

The Likely Battle Between the State Lottery and Atlantic City's Casinos

Will the Combination of Lottery Privatization and Legalized, Online Gambling Create New Competition for N.J. Gaming Dollars?

by Frank DiGiacomo

The New Jersey State Lottery has been in business for over 42 years. Following a 1969 voter referendum, which overwhelmingly approved the establishment of a state lottery, the New Jersey State Constitution was amended, allowing for the establishment of a lottery.¹ New Jersey's Lottery Law² was passed in early 1970. The state's first ticket was sold to then-Governor William T. Cahill in Dec. 1970,³ and since that time the lottery has not looked back. It recently generated a record \$2.76 billion in sales for the fiscal year ending June 2012, topping fiscal year 2011 sales by more than \$122 million.⁴

By statute, the entire net proceeds of the lottery are to be used for state institutions and state aid for education. In fiscal year 2012, the lottery's record-breaking results delivered over \$950 million to programs for education, veterans and the developmental disabled, along with numerous other state institutions.⁵ Significantly, the lottery has continued to grow and thrive, even following the legalization of casino gambling in New Jersey in 1977 and the growth of that industry for decades thereafter. Certainly the significance of the lottery as a revenue generator for state programs cannot be understated. So the question many have asked is, "Why mess with a good thing?"

New Jersey's Lottery Moves Toward Privatization

In a seemingly rare instance where government works efficiently and at no cost to the taxpayers, the Christie Administration, has commenced efforts to privatize certain functions of the lottery. The lottery, thorough the Department of the Treasury, recently issued a request for proposals (RFP), to solicit proposals from bidders to enter into an agreement to provide services, goods and equipment—in other words, a partial

lottery privatization.⁶ The stated purpose of the RFP is to increase the revenue generated by the lottery and to improve upon the lottery's operation, with the ultimate goal of including increasing sales and revenue for state programs.

New Jersey's stated objective in seeking the services of a private manager to operate the lottery is to "strengthen and maximize the future funding for state institutions and state aid for education by maximizing a growing revenue stream in a responsible manner."⁷ This includes the lottery's desire to increase its revenue by improving marketing, expanding upon its game offerings and perhaps exploring the utilization of the Internet to both broaden its player base and expand upon the distribution channels it can provide to those new game offerings.

The timing of the lottery's RFP seems to follow a recent trend by state lotteries. In 2010, the Illinois Lottery commenced upon its own partial privatization. A consortium of private lottery companies entered into a contract to privatize the Illinois game's management.⁸ The private lottery vendors who comprise the consortium managing the Illinois Lottery also currently provide lottery technology services and equipment to dozens of other state lotteries, including New Jersey. Pennsylvania's Governor Tom Corbett also recently entered into a contract to privatize his state's lottery.⁹ Although Pennsylvania's attorney general, Katherine Kane, has rejected the legality of Pennsylvania's Lottery privatization contract,¹⁰ it is clear the trend is for state lotteries to pursue growth opportunities, and privatization is the means through which many states are chosen to achieve that growth. Whether as part of privatization efforts or expanding the offerings to lottery players, the use of the Internet by lotteries has begun, and the breadth of how the Internet is utilized will certainly expand

moving forward.

This recent movement toward privatization and consideration of lottery-based Internet game offerings follows on the heels of a 2010 U.S. Department of Justice (DOJ) opinion that brought greater legal clarity to the issue of whether or not state lotteries could participate in Internet sales of their products.¹¹ The DOJ opinion was issued to both the New York and Illinois lotteries in response to a request from each regarding the legality of selling lottery tickets over the Internet. The DOJ opined that lottery sales over the Internet, on an intrastate basis, even if the transmission crossed state lines for processing purposes, did not violate federal law.¹² The significance of this seemingly narrow opinion has changed the gaming and lottery industries' outlook on the future of Internet-based wagering—online wagering that includes both gaming and lottery offerings.

