

Legislative Analysis



LAWFUL INTERNET GAMING ACT

Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bill 4926 proposed substitute H-2
House Bill 4927 as introduced
Sponsor: Rep. Brandt Iden

Analysis available at
<http://www.legislature.mi.gov>

House Bill 4928 as introduced
Sponsor: Rep. Klint Kesto
Committee: Regulatory Reform
Complete to 12-13-17

BRIEF SUMMARY:

House Bill 4926 would create the Lawful Internet Gaming Act, allow internet gaming to be conducted in accordance with the new Act, license various activities, create the Division of Internet Gaming in the Michigan Gaming Control Board, impose a tax on the conduct of licensed internet gaming, create the Internet Gaming Fund, prohibit certain conduct, establish civil sanctions and criminal penalties for violations of the Act, and authorize the promulgation of rules.

House Bill 4927 would exclude gambling conducted under the new act from prohibitions against gambling under the Michigan Penal Code.

House Bill 4928 would place the maximum term of imprisonment for a violation of the new act within the sentencing guidelines.

Tie-bars: House Bills 4926 and 4927 are tie-barred to each other, and House Bill 4928 is tie-barred to House Bill 4926. A bill cannot take effect unless the bill to which it is tie-barred is also enacted.

Effective date: Each bill would take effect 90 days after it is enacted.

DETAILED SUMMARY:

House Bill 4926

The bill would create the Lawful Internet Gaming Act, a brief description of which follows.

Definitions

The Act provides definitions for numerous terms used throughout it. These include:

Authorized participant: An individual who is at least 21 years of age with a valid internet wagering account with an internet gaming licensee.

Casino: A building or buildings in which gaming is lawfully conducted under the Michigan Gaming Control and Revenue Act (the initiated law voted on by Michigan electors which

authorized the three Detroit casinos) or in which Class III gaming is conducted by an Indian tribe under a facility license issued in accordance with a Tribal gaming ordinance approved by the chair of the National Indian Gaming Commission.

Internet gaming: Operating, conducting, or offering for play an internet game.

Internet game: A game of skill or chance offered for play through the internet in which a person wagers money or something of monetary value for the opportunity to win money or something of monetary value. Free plays or extended playing time won on a game of skill or chance would not be “something of monetary value.” The term would include gaming tournaments conducted via the internet in which persons compete in games authorized by the Division of Internet Gaming.

Internet gaming licensee: A person issued an internet gaming license from the Division of Internet Gaming to conduct internet gaming or otherwise authorized to conduct internet gaming under the Act.

Internet wager: Money or something of monetary value risked on an internet game authorized under the Act.

Internet wagering: The placing of wagers with an internet gaming licensee at a casino using a computer network of both federal and nonfederal interoperable packet switched data networks through which the casino may offer authorized games to authorized participants who have established a wagering account with the casino **and** who are physically present in the state, including on Indian lands located within the state.

Internet wagering account: An electronic ledger in which deposits, withdrawals, amounts wagered or paid on winning wagers, certain charges authorized by the authorized participant, and adjustments to the account are recorded.

Applicability of Act, Location of Operation/Equipment

The Lawful Internet Gaming Act would allow internet gaming only to the extent that it is conducted in accordance with the Act. A law inconsistent with the Act would not apply to internet gaming, and the Act would not apply to lottery games offered by the Bureau of State Lottery.

Under the Act, an internet wager would be considered placed when received by the internet gaming licensee, regardless of the location of the participant at the time the wager was placed. An internet wager received by an internet gaming licensee would be considered to be gambling or gaming conducted in the licensee’s casino, regardless of the authorized participant’s location at the time the wager was placed. Similarly, an internet wager received by a federally recognized Michigan Indian tribe would be gambling or gaming conducted wholly within the tribe’s casino on Indian tribal lands located in the state, regardless of the participant’s location at the time the internet wager was placed. Intermediate routing of electronic data in connection with a wager would not affect the fact that the wager was placed in the licensee’s casino.

