate President Don Gaetz told the South Florida Sun Sentinel. The Seminole Tribe, operator of seven casinos in the state, is also concerned about the cafes, the operation of which could have implications on tribal-state gaming compacts.[22]

In 2012, bills to both prohibit Internet sweepstakes cafes and regulate the cafes were introduced at the Florida state house, but no bills were passed.[23] Heading into the 2013 legislative session, Florida lawmakers are poised to hold off on passing any gaming legislation before a two-year comprehensive review of the state's gaming policy is undertaken. Lawmakers are aiming to develop a holistic gaming policy on gambling to guide them as they consider a multitude of gambling issues in the state, including destination casinos, Internet gaming, and tribal-state gaming compact negotiations, as well as sweepstakes cafes.[24] However, a measure that would prohibit sweepstakes terminals was pre-filed in the state legislature on January 14, 2013.[25]

Georgia

After the passage of S.B. 431 in May 2012, Georgia has regulated its sweepstakes market, nearly out of existence. Previously, in 2011, Governor Nathan Deal ordered state authorities to crackdown on Internet sweepstakes cafes.[26] Governor Deal advocated a clear message for the state's law enforcement to eradicate Internet sweepstakes cafes from the state before the market expanded to uncontrollable levels.[27]

S.B. 431, codified as Act 752, amended Section 10-1-393(16)(b)(N) of the Georgia Code, dealing with unfair trade practices, which now reads: "Any promotion involving an element of chance which involves the playing of a game on a computer, mechanical device, or electronic device at a place of business in this state shall be considered an unlawful lottery as defined in Code Section 16-12-20."[28]

After the passage of S.B. 431 in May 2012, Georgia has regulated its sweepstakes market, nearly out of existence.

The bill also amended the definition of a lottery, found in Section 16-12-20(4) of the Georgia Code.[29] The definition now clearly applies to sweepstakes machines, with a lottery defined as:

> *[T]he payment of cash or other consideration or the payment for merchandise or services 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, other consideration, other evidence of winnings, or other 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, other consideration, or other evidence of winnings …*[30]

S.B. 431 does, however, give cafe operators an alternative for their current sweepstakes machines. Georgia permits coin-operated amusement devices, divided into two classes: Class A machines and Class B machines.[31] Essentially, prizes are limited to free plays for Class A machines and a maximum of five dollars for Class B machines.[32] These machines must be licensed under Section 48-17-9 of the Georgia Code, with licensing fees of $25.00 for Class A machines and $125.00 for Class B machines.[33] S.B. 431 also places new restrictions on the amount of Class B machines rewarding players with prizes, setting the limit at nine machines. Prizes can be in the form of: non-cash merchandise, prizes, toys, gift certificates, or novelties.[34]

The Georgia General Assembly also carved out exceptions for nationally-advertised sweepstakes promotions. The bill's language guarantees large corporations, like McDonalds and PepsiCo., can continue their sweepstakes promotions by allowing:

> *[N]ational or regional promotion, contest, or sweepstakes conducted by any corporation or wholly owned subsidiary or valid franchise of such corporation, either directly or through another entity, provided that, at the time of such promotion, contest, or sweepstakes as long as a corporation is registered under the Securities Exchange Act of 1934 and has total assets of more than $100m.*[35]

North Carolina

North Carolina's Internet sweepstakes cafes have been on a roller coaster ride in recent years. The state banned "video poker" machines in 2006[36] and sweepstakes machines have proliferated throughout the state ever since.[37] In August 2012 researchers estimated sweepstakes cafes could earn between $4.6bn and $13bn in total annual sales, before payouts, in the state.[38]

In 2010, the General Assembly attempted to remedy the perceived loophole through which Internet sweepstakes cafes had been proliferating by passing H.B. 80.[39] H.B. 80 defined an "electronic machine or device" as "a mechanically, electrically or electronically operated machine or device … that is intended to be used by a sweepstakes entrant, that uses energy, and that is capable of displaying information on a screen or other mechanism."[40] The act goes on to define an "entertaining display" as "visual information, capable of being seen by a sweepstakes entrant,

that takes the form of actual game play or simulated game play."[41]

