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BILL ANALYSIS



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Senate Bills 203, 204, and 205 (as reported without amendment)

Sponsor: Senator Mike Kowall (S.B. 203 & 204)

Senator Joe Hune (S.B. 205)

Committee: Regulatory Reform

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RATIONALE

In 2011, the U.S. Department of Justice determined that a ban on interstate gambling over "wire communications" in the Wire Act of 1961 applied only to sports betting. This allowed states to regulate online gaming (or gambling) within their boundaries. Since then, three states, Delaware, Nevada, and New Jersey, have started to do so. Consumers in Michigan, however, do not have a regulated and protected online gaming website to use; this has raised concerns that they are at risk of being cheated or taken advantage of when playing on unregulated sites. Moreover, there are further concerns that unregulated gaming websites may lead to underage gambling, the promotion of gambling addiction, and money laundering schemes. In order to provide a safe environment for Michigan consumers to participate in online gaming, as well as capture revenue for the State, it has been suggested that the State should regulate online gaming and tax online gaming vendors licensed by the State.

CONTENT

Senate Bill 203 would create the "Lawful Internet Gaming Act" to do the following:

- Allow internet gaming to the extent that it was carried out in accordance with the proposed Act.
- Create the Division of Internet Gaming in the Michigan Gaming Control Board, and prescribe its responsibilities.
- Allow the Division to issue applicants an internet gaming license if they met certain criteria.
- Prescribe a \$100,000 application fee, a \$200,000 initial license fee, and a \$100,000 annual fee for an internet gaming license.
- Allow an internet gaming license to be issued only to a casino licensee or, under certain conditions, to a Michigan Indian tribe that operates a casino in the State.
- Allow internet gaming licensees to conduct internet gaming.
- Allow the Division to license internet gaming vendors to provide goods, software, or services to internet gaming licensees.
- Prescribe a maximum \$5,000 application fee, a \$5,000 initial license fee, and a \$2,500 annual fee for an internet gaming vendor.
- Require an internet gaming platform provider to pay an initial license fee of \$100,000, and \$50,000 each year after the initial license was issued.
- Provide that a license would be valid for five years and could be renewed for additional five-year periods.
- Impose a tax of 10% on the gross gaming revenue received by an internet gaming licensee from internet gaming, but provide for the tax rate to be reduced to a rate equivalent to that provided in a compact, amendment to a compact, or other agreement negotiated with the State.
- Require an internet gaming licensee to have adequate gaming participant verification measures, including mechanisms to detect and prevent the unauthorized use of

internet wagering accounts and to detect and prevent fraud, money laundering, and collusion.

- Allow the Division to develop responsible gaming measures, including a statewide responsible gaming database identifying individuals who were prohibited from establishing an internet wagering account or participating in internet gaming offered by an internet gaming licensee.
- Allow the Division to enter into agreements with other jurisdictions to facilitate, administer, and regulate multijurisdictional internet gaming by internet gaming licensees to the extent that entering into an agreement was consistent with State and Federal laws and if the gaming under the agreement were conducted only in the United States.
- Create the "Internet Gaming Fund" and require fees and taxes to be deposited into the Fund.
- Allow the Michigan Gaming Control Board to spend money from the Fund, on appropriation, for the First Responder Presumed Coverage Fund and the Board's costs of regulating and enforcing internet gaming.
- Prescribe a felony penalty of imprisonment for up to 10 years and/or a maximum fine of \$100,000, for a person who committed an action prohibited by the Act.

Senate Bill 204 would amend the Michigan Penal Code to exclude gaming conducted under the proposed Lawful Internet Gaming Act from Chapter XLIV of the Code, which prescribes penalties for illegal gambling activities.

Senate Bill 205 would amend the Code of Criminal Procedure to include the offense proposed by Senate Bill 203 in the sentencing guidelines as a Class D felony against public order.

Each bill would take effect 90 days after its enactment. Senate Bills 203 and 204 are tie-barred. Senate Bill 205 is tie-barred to Senate Bill 203.

A more detailed description of Senate Bill 203 follows.

Internet Gaming

Internet gaming could be conducted only to the extent that it was conducted in accordance with the proposed Act. A law that was inconsistent with the Act would not apply to internet gaming as provided for by the Act. The Act would not apply to lottery games offered by the Bureau of State Lottery.

An internet wager received by an internet gaming licensee would be considered gambling or gaming that was conducted in the licensee's casino located in the State, regardless of the authorized participant's location at the time the participant placed the internet wager.

Only an internet gaming licensee at its casino could aggregate computers or other internet access devices in order to enable multiple players to simultaneously play an internet game. Except as otherwise provided, a person could not aggregate computers or other internet access devices in a place of public accommodation in Michigan, including a club or other association, in order to enable multiple players to simultaneously play an internet game.

"Internet gaming" would mean operating, conducting, or offering for play an internet game. "Internet game" would mean a game of skill or chance that is 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. For purposes of the definition, free plays or extended playing time that was won on a game of skill or chance that was offered through the internet would not be something of monetary value. "Internet game" would include gaming tournaments conducted via the internet in which people competed against one another in one or more of the games

authorized by the Division of Internet Gaming (described below) or in approved variations or composites as authorized by the Division.

Division of Internet Gaming

The Division of Internet Gaming would be created in the Michigan Gaming Control Board. The Division would have the powers and duties specified under the proposed Act and all other powers necessary and proper to enable it to fully and effectively execute the Act to administer, regulate, and enforce the system of internet gaming established by the Act. The Division would have jurisdiction over every person licensed by it, and could take enforcement action against a person that was not licensed by it that offered internet gaming in the State.