The New Jersey Lottery's Privatization Effort

While there was only a single bidder in response to the lottery's RFP, it was a consortium bidder, similar to the Illinois partial privatization. Regardless of how the current privatization ultimately plays out for New Jersey, the fact remains that the lottery, through either its current state-operated structure or by way of some type of private/public partnership, will be looking to expand its market of new, prospective lottery players. The utilization of the Internet and other innovative marketing functions are most certainly on the lottery's horizon, particularly in light of the 2010, DOJ opinion.

In New Jersey, where the casino industry is also a vital part of the state's economy, the relative peaceful coexistence between the lottery and casinos may be jeopardized moving forward, particularly with the legalization of Internet wagering by New Jersey's casi-

nos. This coexistence between the lottery and the state's casino industry has evolved over the years, but it is not directly regulated in a specific way.

New Jersey's Casino Industry

As was the case with the lottery, casino gambling was authorized in New Jersey through a state constitutional amendment. In the case of casinos, passage was in 1976.¹³ The casino gambling amendment authorized the establishment and operation of casinos 'within the boundaries...of Atlantic City.'¹⁴ The casino industry's enabling legislation, the New Jersey Casino Control Act,¹⁵ established the regulatory structure of the state's casino industry and, among many other things, set forth what types of games New Jersey's casinos can offer for wagering by casino patrons. The Casino Control Act defines an "authorized game" or "authorized gambling game," and more significantly provides the state's primary gaming regulatory agency, the Division of Gaming Enforcement, with the authority to deem what are additional, appropriate authorized games for casinos to offer for play.¹⁶ The division has adopted regulations that have authorized many additional games for play in New Jersey's casinos, including numerous variations of poker, craps, other card games and keno.¹⁷

Authority to Select Game Offerings

The Lottery Law, while providing the Lottery Commission with the authority to adopt regulations regarding the "type of lottery to be conducted,"¹⁸ more specifically places limitations on what types of games the lottery may offer. For example, there is a provision in the law that prohibits the lottery from authorizing or conducting any game that uses any "video, mechanical, electrical or other video device, contrivance or machine, which upon the insertion of a coin or token is available to play."¹⁹ This provision, which was enacted as part of

the Lottery Law in 1983, has the effect of prohibiting the lottery from offering for play gaming devices that are commonly referred to as video lottery terminals, or VLTs. The legal distinction between whether a gaming device is a VLT or a slot machine is the subject of decades of court battles and legal opinions. For purposes of this article, VLTs will be defined as essentially slot machines, and they are mostly indistinguishable by a player of either device. The distinction is essentially that a VLT is operated by an authorized, legal lottery and a slot machine is operated by a casino. By way of example, the state of Delaware authorizes casino gambling, including VLTs. Legalized gambling in Delaware, however, is conducted by and through the Delaware Lottery. Since 1995, the Delaware Lottery, through three operating racinos²⁰ (racetrack casinos), publicly runs VLTs and table games and distributes a set percentage of its gaming revenue to both the racino operators and the VLT manufacturer/providers.²¹ Thus, all gaming in Delaware, both casino and lottery, is conducted by the state's lottery.

In New Jersey, the lottery and the casinos do not share a common regulatory agency or enabling statute. As noted, casino gambling in New Jersey is constitutionally required to take place within the borders of Atlantic City, and the Casino Control Act grants the division the statutory and regulatory authority to determine what are authorized gambling games. As a result of that authority to set forth what games it can offer, the casino industry, through the division, has an advantage over the lottery when it comes to claiming or staking out its authorized game turf.

An example of this is the game of keno. A traditional, bingo-like game with roots in ancient China, it has been offered for play in modern casinos for decades. Keno has also garnered renewed interest and play in the lottery

industry.²² Keno in casinos uses 80 balls, which traditionally were in a 'bubble' mixed with blown air and drawn along the lines of modern lottery games, such as the Pick 6 and Powerball. In many modern casinos the numbers one through 80 are selected by a computer random number generator. In New Jersey, the lottery cannot offer the same type of keno game because keno is an authorized gambling game per the regulations promulgated by the division, pursuant to the Casino Control Act. Thus, as an authorized gambling game, the play of keno is limited to casinos in Atlantic City.