The law was promptly challenged, eventually making its way to the North Carolina Supreme Court, which rendered an opinion on December 14, 2012.[42] The Supreme Court held the law constitutional, overturning a previous Court of Appeals decision that had declared the statute an overbroad restriction on speech.[43]

The Supreme Court held that H.B. 80 regulated conduct rather than speech.[44] The cafe operators insisted the language regulated video games, essentially entertainment for the patrons, since tickets could be given without consideration as the parlors involved distributed a certain number of free plays each day.[45] The court used particular language to explain what conduct is actually being regulated by the law, stating, "the statute does not prohibit the video games, only the conduct of a sweepstakes that happens to announce its result through such video games."[46] The court further explained even if the operation of sweepstakes terminal was deemed speech, it is not protected speech, referencing the General Assembly's long-found ability to prohibit speech involved with illegal gambling.[47]

After the Court of Appeals ruling, between 700 and 800 sweepstakes parlors were operating in the state.[48] Cities in the state were charging for permits for machines. In Raleigh, the fees started at $3,500 for the first machine and $1,000 for each additional machine.[49] In Wilmington, the fees were as high as $3,000 per machine.[50] The law came back into effect January 3, 2013, and law enforcement made it clear they would enforce the ban on sweepstakes cafes.[51] However, this may not be the end of North Carolina's saga, as some owners are vowing to make adjustments to their machines and re-open their parlors.[52]

Ohio

In 2012, Ohio saw drastic changes throughout its gaming sector, with the opening of its first casinos and the approval of gaming machines at racetracks. The sweepstakes cafe market also saw expansion during this time. Between late 2011 and early 2012 the industry reached its peak with over 800 active cafes.[53]

However, in the summer of 2012, the passage of H.B. 386—a bill which made multiple changes to gambling regulation in the state—instituted a moratorium on the opening of new establishments for sweepstakes gaming until June 30, 2013.[54] The moratorium was put in place to provide the Ohio General Assembly time to craft legislation regarding the regulation, or prohibition, of the cafes. The moratorium prohibits the addition of new sweepstakes terminals to the market, defined by the bill as:

> [A] mechanical, video, digital, or electronic machine or device that is owned, leased, or otherwise possessed by any person conducting a sweepstakes […] that is intended to be used by a sweepstakes participant who purchases a tangible product to enter a sweepstakes, and that is capable of displaying information on a screen or other mechanism.[55]

The bill further laid out potential characteristics of a sweepstakes terminal device, including: being server based, using simulated game terminals and selecting prizes from a predetermined finite pool of entries or requiring direct payment.[56] To keep operating, H.B. 386 required existing Internet cafes to fill out an affidavit containing their business information.[57] More than 820 affidavits were filed with the Ohio attorney general.[58]

Following the imposition of the state's moratorium, in August 2012, Ohio Attorney General Mike DeWine released a statement that outlined what he thought were important tenants for any eventual sweepstakes regulations.[59] Attorney General DeWine has also been quoted as stating his opinion that an outright ban on cafes might not survive a court challenge, although regulations likely would.[60]

In August 2012, Ohio Attorney General Mike DeWine released a statement that outlined what he thought were important tenants for any eventual sweepstakes regulations.

In November 2012, Representative Matt Huffman (R-4th District) introduced H.B. 605.[61] The bill, which passed the House but never received a vote in the state

Senate, would have effectively prohibited sweepstakes terminal devices as they are currently operated. H.B. 605, had it passed, would have amended the definition of "scheme of chance" to include electronic devices revealing game entries if consideration is paid.

The bill outlined examples of when consideration is paid:

- Less than 50 percent of the goods or services sold are used by patrons.
- Less than 50 percent of patrons use or redeem the goods or services sold.
- More than 50 percent of prizes are revealed in a fashion similar to a "casino game."
- A patron pays more than fair market value for goods or services to receive promotional entries.
- A patron can purchase additional promotional plays directly from the electronic device.
- A cafe owner pays out more than 20 percent of the gross revenue received at the cafe in prize money.