The Division could enter into agreements with other jurisdictions to facilitate, administer, and regulate multijurisdictional internet gaming by internet gaming licensees licensed by the Division to the extent that entering into the agreement was consistent with State and Federal laws and if the gaming under the agreement were conducted only in the United States.

The Division could not authorize, administer, or otherwise license a person to conduct internet wagering on any amateur or professional sporting event or contest, unless doing so would be consistent with State and Federal laws.

For the purposes of the Act, the intermediate routing of electronic data in connection with internet wagering, including routing across State lines, would not determine the location or locations in which the wager was initiated, received, or otherwise made.

"Internet wagering" would mean risking money or something of monetary value on an internet game authorized by the Act.

Internet Gaming License

The Division could issue an internet gaming license to a person that applied for the license if the Division determined that the applicant was eligible for an internet gaming license under the proposed Act and the rules promulgated under it. If the applicant held a casino license under the Michigan Gaming Control and Revenue Act, the Division would have to consider the applicant to be eligible for an internet gaming license, and would have to issue an internet gaming license to the applicant after receiving the application and the application fee if the Division determined that the internet gaming proposed by the applicant complied with the proposed Act.

An internet gaming license would be valid for the five-year period after the date of issuance and, if the Division determined that the licensee continued to meet the eligibility standards under the Act, would be renewable for additional five-year periods.

The Division could issue an internet gaming license only to a person that was one of the following:

- A casino licensee under the Michigan Gaming Control and Revenue Act.
- A federally recognized Michigan Indian tribe that operates a casino in the State in which Class III gaming other than internet gaming is conducted under a facility license issued in accordance with a tribal gaming ordinance approved by the chairperson of the National Indian Gaming Commission.

The Division could not issue an internet gaming license to an Indian tribe unless the tribe, in connection with its application to conduct internet gaming under the proposed Act, waived its sovereign immunity with respect to conducting internet gaming under the Act, including obtaining licensure and subjecting itself to enforcement by the Division in State and Federal courts and paying fees and taxes imposed under the Act.

A qualified applicant could apply to the Division for an internet gaming license to offer internet gaming as provided in the Act. The application would have to be made on forms provided by the

Division and contain the information it required, including detailed information regarding the ownership and management of the applicant, detailed personal and financial information regarding the applicant, and the gaming history and experience of the applicant in the United States and other jurisdictions. However, if the applicant held a casino license under the Michigan Gaming Control and Revenue Act, the applicant would not have to provide any information that it had previously provided to the Division unless notified by the Division that the information could not be located.

An initial application for an internet gaming license would have to be accompanied by an application fee of \$100,000. The rules promulgated under the proposed Act could include provisions for the refund of an application fee, or the portion of an application fee that had not been spent by the Division in processing the application, and the circumstances under which the fee would be refunded.

The Division would have to keep all information, records, interviews, reports, statements, memoranda, or other data supplied to or used by it in the course of its review or investigation of an application for an internet gaming license or a renewal of a license strictly confidential and could use that material only to evaluate an applicant for a license or renewal. These materials would be exempt from disclosure under the Freedom of Information Act (FOIA).

An application would have to be submitted and considered in accordance with the proposed Act and any rules promulgated under it. An institutional investor that held for investment purposes only less than 30% of the equity of an applicant would be exempt from the Act's licensure requirements.

An internet gaming licensee licensed by the Division would have to pay a license fee of \$200,000 to the Division at the time the initial license was issued and \$100,000 each year after that. The Division would have to deposit all application and license fees paid under the Act into the Internet Gaming Fund.

Tribal Internet Gaming

A federally recognized Michigan Indian tribe that operated a casino in the State in which Class III gaming other than internet gaming was conducted under a facility license issued in accordance with a tribal gaming ordinance approved by the chairperson of the National Indian Gaming Commission could conduct internet gaming on the same basis as any internet gaming licensee licensed by the Division, only if either the Indian tribe held an internet gaming license under the proposed Act; or the Indian tribe had entered into a compact with Michigan under the Indian Gaming Regulatory Act, or an amendment to such a compact, that had, to the extent required by the compact, been approved by the Legislature and that met all of the following requirements:

- The compact or amendment specifically authorized the tribe to conduct internet gaming to the same extent as an internet gaming licensee licensed by the Division under the proposed Act could, subject to certain terms and laws.
- The compact or amendment had been approved by the applicable Federal agencies as required by the Indian Gaming Regulatory Act.
- The compact or amendment contained additional provisions regarding verification requirements and mechanisms designed to detect and prevent the unauthorized use of internet wagering accounts and to detect and prevent fraud, money laundering, and collusion, and a requirement that the internet gaming platform provider, if not tribally owned, be licensed as an internet gaming vendor under the proposed Act.

In addition, the compact or amendment would have to include provisions addressing the amount and manner of revenue sharing to be paid to the State by the tribe related to internet gaming; a dispute resolution process, which would have to include a limited waiver of sovereign immunity, to provide the State with legal and equitable remedies enforceable in State and Federal courts to enforce the tribe's agreement to make revenue sharing payments to the State related to internet

gaming; the types of internet games that would be offered; responsible gaming; technical and financial standards for internet wagering accounts, and internet gaming platforms, systems and software, and other electronic components for internet gaming; and one or more mechanisms designed to reasonably verify that an individual who desired to place a wager over the internet gaming platform used by the Indian tribe was 21 years of age or older.

The Act would not limit the additional terms that the State and an Indian tribe could negotiate and include in a compact or amendment to a compact under the Indian Gaming Regulatory Act.

"Internet gaming platform" would mean an integrated system of hardware, software, and servers through which an internet gaming licensee conducts internet gaming under the proposed Act.