A licensee's primary internet gaming operation (including facilities, equipment, and personnel directly engaged in the conduct of internet gaming activities) would have to be located in a restricted area on the casino's premises, although backup equipment used on a temporary basis could be located outside of the casino as long as any wager placed with the licensee is done on equipment physically located within the casino.

Aggregating computers or other internet access devices in order to enable multiple players to simultaneously play an internet game would be restricted to a licensee at its casino.

Division of Internet Gaming, Multijurisdictional Gaming, Sports Betting

The Division of Internet Gaming ("the Division") would be established in the Michigan Gaming Control Board to administer, regulate, and enforce the system of internet gaming established by the Act. The Division would have jurisdiction over licensees and could take enforcement action as provided in the Act against an unlicensed person offering internet gaming in the state.

Under the Act, the Division could enter into agreements for multijurisdictional internet gaming by gaming licensees if consistent with state and federal law and for gaming conducted only in the United States. The Division could permit an internet gaming licensee to conduct internet wagering on amateur or professional sporting events or contests if the wagering were not prohibited by federal law.

Internet Gaming License, Application and License Fees

An applicant for an internet gaming license would have to hold a casino license (the three Detroit casinos). After receiving an application and application fee, the Division would have to issue a license if the internet gaming proposed by the applicant complied with the Act. However, a licensee could not conduct internet gaming until 1 year after the Act's effective date. Included on the application form would be a requirement to provide financial information regarding the applicant and the applicant's gaming history and experience in the U.S. and other jurisdictions.

An application fee of \$100,000 must accompany the application. Departmental rules could allow for a refund of the fee, or a partial refund if not wholly expended in processing the application, and provide the circumstances under which a fee would be refunded.

Information included with the application and records pertaining to the application process would be confidential and not subject to the Freedom of Information Act (FOIA).

An internet gaming license would be valid for 5 years and could be renewed for 5-year periods. The initial license fee would be \$200,000 payable at the time the license is issued. The yearly fee would be \$100,000. Application and license fees would be deposited into the Internet Gaming Fund created by the Act. An institutional investor (such as a financial institution or pension fund) holding less than 30% of the equity of an applicant would be exempt from licensure under the Act.

Tribal Internet Gaming

A federally recognized tribe in Michigan could conduct internet gaming if authorized to do so by a compact with the state, or an amendment to the compact, and requirements of applicable federal law such as the federal Indian Gaming Regulatory Act and the Unlawful Internet Gambling Enforcement Act. A proposal by a tribe to conduct internet gaming could be negotiated and approved by the governor under the terms of an existing compact, by amendments to the compact, or by approving a new compact. The Act specifies the terms of the proposal that would have to be addressed, such as the amount and manner of revenue sharing payments to be made to the state related to internet gaming and the types of internet games to be offered for play (only games authorized by the Division could be offered). The Act would not prohibit the state and a tribe from negotiating and including additional terms in a compact or amendment to a compact.

Internet Gaming Vendor and Gaming Platform Vendor Provider Licenses

An internet vendor gaming licensee would be a person providing to an internet gaming licensee goods, software, or services that directly affect the wagering, play, and results of authorized internet games. Only a person licensed under the Act could provide goods, software, or services as an internet gaming vendor to an internet gaming licensee.

A provisional license would be available to enable the applicant for a vendor license to conduct business with an internet gaming licensee or applicant before receiving a vendor's license. The provisional license would expire on the date listed.

A vendor license would be valid for 5 years and would be renewable for additional 5-year periods if eligibility standards continued to be met. Applications would be made on forms provided by the Division and would have to include certain information specified in the Act, such as financial information regarding the applicant.

A nonrefundable fee to be determined by the Division (but not to exceed \$5,000) would have to accompany the application with a fee of \$5,000 payable upon issuance of a license. The annual fee would be \$2,500.