Under H.B. 605, conducting or participating in a sweepstakes with the use of a sweepstakes terminal device constitutes a felony in the fifth degree.[62] The bill also set a maximum prize limit of $10.[63]

In December, outgoing Senate President Tom Neihaus (R) told reporters that he believed sweepstakes cafe legislation would be addressed "very early" in the 2013 General Assembly. Niehaus said his caucus was leaning toward regulation rather than eliminating the sweepstakes parlors. "I think there is probably more support in my caucus right now for the regulatory scheme as opposed to an outright ban, but it's very close," he said.[64] However, Neihaus did not return to the Senate in 2013, due to term limits.

Pending new legislation, some cities have started to regulate the cafes at the municipal level. Lorain, a city west of Cleveland on Lake Erie, currently has four cafes in operation. The cafes operate between 30 and 80 machines each, with a city-wide total of 193 machines.[65] Sweepstakes cafes in Lorain are charged an annual fee ranging from $2,500 to $12,500, depending on the number of machines operated. Cafes must also pay a $30 fee per machine per month.[66]

In North Ridgeville, Ohio, Mayor David Gillock said the city receives about $120,000 per year for licensing fees for sweepstakes cafes.[67] Gillock also testified before the Ohio Senate's Government Oversight and Reform Committee on December 11, in favor of regulating Internet cafes. "Before we allowed them, we wrote legislation, and it's quite extensive," Gillock said.[68] "We require applicants to undergo background checks," he said.[69] "We fingerprint them. You can't have a felony and own or work in one of these places. We regulate the hours of operation."[70]

The new law makes it a criminal act for a person to own, operate, maintain, place into operation or hold a financial interest "in an electronic video monitor or business that owns, operates, maintains or places into operation or has a financial interest in an electronic video monitor."

Pennsylvania

In fall 2011, sweepstakes cafes began to garner attention across the Keystone State. The Pennsylvania General Assembly responded quickly to the issue. In June 2012, the legislature passed H.B. 1893, codified in Act 81, which amended Section 5513 of Title 18 of the Pennsylvania Consolidated Statutes, dealing with criminal sanctions of gambling devices.[71]

The new law makes it a criminal act for a person to own, operate, maintain, place into operation or hold a financial interest "in an electronic video monitor or business that owns, operates, maintains or places into operation or has a financial interest in an electronic video monitor."[72] The statute further criminalizes participating in a "simulated gambling program," defined by the act to include,

"Any method intended to be used by a person interacting with an electronic video monitor in a business establishment that directly or indirectly implements the predetermination of sweepstakes cash or cash-equivalent prizes or otherwise connects the sweepstakes player or participant with the cash or cash-equivalent prize."[73]

Shortly after being signed by Governor Tom Corbett, Act 81 was challenged, in a Pennsylvania state court, by Telesweeps, an incorporated entity operating an Internet cafe and retail store in Butler Township, Pennsylvania.[74] Telesweeps' Internet cafe housed desktop computers and video monitors and sold cell phone accessories, Internet access time and printing, copying and faxing services.[75] At the Internet cafe, patrons bought charge cards, usually telephone cards that contain points, which can be used on the machines for promotional play to win prizes.[76] At the Telesweeps cafe, prizes were exclusively paid in cash.[77] Also of note, patrons did not need to purchase the cards to get promotional plays, a limited numbers of free plays were available upon request, either via mail or by asking a sales associate.[78]

Telesweeps filed a preliminary injunction trying to prohibit the act from being enforced.[79] The court refused to grant the injunction, stating the claim would not likely succeed on the merits because Telesweeps' operations, while clever, "merely elevates form over substance", and the cafe's operations "constitute gambling."[80]

The court further opined that to find criminal liability under Act 81, a person or business must have "(1) some interest in an electronic video monitor, which (2) allows a user to participate in a simulated gambling program, (3) after that use has paid consideration in some form (4) for a chance at winning (5) a cash prize."[81] As for Telesweeps' machines, the court found the elements were clearly established, making the operators of the cafe in violation of Act 81.[82]

The court decision strengthens Act 81's reach and upholds the constitutionality of the statute. However, the case is currently under appeal in the Middle District Court of Pennsylvania.