"Internet wagering accounts" would mean an electronic ledger in which all of the following types of transactions relative to the internet gaming platform are recorded:

- Deposits.
- Withdrawals.
- Amounts wagered.
- Amounts paid on winning wagers.
- Service or other transaction-related charges authorized by the authorized participant, if any.
- Adjustments to the account.

Internet Gaming Vendors

The Division could issue an internet gaming vendor license to a person to provide goods, software, or services to internet gaming licensees. A person that was not a licensed internet gaming vendor could not provide goods, software, or services as an internet gaming vendor to an internet gaming licensee.

On application by an interested person, the Division could issue a provisional internet gaming vendor license. A provisional license would allow the applicant to conduct business with an internet gaming licensee or applicant for an internet gaming license before the internet gaming vendor license was issued. A provisional license would expire on the date provided in the license by the Division.

An internet gaming vendor license would be valid for the five-year period after the date of issuance. The license would be renewable after the initial five-year period for additional five-year periods if the Division determined that the internet gaming vendor continued to meet the eligibility standards of the proposed Act.

A person could apply to the Division to become an internet gaming vendor licensee as provided in the Act and the rules promulgated under it.

An application would have to be made on forms provided by the Division and contain any information it required, including detailed information regarding the ownership and management of the applicant, detailed personal and financial information regarding the applicant, and the gaming history and experience of the applicant. However, if the applicant were licensed as a supplier under the Michigan Gaming Control and Revenue Act, the applicant would not have to provide any information that it had previously provided to the Division unless notified by the Division that the information could not be located. An application would have to be accompanied by a nonrefundable application fee in an amount to be determined by the Division, not to exceed \$5,000.

The Division would have to keep all information, records, interviews, reports, statements, memoranda, or other data supplied to or used by it in the course of its review or investigation of an application for licensure as an internet gaming vendor strictly confidential and could use the

materials only to evaluate an applicant for licensure. These materials would be exempt from disclosure under FOIA.

An internet gaming vendor would have to pay a license fee of \$5,000 to the Division at the time an initial license was issued to the vendor and \$2,500 each year after the initial license was issued. An internet gaming platform provider would have to pay a license fee of \$100,000 to the Division at the time the initial license was issued to the provider and \$50,000 each year after the initial license was issued. The Division would have to deposit all application and license fees paid under the proposed Act into the Fund.

"Internet gaming vendor" would mean a person that provides to an internet gaming licensee goods, software, or services that directly affect the wagering, play, and results of internet games authorized, conducted, and played under the Act, including goods, software, or services necessary to the acceptance, operation, administration, or control of internet wagers, internet games, internet wagering accounts, or internet gaming platforms. Internet gaming vendor would not include a person that provided to an internet gaming licensee only such goods, software, or services that it also provided to others for purposes not involving internet gaming, including a payment processor or a geolocation service provider.

Gross Gaming Revenue Tax

A person that received an internet gaming license from the Division would be subject to a tax of 10% on the gross gaming revenue received by the licensee from internet gaming conducted under the proposed Act. The licensee would have to pay the tax on a monthly basis. The payment for a month would be due on the 10th day of the following month.

If, as provided in a compact, amendment to a compact, or other agreement negotiated with the State, a person were able to lawfully conduct internet gaming in the State for a period of time subject to payment of a revenue share or other payment to the State that was lower than the tax rate described above, the tax rate would automatically be reduced to a rate equivalent to the rate paid as a revenue share or other payment under the compact, compact amendment, or other agreement with the State during that period of time, as determined by the Michigan Gaming Control Board. If the State entered into compacts, compact amendments, or agreements described in these provisions with more than one person, the tax rate would be reduced to the rate in the compact, amendment, or agreement with the lowest rate. For all calculations under these provisions, if there were more than one rate paid under a compact, compact amendment, or agreement, the rate to be applied would be the highest rate in the compact, amendment, or agreement in effect during the applicable time period.

"Gross gaming revenue" would mean the total of all internet wagers actually received by an internet gaming licensee licensed by the Division, less the total of all winnings paid out to authorized participants.

"Winnings" would include all of the following:

- The total amount authorized participants receive as prizes during the accounting period.
- Stakes returned to authorized participants.
- Other amounts credited to authorized participants' accounts, including the monetary value of loyalty points, free play, and other similar complimentaries and incentives granted to authorized participants as a result of participation in internet games.

Additional Division Responsibilities

Except for internet gaming conducted by an Indian tribe that had entered into a compact with the State, the Division would have jurisdiction over and would have to supervise all internet gaming operations governed by the proposed Act. The Division could do anything necessary or desirable to effectuate the Act, including all of the following:

- Develop qualifications, standards, and procedures for approval and licensure of internet gaming licensees and internet gaming vendors.
- Decide promptly and in reasonable order all license applications and approve, deny, suspend, revoke, restrict, or refuse to renew internet gaming and internet gaming vendor licenses.
- Conduct all hearings pertaining to violations of the Act or rules promulgated under it.
- Provide for the establishment and collection of all license fees and taxes imposed by the Act and the rules, and the deposit of the fees and taxes into the Fund.
- Investigate, issue cease and desist orders, and obtain injunctive relief against a person that was not licensed by the Division that offered internet gaming in the State.
- Develop and enforce testing and auditing requirements for internet gaming platforms, internet wagering, and internet wagering accounts.
- Develop and enforce requirements for responsible gaming and player protection, including privacy and confidentiality standards and duties.
- Develop and enforce requirements for accepting internet wagers.
- Adopt by rule a code of conduct governing Division employees that ensured, to the maximum extent possible, that people subject to the Act avoided situations, relationships, or associations that could represent or lead to an actual or perceived conflict of interest.
- Develop and administer civil fines (up to \$5,000 per violation) for internet gaming and internet gaming vendor licensees that violated the Act or the rules promulgated under it.
- Audit and inspect, on reasonable notice, books and records relevant to internet gaming operations, internet wagers, internet wagering accounts, internet games, or internet gaming platforms, including the books and records regarding financing and accounting materials held by or in the custody of an internet gaming or internet gaming vendor licensee.
- Acquire or lease real property and make improvements to it, and lease or purchase personal property.