An internet gaming platform provider would pay a license fee of \$100,000 at the time of issuance of the license and \$50,000 each year after that. ("Internet gaming platform provider" is not defined in the Act, nor any requirements specified. The Act defines "internet gaming platform" to mean an integrated system of hardware, software, and servers through which an internet gaming licensee conducts internet gaming under the Act.)

Application and license fees would be deposited into the Internet Gaming Fund created under the Act. Information included with the application and records pertaining to the application process would be confidential and not subject to the Freedom of Information Act (FOIA). An institutional investor holding less than 30% of the equity of an applicant would be exempt from licensure under the Act.

Jurisdiction of the Division, Civil Fines, Civil Remedies

The Division would have jurisdiction over and responsibility to supervise all internet gaming operations governed by the Act except for internet gaming conducted by an Indian tribe under a compact with the state. The Act lists numerous tasks the Division could do that would be necessary or desirable to effectuate the Act. These include the following:

- Develop qualifications, standards, and procedures for approval and licensure of internet gaming licensees and gaming vendors (internet gaming platform provider licensee is not mentioned here).
- Conduct hearings pertaining to violations of the Act or rules.
- Develop and enforce testing and auditing requirements for internet gaming platforms, internet wagering, and internet wagering accounts.
- Develop and administer civil fines (not to exceed \$5,000 per violation) for internet gaming licensees and internet gaming vendor licensees that violate the Act or departmental rules.

The Division could investigate, issue cease and desist orders, and obtain injunctive relief against a person that is not licensed and that is offering internet gaming in the state. Information, records, interviews, reports, and other data supplied to or used by the Division in the course of an investigation of a licensee would be confidential and not be subject to FOIA.

Rule Promulgation

The Division would be required, within 1 year after the Act takes effect, to promulgate rules governing the licensing, administration, and conduct of internet gaming necessary to carry out the Act. The promulgation of emergency rules would not satisfy the requirement that would allow a person to conduct internet gaming. Rules must be promulgated under the Administrative Procedures Act and could only include things expressly authorized by the Act, including the following:

- Types of internet games to be offered; poker must be offered.
- Qualifications, standards, and procedures for approval and licensure of internet gaming licensees and internet gaming vendor licensees.
- Requirements to ensure responsible gaming.
- Technical and financial standards for internet wagering, wagering accounts, and internet gaming platforms, systems, and software or other electronic components for internet gaming.
- Procedures for conducting contested case hearings.
- Procedures and requirements for the acceptance, by an internet gaming licensee, of internet wagers initiated or otherwise made by persons located in other jurisdictions.
- Requirements for multijurisdictional agreements entered into with other jurisdictions. These would include qualifications, standards, and procedures for approval of vendors providing internet gaming platforms in connection with the agreement.

Age Verification Requirements, Requirements of Internet Gaming Licensees

An internet gaming licensee would be required to provide 1 or more mechanisms on the gaming platform it uses that are designed to:

- Reasonably verify that an authorized participant is at least 21 years of age. An individual would have to satisfy the verification requirements in order to establish an internet gaming account or to make an internet wager on an internet game.
- Limit internet wagering to transactions that are initiated and received or otherwise made by an authorized participant located in Michigan or a jurisdiction in the United States in which internet gaming is legal.
- Detect and prevent the unauthorized use of internet wagering accounts, and detect and prevent fraud, money laundering, and collusion.

An internet gaming licensee could not knowingly authorize an individual less than 21 years old or an individual whose name appears in the responsible gaming database created under the Act to establish an internet gaming account or knowingly allow them to wager on internet games offered by the licensee—unless required and authorized by the Division for testing purposes or to otherwise fulfill the purposes of the Act.