South Carolina

South Carolina's sweepstakes market is awash with uncertainty. Magistrates across the state have come to divergent conclusions on the legality of sweepstakes machines and municipalities have taken different approaches to regulation of the machines. Some municipalities have chose to regulate and charge permit fees for the machines, while others have placed a moratorium on new cafes while waiting for state-wide legislation. Finally, some municipalities have found the machines to be illegal, prosecuting cafe owners and operators, and in some cases patrons.

South Carolinian policy regarding gambling machines is unique. In the 1990s, video poker machines began popping up across the state.[83] The issue even played a role in the 1998 gubernatorial election, with controversy surrounding the machines leading to a scheduled referendum in 1999.[84] But, the South Carolina Supreme Court outlawed video poker machines in 1999, finding a referendum to allow video poker machines in the state unconstitutional.[85] The court held the referendum gave the citizens the power to legislate, a power expressly prohibited by the state's general assembly.[86] The rise of sweepstakes is seen, by some, as the second coming of video poker.[87]

The South Carolina Law Enforcement Division (SLED) and local authorities have banded together to raid sweepstakes cafes.[88] In June 2011, the state's Attorney General issued an opinion on sweepstakes, explaining the process to determine the legality of video machines:

> *Any machine, board or device prohibited by Section 12-21-2710 must be seized by any law enforcement office and at once taken before any magistrate of the county ... who shall immediately examine it, and if satisfied that it is in violation of Section 12-21-2710 or any other law of this State, direct that it immediately be destroyed.*[89]

Magistrates in Horry County found sweepstakes machines to be illegal, whereas magistrates from Kershaw County, Greenville County and Georgetown County concluded the machines are legal.[90]

The games have been held legal for a variety of reasons, with the main two being: (1) the machines do not accept or dispense currency or coins and (2) the sweepstakes entries do not require purchases.[91] Other states like North Carolina and Pennsylvania have ruled on this matter, finding the free plays to be a "ruse" and the consideration in the form of phone cards and Internet time rarely used.[92]

The state introduced legislation in 2012 to outlaw the machines outright. The bill passed the South Carolina House of Representatives, but was stopped in the Senate.[93] A similar bill was introduced in the Senate, but no action was taken.[94] Senate Judiciary Committee Chairman Larry Martin (R-Pickens) plans on pushing prohibitory legislation again in 2013, having pre-filed a bill on December 13, 2012.[95]

Texas

Texas does not have a law specifically prohibiting sweepstakes terminals at Internet cafes. However, Texas has seen successful federal prosecution pursuant to violations of state and federal anti-gambling laws. In August 2012, the Fifth Circuit Court of Appeals upheld an illegal gambling conviction for two Texas men in connection with their operation of three sweepstakes cafes.[96] The men were found guilty of gambling promotion, keeping a gambling place and possession of a gambling device.[97] The court found the Texas District Court's decision was based on a sufficient amount of evidence.[98]

The court concluded that "a reasonable fact-finder could infer that the sale of Internet time at the defendant's cafes was an attempt to legitimize an illegal lottery."