A party aggrieved by an action of the Division denying, suspending, revoking, restricting, or refusing to renew a license could request a hearing before the Division. A request for hearing would have to be made to the Division in writing within 21 days after service of notice of the action by the Division.

The Division would have to keep all information, records, interviews, reports, statements, memoranda, and other data supplied to or used by the Division in the course of any investigation of a person licensed under the Act strictly confidential and would have to use that material only for investigative purposes. The material would be exempt from disclosure under FOIA.

Administrative Rules

The Division would have to promulgate rules governing the licensing, administration, and conduct of internet gaming necessary to carry out the proposed Act within one year after its effective date. A person could not conduct internet gaming under the Act until 150 days after the Division promulgated the rules and they took effect. The promulgation of emergency rules would not satisfy the requirement for the promulgation of rules to allow a person to conduct internet gaming. The rules could include only things expressly authorized by the Act, including all of the following:

- The types of internet games to be offered, which would have to include at least poker.
- The qualifications, standards, and procedures for approval and licensure by the Division of internet gaming and internet gaming vendor licensees consistent with the Act.
- Requirements to ensure responsible gaming.
- Technical and financial standards for internet wagering, internet wagering accounts, and internet gaming platforms, systems, and software or other electronic components for internet gaming.
- Procedures for conducting contested case hearings under the Act.
- Procedures and requirements for the acceptance, by an internet gaming licensee licensed by the Division, of internet wagers initiated or otherwise made by people located in other jurisdictions.

- Requirements for multijurisdictional agreements entered into by the Division with other jurisdictions, including qualifications, standards, and procedures for approval by the Division of vendors providing internet gaming platforms in connection with the agreements.

Gaming Participant Verification

An internet gaming licensee licensed by the Division would have to provide one or more mechanisms on the internet gaming platform that the licensee used that were designed to reasonably verify that an authorized participant was 21 years of age or older and that internet wagering was limited to transactions that were initiated and received or otherwise made by an authorized participant located in the State or a jurisdiction in the United States in which internet gaming was legal.

An individual who wished to place an internet wager under the proposed Act would have to satisfy the verification requirements before he or she could establish an internet gaming account or make an internet wager on an internet game offered by an internet gaming licensee.

An internet gaming licensee could not knowingly authorize either of the following individuals 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 otherwise to fulfill the purposes of the Act:

- An individual less than 21 years old.
- An individual whose name appeared in the Division's responsible gaming database.

An internet gaming licensee also would have to include mechanisms on the internet gaming platform the licensee used that were designed to detect and prevent the unauthorized use of internet wagering accounts and to detect and prevent fraud, money laundering, and collusion.

Responsible Gaming Database & Responsible Gaming

The Division could develop responsible gaming measures, including a statewide responsible gaming database identifying individuals who were prohibited from establishing an internet wagering account or participating in internet gaming offered by an internet gaming licensee. The executive director of the Michigan Gaming Control Board could place an individual's name in the responsible gaming database if any of the following applied:

- The individual had been convicted in any jurisdiction of a felony, a crime of moral turpitude, or a crime involving gaming.
- The individual had violated the proposed Act or another gaming-related act.
- The individual had performed an act or had 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 gaming.
- The individual's name was on a valid and current exclusion list maintained by the State or another jurisdiction in the United States.

The Division could promulgate rules for the establishment and maintenance of the responsible gaming database. An internet gaming licensee, in a format specified by the Division, could provide the Division with names of individuals to be included in the database.

An internet gaming licensee licensed by the Division would have to display, on the internet gaming platform used by the licensee, in a clear, conspicuous, and accessible manner, the number of the toll-free compulsive gambling hotline maintained by the State and offer responsible gambling services and technical controls to participants, consisting 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.

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

Internet Gaming Fund

The "Internet Gaming Fund" would be created in the State Treasury. The State Treasury could receive money or other assets required to be paid into the Fund under the proposed Act or from any other source for deposit into the Fund. The State Treasurer would have to direct investment of the Fund, and would have to credit to it interest and earnings from Fund investments. Money in the Fund at the close of a fiscal year would have to remain in the Fund and could not lapse to the General Fund.

The Michigan Gaming Control Board would be the administrator of the Fund for auditing purposes, and the Board could spend money from the Fund, on appropriation, for both of the following:

- Each year, \$5.0 million to the First Responder Presumed Coverage Fund created in the Worker's Disability Compensation Act.
- The Board's costs of regulating and enforcing internet gaming under the proposed Act.

(Under the Worker's Disability Compensation Act, a member of a fully paid fire department or public fire authority who is in active service of the fire department or public fire authority, has been employed 60 months or more in the active service of the department or public fire authority at the time cancer manifests itself, and is exposed to the hazards incidental to fire suppression, rescue, or emergency medical services in the performance of his or her work-related duties with the department or authority must suspend a claim against his or her employer under the Act and may claim like benefits from the First Responder Presumed Coverage Fund for any respiratory tract, bladder, skin, brain, kidney, blood, thyroid, testicular, prostate, or lymphatic cancer.)