Responsible Gaming Database, Posting of Compulsive Gambling Hotline

The Division could develop responsible gaming measures, including a statewide responsible gaming database that would identify individuals who are prohibited from establishing an internet wagering account or participating in internet gaming offered by an internet gaming licensee. An individual's name could be placed in the database if any of the following apply to the individual:

- He or she has been convicted in any jurisdiction of a felony, a crime of moral turpitude, or a crime involving gaming.
- He or she has violated the Act or another gaming-related act.
- He or she has performed an act, or has a notorious or unsavory reputation, such that his or her participation in internet gaming under the Act would adversely affect public confidence and trust in internet gaming.
- His or her name is on a valid and current exclusion list maintained by Michigan or another U.S. jurisdiction.

Names of individuals to be included on the list could be provided by an internet gaming licensee in a format specified by the Division.

The number of the toll-free compulsive gambling hotline maintained by the state would have to be displayed in a clear, conspicuous, and accessible manner on the internet gaming platform used by an internet gaming licensee. Also, responsible services and technical controls must be offered to participants. This would consist of both temporary and permanent self-exclusion for all internet games offered and the ability for participants to establish their own periodic deposit and internet wagering limits and maximum playing times.

A participant could voluntarily prohibit himself or herself from establishing an internet wagering account with a licensee. The voluntary self-exclusion list could be incorporated into the responsible gaming database and both be maintained by the Division in a confidential manner. Both lists would be exempt from disclosure under FOIA.

Prohibited Conduct, Criminal Penalties

The Act would prohibit a person from doing any of the following:

- Offering internet gaming for play without an internet gaming license.
- Knowingly making a false statement on an application for a license issued under the Act.
- Knowingly providing false testimony to the Michigan Gaming Control Board or its authorized representative while under oath.

A violation of any of the above would be a felony punishable by imprisonment for not more than 10 years and/or a fine of not more than \$100,000. A license could not be issued to a person that committed a listed violation. An action to prosecute a violation could be brought by the attorney general or a county prosecuting attorney in the county in which the violation occurred or in Ingham County, at either of the officials' discretion.

Gross Gaming Revenue Tax, Allocation of Tax

An internet gaming licensee would be subject to a 15% tax on the gross gaming revenue from internet gaming conducted under the Act. The tax must be paid on a monthly basis, due on the 10th day of the following month. Regarding Indian tribes conducting internet gaming under a compact or amended compact, the Act would provide a different means of establishing an appropriate tax (see the bill for specifics).

The tax would have to be allocated as follows:

- 55% to the city in which the internet gaming licensee's casino is located, for use in that city in connection with the following:
 - Hiring, training, and deployment of street patrol officers.
 - Neighborhood and downtown economic development programs designed to create jobs.
 - Public safety programs such as emergency medical services, fire department programs, and street lighting.
 - Anti-gang and youth development programs.
 - Other programs designed to contribute to the improvement of the quality of life.
 - Relief to the taxpayers of the city from 1 or more taxes or fees imposed by the city.
 - Costs of capital improvements.
 - Road repairs and improvements.
- 45% to the state to be deposited into the Internet Gaming Fund.

Internet Gaming Fund

The Internet Gaming Fund would be created in the treasury. Money or assets required to be paid into the Fund or received from any other sources would be received by the state treasurer. Interest and earnings from Fund investments would be credited to the Fund. The Michigan Gaming Control Board would be the administrator for auditing purposes. The Board would be required to expend money from the Fund, on appropriation, for its costs of regulating and enforcing internet gaming under the Act.

House Bill 4927

House Bill 4927 would add a new section to the Michigan Penal Code to specify that Chapter XLIV (Gambling) does not apply to gambling conducted under the proposed new Lawful Internet Gaming Act.

Proposed MCL 750.310d

House Bill 4928

House Bill 4928 would amend the Code of Criminal Procedure to specify that internet gaming offenses under Section 13 of the proposed new Lawful Internet Gaming Act are a Class D felony against the public order punishable by a maximum term of imprisonment of 10 years.