The defendants were charged under 18 U.S.C. § 1955, making it a crime to conduct, finance, manage, supervise, direct or own all or part of an "illegal gambling business."[99] The act defines a gambling business as one which:

> *"(i) is a violation the law of the State in which it is conducted, (ii) involves five or more persons who conduct, manage, supervise, direct, or own all or part of such business, and continuously operates for a period of time of more than 30 days or has a gross revenue of $2,000 or more on any single day."*[100]

The defendants argued that their actions were not illegal under Texas law.[101] The Texas laws in question were prohibitions against gambling promotion[102], keeping a gambling place[103], and possessing a gambling device[104]. To find a violation of any of the three statutes, gambling—prize, chance, and consideration—must be present.[105]

As in most Internet sweepstakes cafes throughout the state, patrons of the three Internet cafes under dispute purchased Internet time and received free promotional plays for sweepstakes games, as well as free food and drinks.[106] But, the case turned on how the Internet time was being used, and whether the primary time was to access the Internet or participate in sweepstakes games with the chances of winning a prize.[107] The court concluded that "a reasonable fact-finder could infer that the sale of Internet time at the defendant's cafes was an attempt to legitimize an illegal lottery."[108] Evidence showed patrons were not valuing their Internet time, with hundreds of thousands of Internet minutes being unused.[109]

With the Fifth Circuit Court of Appeals upholding a conviction for operation of a sweepstakes cafe, precedent is now clear that the cafes are considered to participate in illegal gambling activities under Texas law. [110] Just over two weeks after the Davis opinion was issued, law enforcement agents targeted a Halton City-based HEST Technologies Inc. sweepstakes operation.[111] However, without assistance from federal law enforcement agents, small town police departments are struggling to enforce gambling machine prohibitions.[112]

State Summary Reference Chart

The following chart contains quick reference material on laws, regulations and opinions relevant to Internet sweepstakes cafes. The reference table is not meant to be an exhaustive list of all relevant laws, regulations and opinions but a compilation of the most commonly cited information.

State	Gaming Tax Rate	Corp. Tax Rate[1]	Court Decision[2]	State Laws	Attorney General Opinion
Alabama	*	6.5%	✓[3]		✓[4]
Arkansas	*	1% to 6.5%	✓[5]		
California	*	8.84%			✓[6]
Florida	50% on slot machines	5.5%			✓[7]
Georgia	*	6%		✓[8]	✓[9]
Idaho	*	7.6%	✓[10]		
Indiana	15% to 40% graduated tax rate	9.5%			✓[11]
Kentucky	*	4% to 6%			✓[12]
Massachusetts	25% for casinos, 49% for single state slot parlor[13]	8%		✓[14]	✓[15]
Michigan	19%	6%			✓[16]
Mississippi	Graduated up to 8% tax, with up to an additional 4% to local governments	3% to 5%	✓[17]		
New Hampshire	*	8.5%		✓[18]	
New Mexico	26% (racetracks), 10% (non-profits)	4.8% to 7.6%	✓[19]		
North Carolina	*	6.9%	✓[20]	✓[21]	
Ohio	33%(casinos); 33.5% (racetrack VLTs)	.026% (Gross receipts tax rate)			✓[22]
Pennsylvania	34% on slot machines	9.99%	✓[23]	✓[24]	
South Carolina	*	5%			✓[25]
Texas	*	0.5% to 1.0%	✓[26](federal)		✓[27]
Utah	*	5%		✓[28]	
Virginia	*	6%		✓[29]	✓[30](not illegal)

[1] All gaming tax rates are compiled from the American Gaming Association's 2012 State of the States Report, except Massachusetts.
[2] All corporate income tax rates were compiled from the Tax Foundation's website. http://taxfoundation.org/sites/taxfoundation.org/files/docs/state_corp_income_rates_2000-2012-20120216.pdf
[3] Barber v. Jefferson County Racing Assoc., Inc., 960 So. 2d 599 (Ala. 2006).
[4] AL. A.G. Op. 2005-173 (Aug. 9, 2005).
[5] Cancun Cyber Café and Business Center, Inc. v. City of North Little Rock, 2012 Ark. 154. (This case held the plaintiff sought an advisory opinion and there was not an actual legal controversy.)
[6] CA. Bureau of Gambling Control Law Enforcement Advisory "Internet Cafés" (Dec. 5, 2012). <http://oag.ca.gov/sites/all/files/pdfs/gambling/internet_cafes.pdf>. (Not an official Attorney

General's opinion, but issued under the Department of Justice, and is a call for law enforcement to prosecute or pursue civil or administration actions in connection with Internet cafe gambling operations.)