Prohibitions & Penalties

It would be a felony for a person to do any of the following:

- Offer internet gaming for play in the State if the person were not an internet gaming licensee.
- Knowingly make a false statement on an application for a license to be issued under the proposed Act.
- Knowingly provide false testimony to the Michigan Gaming Control Board or its authorized representative while under oath.

The felony would be punishable by imprisonment for up to 10 years or a maximum fine of \$100,000, or both. The Division could not issue a license under the Act to a person that violated these provisions. The Attorney General or a county prosecuting attorney would have to bring an action to prosecute a violation in his or her discretion, in the county in which the violation occurred or in Ingham County.

Invalidation

If a court entered a final judgment or order that had the effect of invalidating or otherwise rendering inoperative the section of the proposed Act that would authorize the Division to issue an internet gaming license to a person that held a casino license under the Michigan Gaming Control and Revenue Act, the entire proposed Act would be inoperable and of no effect.

If a court held that a provision of the Act, or the application of a provision of the Act to any person or circumstance, were invalid other than as provided above, the validity and application of the remainder of the Act to other people and circumstances would not be affected.

Legislative Findings

The bill states several legislative findings, including the following:

"In an opinion dated September 20, 2011, the United States Department of Justice reversed its previous interpretation of 18 USC 1084, commonly referred to as the federal wire act, allowing states, subject to certain restrictions, to legalize and regulate internet gaming and capture the revenue for the benefit of state governments."

"In order to protect residents of this state who wager on games of chance and skill through the internet and to capture revenues and create jobs generated from internet gaming, it is in the best interest of this state and its citizens to regulate this activity by authorizing and establishing a secure, responsible, fair, and legal system of internet gaming that complies with the United States Department of Justice's September 2011 opinion concerning 18 USC 1084."

"The legislature additionally finds that this act is consistent and complies with the unlawful internet gambling enforcement act of 2006, 31 USC 5361 to 5367, and specifically authorizes use of the internet to place, receive, or otherwise knowingly transmit a bet or wager if that use complies with this act and the rules promulgated under this act."

Proposed MCL 750.310c (S.B. 204)
MCL 777.14d (S.B. 205)

BACKGROUND

In 2011, the U.S. Department of Justice (DoJ) determined that a ban on interstate gambling over "wire communications" in the Wire Act of 1961 applied only to sports betting. The Act prohibits anyone engaged in the business of betting or wagering from knowingly using a wire communication facility to transmit bets, wagers, or information assisting in the placing of a bet or wager on any sporting event or contest, or for the transmission of a wire communication that entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers. New York and Illinois had asked for an opinion determining whether in-state online lottery transactions would violate the Wire Act. Until the DoJ issued its decision, the Act had been interpreted to include online gaming as a prohibited activity.

The Unlawful Internet Gambling Enforcement Act (UIGEA) also prohibits certain "unlawful internet gambling" and financial transactions related to gambling but allows for interstate gambling as long as it does not violate state law. The Criminal Division of the DoJ had raised concerns that the Wire Act could have criminalized conduct that would be lawful under the UIGEA. In its 2011 interpretation of the Wire Act, however, the DoJ found that it was not necessary to address the statutes' interaction, because the Wire Act applied only to wagering on sporting events or contests, which the lotteries proposed by Illinois and New York did not involve.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Michigan residents who have access to the internet already are able to make wagers on the many internet gaming sites available to the public. (One 2010 survey found 2,679 internet gambling sites owned by 665 companies.¹) Moreover, people are using the internet more frequently for entertainment purposes because online options, such as streaming movies or television, are

¹ Survey cited by David O. Stewart, Ropes & Gray, LLP, *Online Gambling Five Years after UIGEA*, 2011.

becoming more available and accessible. Because of the lack of internet gaming regulation in the United States, however, consumers who like to gamble and wish to do so online typically must use sites that are based in different countries, which often have little regulation. Consumers might make wagers on sites where games could be fixed or players could collude against them, or on sites that could close or not pay out winnings. In one such circumstance, Lock Poker, an online gaming website, was abruptly closed and had an estimated \$10.0 million to \$15.0 million in unprocessed customer withdrawals that had been outstanding.² Furthermore, the lack of consumer protections and the prevalence of internet access provide minors easy access to gaming opportunities.

The bills would remedy these problems by providing strong consumer protections through State regulation, allowing for safe and fun online gaming while embracing the migration toward online entertainment. Three other states, Delaware, New Jersey, and Nevada, have proven that online gaming can be successfully regulated at the state level. Reportedly, New Jersey has seen fewer black market online casinos operating in its jurisdiction because those sites cannot compete with the regulated sites. According to a document reviewing online gaming regulation in New Jersey one year after its implementation, the Director of the New Jersey Division of Gaming Enforcement stated, "From a regulatory standpoint, our system is working. There have been no major infractions or meltdowns or any systematic regulatory failures that would make anyone doubt the integrity of operations. The issues that have arisen have been dealt with appropriately just like in the brick-and-mortar casinos."

Supporting Argument

The bills would give the State an additional source of revenue without having to raise taxes. This revenue could be spent for purposes such as education, health care, or infrastructure. According to H2 Gambling Capital, a firm that provides gambling sector data, the global revenue for online gambling was nearly \$30.0 billion in 2010. New Jersey, the state most comparable to Michigan among the three states that have online gambling, had generated roughly \$50.0 million in online gaming tax revenue as of July 2016. Combined revenue reports consolidated by Problem Gambling Solutions, Inc. determined that, in 2012, Michigan ranked seventh out of the 50 states and Washington, D.C., in collective lottery sales, commercial casino gaming revenue, and Indian gaming revenue, with \$5.3 billion total, displaying that Michigan has a large gambling market. The State should capitalize on the opportunity to regulate online gaming as quickly as possible to capture some of this revenue. Moreover, the State could partner with New Jersey or other states that regulate online gaming in the future to enhance revenue and broaden the player pool. The states that already are regulating online gaming have seen the economic benefit and Michigan could, too.