On its face, keno's designation as an authorized gambling game has the effect of making it an exclusive option to be offered by the casino industry in New Jersey. While that may not appear to be such a big deal to the casual observer, it is a restriction upon the lottery, and more globally a restriction on the types of games it can offer to its players.

Again, there is a recent trend in state lotteries to offer keno-style lottery games. The Massachusetts Lottery, perhaps the most successful and profitable state-run lottery in the United States, offers a keno game drawing approximately once every four minutes.²³ Players of keno through the Massachusetts Lottery can also purchase 30 consecutive keno game blocks to allow them to keep up with the quick pace of keno drawings.

The ability of the Massachusetts Lottery to generate multiple wagers from players through its keno-based lottery game cannot be understated. The Massachusetts Lottery has made the promotion of keno one of its marketing priorities in 2013,²⁴ and in its fiscal year 2012 keno accounted for over \$790 million in revenue to the Massachusetts Lottery, reflecting 16.7 percent of its total sales.²⁵

As evidenced by Massachusetts, the potential for keno-style lottery games is

significant. However, in New Jersey keno is a game limited and only permitted to be offered for play in New Jersey by Atlantic City casinos. So how successful is keno currently in New Jersey casinos? A review of the New Jersey casino industry's revenue numbers for Jan. 2013 indicates there are only two New Jersey casinos currently offering keno to their patrons, and the total monthly revenue in Jan. 2013 from Keno by those two casinos was less than \$46,000.²⁶ Even adjusting for seasonal fluctuations, New Jersey's casinos generate a total annual gaming revenue from keno of approximately \$600,000. When compared to \$790,000,000 in keno revenue generated by the Massachusetts Lottery, New Jersey's casino-based keno revenue is insignificant. It is likely the New Jersey Lottery Commission and the future private lottery manager would welcome the opportunity to offer a keno-based lottery product given its proven potential in Massachusetts. Under the current law that is likely not an option.

The keno example demonstrates the issue of potential competition between the lottery and the state's casino industry for game offerings. However, the combination of the lottery's partial privatization, fueled with the near term likelihood of both the lottery and casino industry offering play to patrons through the Internet, sets the stage for a battle for New Jersey's gaming patrons and their gaming dollars. As noted above, despite both the lottery and casino industry beginning in the 1970s, there has been a relatively peaceful coexistence. In large part that coexistence was due to the fact that the lottery, as a state agency, went about its business seemingly not in direct competition with Atlantic City's casinos. While they both technically conduct 'gambling,' the purchasing of a Pick 6 or an instant scratch-off ticket certainly did not appear to conflict or compete with play-

ing a slot machine or blackjack. While there were instances where the casino industry took measures to protect its turf, such as the 1983 amendment to the Lottery Law to prohibit the lottery from authorizing the play of VLTs, the two factions have, for the most part, coexisted despite no clear statutory or regulatory basis requiring each to do so.

In New York, with the exception of tribal gaming and horseracing, the New York Lottery operates legalized gambling in the state, including New York's nine non-tribal casinos.²⁷ In Maryland, the state's three casinos are regulated by and through the Maryland Lottery.²⁸ As noted earlier, the Delaware Lottery regulates and operates all forms of gambling in that state. Delaware, the first state to legalize intrastate online gaming, recently had the state's lottery issue an RFP to solicit bids to commence Internet gambling within its borders.²⁹ Internet gambling under Delaware's law will include the sale of traditional Delaware lottery tickets through the Internet, but also licensed racino operators offering Internet-based VLTs and table games within the state. Therefore in Delaware, both Internet gambling and brick and mortar casino gambling will continue to be conducted by the Delaware Lottery.