[7] FL. A.G. Op. 98-07 (Feb., 5, 1998). See also, FL. A.G. Op. 2007-48 (Nov. 7, 2007) and FL. A.G. Op. 2011-14 (July 19, 2011).

[8] Georgia Senate Bill 431 (2012).

[9] "Deal initiative aims to end internet gambling parlors," (August 18, 2011) Georgia.gov http://gov.georgia.gov/press-releases/2011-08-18/deal-initiative-aims-end-internet-gambling-parlors (accessed Dec. 21, 2012). (Not an attorney general opinion, rather a statement of policy by Georgia's Governor to end sweepstakes cafe gaming.)

[10] MDS Investments, LLC v. State of Idaho, 65 P.3d 197 (2003).

[11] M. Webb, "Indiana, Florida Move Closer to Sweepstakes Video Ban," Vending Times (Oct. 11, 2011) <http://www.vendingtimes.com/me2/dirmod.asp?sid=EB79A-487112B48A296B38C81345C8C7F&nm=Vending+Features&type=Publishing&mod=Publications%3A%3AArticle&mid=8F3A7027421841978F18BE895F87F791&tier=4&id=A-262C9A315A9493180C51A7A2074BE46> (accessed Jan. 14, 2013); "Sweepstakes Electronic Gaming Devices Illegal in Indiana," Indiana State Excise Police (Oct. 3, 2011) <http://www.in.gov/atc/isep/files/Sweepstakes_Electronic_Gaming_Devices_Illegal_in_Indiana.pdf> (accessed Jan. 14, 2013). (Order was issued by the Alcohol and Tobacco Commission, for the Indiana State Excise Police to notify all businesses about illegality of sweepstakes machines, with orders to cite offenders during officer follow-ups.)

[12] K.Y. A.G. Op. 10-007 (2010)

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[19] State on New Mexico v. Vento, 2012 N.M. App. LEXIS 78 (Ct. App. July 26, 2012). (Court of Appeals of New Mexico decision about sweepstakes cafés. No precedential information, but does provide useful dicta on sweepstakes cafes.)

[20] Hest Technologies, Inc. v. State ex Rel. Perdue, No. 169A11-2 (N.C., Dec. 14, 2012), reversing 725 S.E.2d 10 (N.C. Ct .App. Mar. 6, 2012).

[21] N.C.G.S. § 14-306.4(b) (2012).

[22] "Attorney General DeWine Reiterates Call for Internet Café Regulations as Owners Exploit Loopholes in Ohio Law," Ohio Attorney General (Aug. 7, 2012) <http://www.ohioattorneygeneral.gov/Media/News-Releases/August-2012/Attorney-General-DeWine-Reiterates-Call-for-Intern> (accessed Jan. 14, 2013).

[23] Telesweeps of Butler Valley, Inc. v. Kelly, No. 3:12-CV-1374, 2012 WL 4839010 (M.D. Pa. Oct. 10, 2012).

[24] 18 Pa. Cons. Stat. § 5513 (2012).

[25] SC. A.G. Op. Products Direct LLC, 2011 (June 6, 2011).

[26] U.S. v. Davis, Case No. 11-40265 (C.A. 5, Aug. 1, 2012).

[27] "Sweepstakes Cafés Lose Gamble against Texas Laws," Attorney General of Texas (Oct. 9, 2012) <https://www.oag.state.tx.us/alerts/alerts_view.php?id=278&type=3> (accessed Jan. 14, 2013). (Important to note, in Texas, the attorney general can only prosecute gambling crimes if a local district attorney seeks the AG's assistances or grants AG prosecutors authority to pursue a case in that DA's jurisdiction.)

[28] Utah House Bill 40 (2012). (The law prohibits "fringe gambling," which state law enforcement agents used to raid cyberspace cafes in 2012.)

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[18] Seminole County, Florida Code of Ordinances, Chapter 222, Section 222.7 et. seq.

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