Response: It is unknown how much revenue the State would actually capture if the bills were enacted, as projections are difficult to make. According to a *USA Today* article in 2014, the three states that started regulating online gaming received either "underwhelming" or modest revenue when they launched.³ The same article reported that Morgan Stanley decreased its market projection for the U.S. online gaming industry by 30%, from \$5.0 billion to \$3.5 billion, by 2017 following a review of the first few months of online gaming operations in Delaware, Nevada, and New Jersey. Moreover, revenue to the State could decline under the bills if overall gaming activity remained at the same level, since online gambling would be subject to lower taxation compared to other forms of gaming.

Supporting Argument

The bills could create up to 22,000 new jobs and provide economic growth for the State. The online gaming industry would require new employees to market the activity and provide technical and customer services to consumers, among other things.

² Estimated number provided by *US Poker* and cited on *PokerNews*.

³ Adrienne Lu, "Online Gambling Revenues Fall Short", *USA Today*, June 24, 2014.

Supporting Argument

Regulating online gaming in Michigan would make this State a tourist destination for online poker tournaments or other online gaming events. Participants would fill Michigan hotels and eat at local restaurants, increasing economic activity across the State. However, other states, including nearby states such as Pennsylvania, also are considering regulating online gaming. The sooner Michigan begins to regulate online gaming, the sooner it may see benefits. If the State delays, other states may capitalize on the mostly empty market and seize the advantage.

Supporting Argument

The technology and ability to successfully regulate online gaming and make it a safe, enjoyable, and secure experience are available. States can prevent minors from participating by requiring any consumer who opens a new account to prove that he or she is of the legal gambling age. The states that have implemented online gaming have yet to report any cases of underage access. Online gaming vendors also can allow consumers to limit themselves, so gambling remains fun and does not turn into an addiction. For example, consumers can place a limit on how much they may bet, deposit, and play, and may exclude themselves from online gaming on a website altogether. Vendors also can provide links for consumers to find addiction help if they need it.

Furthermore, there are sufficient data and technology to prevent cheating, collusion, and money laundering. Regulated vendors screen all bets and record all games and hands played. Over the course of thousands of hands or games, vendors can determine what "normal" player behavior is and become proficient at detecting suspicious play. This allows for a safe and secure playing environment for consumers. Additionally, vendors can accurately determine a player's location through geolocation software. This ensures that consumers located within a state are the only players allowed to play on the vendors' sites. Finally, states can require adequate oversight and auditing mechanisms to ensure that online gaming is regulated fairly and appropriately. Under the bills, only those vendors that had advanced software, technical expertise, and transparency would be able to meet the criteria to operate online casinos. This technology also would make online casinos better equipped than their physical counterparts to oversee players' activities.

Response: Online gaming cannot be regulated as easily as this argument suggests, and online gaming environments cannot be controlled in the same manner as casino environments are. A memo from the FBI in 2009 to Congressman Spencer Bachus regarding online gaming stated that, while vendors could create safeguards to deter cheating and collusion, they may not have any incentive to do so. Furthermore, the memo stated that geolocation systems, which identify where an individual is logging online, and proof of personal identification can be bypassed or tricked. According to McAfee, a cybersecurity company, there is free software that can direct internet traffic through a series of relays to conceal users and their locations and usage from surveillance, defeating any attempt to monitor online activities. Users also can employ proxy servers to make a connection appear as if it is coming from another location or country. These services minimize the obstacles that users must overcome to use online gaming platforms for criminal means. Also, while vendors may be able to determine whether an account is created by a consumer who is legally able to gamble, there is nothing to stop him or her from providing a minor access to the consumer's device connected to the online gaming website.

Opposing Argument

Online gaming can contribute to gambling addiction. According to a 2005 report on the psychosocial impacts of online gaming from Nottingham Trent University in the United Kingdom, as technology continues to develop, there is increased scope to manipulate the potentially addictive structural characteristics of gambling activities in order to enhance their appeal. The report concluded that addictions are about rewards and the speed of acquiring them, something that online gaming lends itself to with solitaire-style games, fast-paced play, and overall accessibility.

Response: A study from the University of Nevada, Las Vegas showed that online gambling does not increase the rate of gambling addiction.⁴ The study used data from a 2010 British gambling prevalence study and a 2006 survey conducted in Ontario, Canada. The researchers used

⁴ Holly Devore, "Would Internet Access Turn You Into a Problem Gambler?", *UNLV News Center*, November 4, 2014.

an instrumental variables model approach and found that participation in online gambling does not have a causal effect on problem gambling observed throughout the general population. A second study from the State University of New York at Buffalo made a similar point.⁵ According to an article describing the study, researchers at the university's Research Institute on Addictions compared separate telephone surveys from 1999 to 2000 and from 2011 to 2013 and found that, despite an increase in gambling opportunities over time, rates of problem gambling remained stable. In addition, online casinos would be more likely to have more effective tools to prevent or identify problem gambling and assist those who have a problem than physical casinos. Tools could include such things as monitoring players and allowing them to view their history, or self-exclusion or limiting options.