Another example of a more clearly defined line between a state's lottery and its burgeoning casino industry is seen in Massachusetts. The Massachusetts State Lottery has been operating since 1972,³⁰ and on a per-capita basis generates more revenue than any other state lottery in the U.S. In Nov. 2011, Massachusetts enacted into law the Expanded Gaming Act,³¹ to allow for three full casinos and one slot machine-only casino within the state. Recognizing the historical importance of the Massachusetts State Lottery, the state's Legislature has been planning for the future, and seems intent on clearly defining the boundaries between the Massachusetts lottery and casino indus-

try moving forward. There are two pending bills in Massachusetts—one that will authorize Internet lottery sales and a second that would authorize Internet gambling. The latest versions of both bills are structured to not compete with the Massachusetts Lottery.³²

The recent DOJ opinion does open the door to enhanced Internet/online lottery offerings; however, in New Jersey, those potential offerings by the lottery would need to be balanced against the Internet gaming options now afforded to New Jersey's casino industry. New Jersey Assembly Bill 2578, which was conditionally vetoed by Governor Chris Christie, then modified by the Legislature and signed into law by the governor on Feb. 26, 2013, amends the Casino Control Act to authorize, intrastate, Internet gaming to be offered by New Jersey casinos. Significantly, in New Jersey Internet gaming will only be able to be offered by licensed casinos in the state. Those casinos are permitted to enter into agreements with technology companies to assist them in offering Internet gaming within New Jersey, but it must be accomplished through an existing casino license.

The revised Casino Control Act, through A-2578, further expanded the types of games casinos can potentially offer to be played by casino patrons online. A-2578 expanded the division's discretion with regard to authorized gambling games under the Casino Control Act, as those games may be offered "through the Internet." In addition to including the traditional 'casino games' the revised Casino Control Act provides the division with the authority to "also include any game that the division may determine by regulation to be suitable for use for wagering through the Internet."³³ In other words, the division can authorize games for Internet wagering that are not also authorized for play in the brick and mortar casinos. This is an effective and potentially powerfully tool

for New Jersey casinos and their burgeoning Internet gaming market. The ability to offer additional games, beyond what are traditional casino games, will present New Jersey with advantages over both Nevada and Delaware, states that have also recently authorized their own versions of legalized Internet gaming.

The new Internet gaming law makes no mention or reference to the lottery. The law's impact upon the lottery and the casino industry remains to be seen. Certainly, there is much hope that Internet gaming will help revitalize Atlantic City's casino industry.

What role, if any, will the upcoming partial privatization of the lottery play as the casino industry expands into Internet gaming? Will there be competition between the lottery and the burgeoning Internet gaming industry in New Jersey? Unfortunately for both, such a conflict appears likely, and more so now that the lottery has commenced a partial privatization of its operations. How this plays out will determine the success of both the lottery and the casino industry in this state in the coming decade. □