MCL 777.14d

FISCAL IMPACT:

In general, the bills likely would result in a net reduction in revenues to state and local governments, including the City of Detroit, mainly due to the tax and revenue structure differences between the proposed online gaming and existing gaming sources. Determining a fiscal impact is difficult in both scope and magnitude due to the financial, legal, and tax structure of the Michigan gaming industry; the dynamic interplay between the different types of gaming offered in Michigan (commercial casinos, tribal casinos, and a state-run lottery); and the relatively small sample size of states that have legalized internet casino gaming (Delaware (2012), Nevada (2013), and New Jersey (2013)). Additionally, casino revenues are affected by economic conditions, societal trends, expansion of gaming in other states, and the offering of alternative gaming opportunities, all of which make differentiating between correlation and causation when reviewing other states difficult.

Further, the scope and magnitude of the fiscal impact would depend on whether online gaming had a substitution, neutral, or stimulative effect on other forms of gaming. All of these factors are discussed in more detail below.

State School Aid Fund

The State School Aid Fund (SAF) likely would realize reduced revenues under House Bill 4926. Currently, casino adjusted gross receipts are levied a casino wagering tax of 19%. Of that amount, 42.6% is distributed to the SAF. Under the bill, the internet gaming tax revenue would be deposited in the Internet Gaming Fund rather than distributed to the SAF

and the City of Detroit as the current casino wagering tax is. Therefore, every \$1 in gross gaming revenues lost at brick and mortar casinos due to the introduction of internet gaming would result in an 8.1 cent loss to the SAF.

Internet gaming presumably would also reduce lottery sales, mainly by diverting participants from the iLottery platform, because many of the games offered would be substantially similar from a user perspective, but payouts for individuals playing casino-operated games would be higher. Higher payout rates would likely lead to increased internet gaming play at the expense of iLottery play. Net revenue from iLottery is deposited in the SAF. Therefore, any diminishment in iLottery sales from the introduction of online gaming would result in lower SAF transfers from the Bureau of State Lottery. In 2016 net revenues from iLottery totaled \$48.0 million. Net revenues from iLottery are estimated at \$80.0 million for 2017.

So, if no substitution effect were assumed and online gaming had a neutral or stimulative effect on brick and mortar casino revenues, the SAF could still realize a decrease in dedicated revenues. However, the lower tax rate for online gaming likely would result in the Detroit casinos promoting online gaming at the expense of brick and mortar gaming. The tax rate spread between the internet gaming tax and the casino wagering tax, and therefore the extent of the incentive, would depend on negotiated tax rates between the state and the tribal casinos since the state internet gaming tax is dependent on the lowest negotiated tax rate. Any substitution effect would create a more significant impact on the SAF.

City of Detroit Revenues

The bill likely would reduce City of Detroit revenues from casino gaming sources. Currently, casino adjusted gross receipts are levied a casino wagering tax of 19%. Of that amount, 57.4% is distributed to the city of Detroit. In FY 2015-16, the City of Detroit received approximately \$152.1 million.

Assuming some substitution effect, for every \$1 in gross gaming revenues that was lost at brick and mortar casinos due to the introduction of internet gaming, the city of Detroit would lose 10.9 cents of the casino wagering tax. However, for every \$1 of gross gaming revenue taxed at the 15% rate under HB 4926, the City of Detroit would receive 8.25 cents. When combined, the net result would be loss of 2.65 cents for every \$1 transferred from brick and mortar gaming to internet gaming. If the state tax rate of 15% were lowered due to a negotiated lower internet gaming tax rate under a Tribal-State Compact, the revenue loss to the City of Detroit would be greater.

In addition, any revenue substitution would reduce revenues from the Municipal Services Fee that each casino pays (equal to the greater of 1.25% of adjusted gross receipts or \$4.0 million) to the city of Detroit. In 2016, the city of Detroit realized \$17.3 million from the municipal services fee. Due to the way the fee is currently structured in statute, the municipal services fee would go no lower than \$4.0 million per casino, or \$12.0 million total.