Opposing Argument

Senate Bill 203 could be considered unconstitutional from several different perspectives. Under Article 4, Section 41 of the Michigan Constitution, any law enacted after January 1, 2004, that authorizes any form of gambling must be approved by a majority of voters in a statewide election and a majority of electors voting in the township or city where the gambling would take place. Without requiring a statewide vote, the bill would violate this provision. The bill also could violate the Commerce Clause of the U.S. Constitution; Michigan's equal protection clause; State and Federal due process protections; and Michigan's separation of powers clause. Furthermore, the legislation could be considered unconstitutionally overbroad.

In addition, it should be pointed out that the DoJ's opinion did not amend any current laws. In fact, the DoJ's opinion could be withdrawn or reversed at any point. This would make any online gaming prohibited in the United States, as it was before the opinion was issued.

Response: Article 4, Section 41 of the Michigan Constitution specifically exempts the Detroit casinos (MotorCity, MGM Grand Detroit, and Greektown) and Indian tribal gaming from that section, and it is these casinos and the Indian tribes that would be potential licenses under the proposed Act. Also, it has been reported that DoJ opinions such as the one issued on the Wire Act have been overturned only 2% of the time.

Opposing Argument

The bills would erode tribal sovereignty. Specifically, Senate Bill 203 would require Michigan Indian tribes to waive their sovereign immunity if they wished to participate in online gaming. While this would not be illegal, it could be unacceptable to the tribes. Furthermore, subjecting tribes to Michigan Gaming Control Board licensure and regulatory structures could be challenged as a violation of the Indian Gaming Regulatory Act.

Also, the bill could affect revenue from tribal gaming that the State currently receives. In 1993, some of the tribes signed a compact with the State that required the tribes to pay 8% of their net gaming wins to the Michigan Strategic Fund in exchange for "exclusivity", or security from the State's approving a nearby casino. When the Detroit casinos opened, the tribes argued that the State broke its promise of exclusivity. For that reason, six tribes that had made compacts with the State in 1993 stopped making those payments to the Fund by 1999. Similarly, in 2015, the Gun Lake Tribe withheld payment to the Fund after the State began selling lottery tickets online. This created a budget emergency for the Michigan Economic Development Corporation, although a settlement was reached. The Tribe had claimed that the internet sale of lottery tickets violated the compact it had with the State. If the State started to regulate online gaming, the tribes that still make payments to the State could use the same argument.

In addition, the option of amending compacts to include an online gaming agreement would be cumbersome and time-consuming when compared to the streamlined process the Detroit casinos would have. This would put the tribes at a competitive disadvantage. Also, compact renegotiations presumably would include concessions by the tribe, restricting its bargaining power and ability to engage in good faith discussions with the State.

⁵ Cathy Wilde, "Expansion of Gambling Does Not Lead to More Problem Gamblers, Study Finds", *The State University of New York News Center*, November 5, 2014.

Finally, the bill would protect casinos licensed under the Michigan Gaming Control and Revenue Act from an adverse court ruling that invalidated provisions of the law, unless it invalidated the authority of the Division to issue an internet gaming license to a licensed casino. Tribal casinos are not licensed under the Act, so they would not be protected.

Opposing Argument

The proposed exemptions from the Freedom of Information Act could create distrust or make consumers skeptical of the State's regulation of online gaming. This could interfere with the creation of a safe and trusting environment through online gaming regulation.

Opposing Argument

The bills could decrease revenue for casinos physically located across the State. If online gaming were to hurt the Detroit casinos, it could exacerbate Detroit's debt. Furthermore, online gaming could have a lasting negative effect by diverting money away from poor populations and local businesses.

Response: Studies and reports have shown that online gaming does not decrease revenue for physical casinos. On the contrary, it creates additional benefits by providing a new demographic and clientele. During 2014 testimony in Pennsylvania, Caesars Entertainment Corporation reported that 91% of its New Jersey online customers were not in the casino's "land-based" database. The casino also reported an increase in the amount of play in the physical casino from those who were logged in the land-based database. In 2014, Borgata's online gambling properties in New Jersey reported that about 85% of their online players had not had rated play, or tracked activity through a frequency or player's card, at Borgata in at least two years, displaying that online gaming was having no net change on the casino's clientele. More recently, Atlantic City casinos in 2016 reported positive revenue for the first time in about a decade.⁶

Opposing Argument

The legislation would not be fair for the Detroit casinos, as they would have to pay a strict tax on any gaming revenue if they wished to participate in online gaming. Indian tribes, however, would have the ability to negotiate a compact with the State and be regulated differently. Theoretically, the Indian tribes that participated could negotiate and pay a lower tax on any online gaming revenue than the Detroit casinos paid.

Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

Senate Bill 203

The bill would have an indeterminate negative impact on the City of Detroit, result in additional expenses to the Michigan Gaming Control Board, generate additional revenue to the First Responder Presumed Coverage Fund, and have an indeterminate impact on the General Fund and School Aid Fund. There are a number of factors that would affect revenue in a variety of ways. Much of the variation in estimates arises from the extent to which Internet Gaming Fund revenue would supplant revenue from other gaming activities. No state that has introduced internet gaming while also having casinos and a state lottery has yet to have an overall increase from all three sources, so it is difficult to estimate an overall revenue increase with the introduction of internet gaming for the State of Michigan. However, it is possible that the State could experience an overall increase even if internet gaming revenue is taken from other gaming activities.

Furthermore, more felony arrests and convictions could increase resource demands on law enforcement, court systems, community supervision, jails, and correctional facilities. The average

⁶ "Internet gambling helps Atlantic City casinos post first revenue hike in 10 years", *News 12: New Jersey*, January 12, 2017.

cost to State government for felony probation supervision is approximately \$3,024 per probationer per year. For any increase in prison intakes, in the short term, the marginal cost to State government would be approximately \$3,764 per prisoner per year. Any associated increase in fine revenue would increase funding to public libraries.