Endnotes

1. N.J. Const. art. IV, §7, ¶ 2, subpar. C, which made it legal for the Legislature to authorized the conduct of state lotteries.
2. N.J.S.A. 5:9-1 *et seq.*
3. New Jersey Lottery Annual Report, 2011.
4. New Jersey Lottery, Press release Aug. 20, 2102.
5. *Id.*
6. A request for proposal (RFP) 13-x-22694 for lottery growth and management services, issued Aug. 10, 2012 by the state of New Jersey, Department of Treasury, Division of Purchase and Property.
7. N.J. Lottery RFP § 1.2.1.
8. State of Illinois, Executive Depart-
- ment, notice of award—illinois lottery private management agreement dated Sept. 15, 2010.
9. Jan. 17, 2013, news release from Gov. Tom Corbett—*Governor Corbett Determines Lottery Private Management Agreement is in Seniors' Best Interest.*
10. Feb. 14, 2013, press release from the Pennsylvania Office of the Attorney General, where Attorney General Kane announced she had determined she could not approve the proposed contract between the Pennsylvania Lottery and Camelot Global Services, determining that the executive branch of the Pennsylvania's government had exceeded its authority under the Pennsylvania Constitution.
11. U.S. Department of Justice Memorandum Opinion, Sept. 20, 2011, Whether Proposals By Illinois and New York to Use the Internet and Out-of-State Transaction Processors to Sell Lottery Tickets to In-State Adults Violate the Wire Act. Available at www.justice.gov/olc/2011/state-lotteries-opinion.pdf.
12. Specifically, the Interstate Wire Act of 1961, 18 U.S.C.A. §1081, commonly referred to and the "Wire Act."
13. N.J. Const. art. IV, §7, ¶ 2, subpar. D.
14. *Id.*
15. N.J.S.A. 5:12-1 *et. seq.*
16. N.J.S.A. 5:12-5. Definition of "authorized game" or "authorized gambling game" includes "roulette, baccarat, blackjack, craps, big six wheel, slot machines, minibaccarat, red dog, pai gow, and sic bo; any variations or composites of such games, provided that such variations or composites are found by the division suitable for use after an appropriate test or experimental period under such terms and conditions as the division may deem appropriate; and any other game

which is determined by the division to be compatible with the public interest and to be suitable for casino use after such appropriate test or experimental period as the division may deem appropriate."

17. N.J.A.C. 13:69F, subchapters, 1 through 37.
18. N.J.S.A. 5:9-7.a.(1).
19. N.J.S.A. 5:9-7.1.
20. The term "racinos" is an industry term that refers to casinos that operate at horseracing tracks.
21. The Horse Racing Redevelopment Act, 1994 Del. Laws 446.
22. Versions of keno are currently offered by state run lotteries in Ohio, Georgia, Massachusetts, Oregon, Michigan and the District of Columbia.
23. Massachusetts State Lottery Website, available at <http://www.masslottery.com/games/keno.html>.
24. Massachusetts State Lottery Website available at http://www.masslottery.com/games/promotions/Keno_Time_To_Play_Promo.html.
25. Massachusetts State Lottery Commission – Statement of Operations, June 2012. Report dated Jan. 22, 2013.
26. New Jersey Division of Gaming Enforcement Monthly revenue reports – Jan. 2013.
27. New York Tax – Article 34, §1617-a, Video Lottery Gaming.
28. Code of Maryland Regulations, (COMAR) Title 14, Independent Agencies and Maryland State Government Article, Section 9-1A-01, *et seq.*
29. The RFP for Internet gaming in Delaware is called "Internet Gaming System and Services Solution, FIN13001-iGaming," Jan. 31, 2013. Responses are due March 15, 2013. Available at http://bids.delaware.gov/bids_detail.asp?i=1714&DOT=N.
30. Massachusetts State Lottery Com-

mission, Information Packet, 1972-2012.

31. Massachusetts General Laws, Ch. 23 § 1 *et. seq.* Signed into Law by Governor Deval Patrick.
32. Massachusetts Bills: Internet Lottery Bill S. 101—The citation is 2013 Senate Doc. No. 473; and Online Gaming. Bill S. 197—The citation is 2013 Senate Doc. No. 1768.
33. Revised, Casino Control Act, N.J.S.A. 5:12-5.

Frank A. DiGiacomo is a partner with Duane Morris LLP, and practices in the area of gaming law with a focus on representing companies and persons both within the gaming industry and who conduct business with the gaming industry. He is experienced in representing public and privately held casinos, gaming technology providers and lottery companies in connection with licensing, regulatory investigations, compliance matters, financings, equity offerings, mergers and acquisitions, restructurings and other gaming regulatory issues.

This article was originally published in the April 2013 issue of New Jersey Lawyer Magazine, a publication of the New Jersey State Bar Association, and is reprinted here with permission.