The city also receives a development agreement payment based on adjusted gross receipts from the casinos. The payment is a percentage-based payment that increases from 1% to 2% once adjusted gross receipts reach \$400.0 million. In addition, once the \$400.0 million mark is reached, the casino is required to make an additional \$4.0 million deposit to the City of Detroit. As is the case with the other revenues, any substitution effect would reduce revenues received from the development agreement payment.

If the impact on brick and mortar casino revenue were relatively neutral or stimulative, the City of Detroit would realize increased revenues. The magnitude of the increase would depend on a combination of the effective tax rate and any new revenues directly attributable to enhanced brick and mortar play due to online gaming.

That said, the commercial casinos in Detroit would have an incentive to promote online gaming at the expense of brick and mortar play due to the lower tax rate of online gaming. The tax rate spread, and therefore the extent of the incentive, would depend on the lowest negotiated tax rate between the state and the tribal casinos.

Tribal Gaming – Payments to the State of Michigan

Tribal casino payments to the State of Michigan under the Tribal-State Compacts are made directly to the Michigan Strategic Fund and Michigan Economic Development Corporation (MSF/MEDC). Any fiscal impact would depend on the negotiated terms related to online gaming revenue sharing payments. Of the 12 tribes, 6 tribes do not currently make revenue sharing payments to the state. The other 6 tribes pay between 4% to 12% of net win. Payments to MSF/MEDC totaled \$60.0 million in 2016.

If the tribes that currently don't make revenue sharing payments to the state negotiate a revenue sharing agreement for online gaming, the state would realize increased revenues. However, the magnitude and purpose of those revenues would depend on the terms of the negotiated compact.

Any fiscal impact related to tribes currently making revenue sharing payments to the state would depend on the percentage of the online gaming payment agreed upon and the substitution effect of online gaming versus brick and mortar casino gaming.

Additionally, tribal casinos that currently make revenue sharing payments to MSF/MEDC could choose to withhold payments if they deem online gaming to be an expansion of gaming. Each tribe would have to determine whether revenues generated from online gaming would exceed revenues saved from withholding state payments.

Tribal Gaming – Payments to Local Units of Government

The provisions of the bill would have an indeterminate fiscal impact on tribal casino payments to local units of government. Any fiscal impact would depend on the tax rate for online gaming agreed to by the tribal casino and the State and the substitution effects that result. All tribal casinos make payments equal to 2% of net win to local units of government in their defined regional area. These payments totaled \$29.2 million in 2016. These

payments cannot be withheld for an expansion of gaming violation of the Tribal-State Compacts.

Administration and Enforcement

The bill would create a new division within the Michigan Gaming Control Board. This would increase costs associated with staffing, office space, information technology, and other administrative, enforcement, audit, and regulatory costs. The extent of these costs is unknown. However, the bill would authorize the licensing and application fees levied on internet gaming licensees and vendors to be used to cover administrative expenses. In addition, 45% of the funds collected under the internet gaming tax are deposited in the Internet Gaming Fund for use on administration. Presumably, the funds collected and allocated for administration under the bill would be sufficient to cover necessary expenses related to administration and enforcement of the provisions of the bill.

Impact on the Judiciary and/or State and Local Corrections

The bill would have an indeterminate fiscal impact on the state's correctional system and on local court systems. Information is not available on the number of persons who might be convicted under provisions of the bill. New felony convictions would result in increased costs related to state prisons and state probation supervision. In fiscal year 2016, the average cost of prison incarceration in a state facility was roughly \$36,000 per prisoner, a figure that includes various fixed administrative and operational costs. State costs for parole and felony probation supervision averaged about \$3,500 per supervised offender in the same year. Civil fines would increase revenues going to the state Justice System Fund, which supports various justice-related endeavors in the judicial branch, and the Departments of State Police, Corrections, and Health and Human Services. The fiscal impact on local court systems would depend on how provisions of the bill affected caseloads and related administrative costs. Any increase in penal fine revenues would increase funding for local libraries, which are the constitutionally designated recipients of those revenues.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.