Lottery

It is likely that the Michigan Lottery's instant lottery and internet iLottery would directly compete with internet gaming in the State since these games are similar in that they are played day-to-day as opposed to the larger lottery games, which have more activity when jackpots are large and less activity when jackpots are smaller. Instant ticket games currently account for 36% of total Lottery revenue (up from 33% four years ago), and they accounted for 57% of the total increase in lottery revenue over the past four years (\$628.0 million). The iLottery, which totaled \$48.0 million in revenue in fiscal year 2015-16, the largest amount since its introduction in 2014, would be the most directly in competition with internet gaming. In the long term, the iLottery and instant ticket games could move to internet gaming. It is estimated that between 1% and 3% of Lottery revenue could move to internet gaming, but accounting for the amount of instant gaming activity, this amount could be up to 5% in the long term (beyond four years). The amount of State Lottery revenue that goes to the School Aid Fund (SAF) is roughly 28%, while internet gaming would be taxed at 10%. This means that for every 1% decrease in Lottery revenue (\$31.2 million in total revenue with \$8.6 going to the School Aid Fund), there would be a net loss to the State of \$5.5 million since internet gaming would raise only \$3.1 million for the Internet Gaming Fund. For the long term, if the State Lottery were to lose 3% to 5% of revenue to internet gaming, the State would lose between \$16.5 million and \$27.5 million in SAF dollars.

Another way to think about the revenue shift is that for every 1% decrease in total State Lottery activity due to internet gaming, the internet gaming would need to generate \$86.0 million in order to be revenue neutral; and for every 3% decrease in Lottery activity, the internet gaming revenue would need to be \$258.0 million. It is projected that internet gaming revenue would generate \$220 million to \$280 million over the long term, so it is possible that internet gaming could be revenue neutral if the loss to State Lottery were less than 3% and internet gaming met its expectations. However, if the loss were greater than 3% or it took longer for internet gaming to be established, then the State would experience a net revenue loss in the tens of millions of dollars.

Casinos

Casinos are taxed at 19% of "net win" (gross receipts less winnings paid to wagers), with 8.1% going to the School Aid Fund and 10.9% going to the City of Detroit. Since internet gaming would be taxed at 10%, for every 1% decrease in casino revenue for internet gaming, the State would actually experience an increase of \$150,000. This means that even if there were a significant change in revenue from casinos to internet gaming, the State would largely remain revenue neutral. However, with the potential for a reduced tax rate due to a lower rate under a compact, this amount could be less.

City of Detroit

The City of Detroit would experience a revenue decrease as a result of internet gaming. If the Detroit casino revenue were to decrease between 1% and 3% due to internet gaming in the long term, the City would experience a revenue loss of between \$1.5 million and \$4.5 million. Since internet gaming would not produce revenue for the City of Detroit, the City would not have any way to mitigate the revenue loss.

Tribal Casinos

The bill could affect money received from tribal gaming in the event that additional Indian tribes declined to make payments, similar to what occurred when tribes declined to pay the State due to the opening of the three Detroit casinos and the introduction the Lottery's iLottery games. These

payments significantly fund the Michigan Economic Development Corporation (MEDC) and the Jobs for Michigan Investment Fund, and in FY 2014-15 totaled \$43.9 million. This revenue, however, is not included in the State revenue totals and is only represented in the Michigan Strategic Fund (MSF)/MEDC financial report. The State would experience a direct impact from the loss of tribal revenue to the MSF/MEDC only because some employees who are funded with the corporate funding administer some of the State-appropriated programs. The corporate funds also provide additional funding to State programs as well as other economic development programs. If the MSF/MEDC lost all of the tribal revenue, the State could have less administration of economic development programs or need to provide additional revenue to supplement the MSF and administer those programs.

School Aid Fund

The School Aid Fund would experience a loss due to any shift in gaming revenue to internet gaming even if overall State revenue remained revenue neutral. If the State Lottery revenue shifted to internet gaming in the long term by 3% to 5% and casino revenue shifted by 1% to 3%, the School Aid Fund would experience a loss of between \$27.0 million and \$46.7 million or roughly \$18 to \$32 per pupil. This could significantly affect appropriations from the School Aid Fund.

Administration

The bill would result in additional expenses to the Michigan Gaming Control Board to regulate and issue licenses for internet gaming, and internet gaming vendors. The applications and license fees would make up the majority of the administrative revenue for the Board. Since the initial licenses would be valid for five years, it is difficult to predict whether the administrative revenue would be sufficient to support the regulatory costs. However, the Department of Treasury estimates that the fee amount would be sufficient to cover the administrative expenses of internet gaming. If the Board needed additional revenue for administration, there would be an even greater overall negative impact on the State.

First Responder Presumed Coverage Fund

The bill would result in \$5.0 million in annual appropriations to the First Responder Presumed Coverage Fund. Using the introduction of the iLottery games to predict initial revenue, it is estimated to take two full years from introduction for revenue to be sufficient to make this annual appropriation.

Senate Bill 204

The bill would have no fiscal impact on State or local government.

Senate Bill 205

The bill would have no fiscal impact on local government and an indeterminate fiscal impact on the State, in light of the Michigan Supreme Court's July 2015 opinion in *People v. Lockridge* (in which the Court struck down portions of the sentencing guidelines law). According to one interpretation of that decision, the sentencing guidelines are advisory for all cases. This means that the addition to the guidelines under the bill would not be compulsory for the sentencing judge. As penalties for felony convictions vary, the fiscal impact of any given felony conviction depends on judicial decisions.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.