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Do you have clients who want to give video gambling a try? This article explains the legal and regulatory hurdles facing restaurants, bars, and other eligible establishments interested in participating in the video gaming industry.

Vegas Comes to the Corner Pub: Guiding Business Clients Through the Video Gambling Law

With the Illinois video gaming industry finally up and running, eligible bars and other establishments have an opportunity to offer patrons an exciting new entertainment option – video gambling terminals (“VGTs”) just like those state-of-the-art glittering machines found at Bellagio, Wynn, and other casino resorts on the Las Vegas Strip. However, to participate in the industry, these establishments must successfully traverse an unfamiliar legal and regulatory terrain.

On October 9, 2012 – more than three years after the Illinois Video Gaming Act¹ (the “Act”) was enacted – the first such machines began operating in the state. The long-awaited activation of the VGTs in Illinois created considerable excitement among operators of licensed bars, truck stops, and fraternal and veterans organizations, establishment owners and with others interested in participating in this burgeoning industry.

This article provides a roadmap through the legal and regulatory hurdles facing restaurants, bars, and other eligible businesses interested in video gaming. The first section gives background on the Act and the industry players and their distinct roles. The second looks at eligibility requirements for bars and restaurants. Finally, the article turns to key questions about video gambling business counselors are likely to hear from clients.

Types of licenses

The Act provides for seven categories of licenses to be issued by the Illinois Gaming Board: manufacturer, distributor, terminal operator, establishment, supplier, terminal handler, and technician.²

Manufacturer. Manufacturers are responsible for manufacturing and assembling the VGTs and selling them to licensed distributors, unless the manufacturer also has a distributor’s license, in which case it can distribute its VGTs directly to terminal operators.³ Most of the largest manufacturers have exclusive relationships with a particular distributor to distribute only its VGTs (the exception is Bally Gaming, which is serving as its own distributor). IGT has partnered with American Vending Sales, Inc., Spielo International Canada ULC has partnered with American Gaming & Electronics, Inc., WMS has partnered

with H. Betti Industries Inc., and Aristocrat Technologies, Inc. has partnered with Moss Gaming, Inc.

Distributor. Distributors are responsible for the sale of VGTs to licensed terminal operators.⁴ Because each major distributor works with a single manufacturer, one of their key roles is to market their manufacturer’s VGTs to the licensed terminal operators and help these

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operators obtain financing for the VGT purchase.

Terminal operator. Terminal operators are responsible for entering into use agreements with licensed establishments to place VGTs on the establishment’s premises. Together with the establishments, they are responsible for managing the day-to-day operations of the industry. Operators’ responsibilities include the maintenance, repair and emergency service of VGTs, collection of revenue generated by VGTs, and deposit of the required portion of revenues into a designated bank account to cover the related tax obligations owed to the state and the municipality or county, as detailed below.⁵

While the major manufacturers and distributors are medium to large corporations with strong national and often

international operations, the operators tend to be small businesses that fall into one of the three following categories.

1. Vending/amusement companies.

Many such companies have been in the business of providing pool tables, jukeboxes, arcade machines and other, similar equipment to bars since well before the Act was passed. Most of these companies are family-owned and many have been passed down through several generations. They often have decades-old relationships with bars.

For a variety of reasons, only a fraction of the vending companies in existence when the Act was passed have obtained a terminal operator’s license. Some companies were owned by individuals with criminal histories or reputed associations with unsavory characters, who recognized they would not pass muster with the Gaming Board.

Others chose not to apply after calculating the millions of dollars of debt they would incur to purchase VGTs for their locations.⁶ Still others were rejected for licensure by the Board or withdrew upon being advised by gaming counsel that their application might be rejected, even if the likelihood was slim.⁷

As detailed in the footnotes, the economic consequences of having a gaming license application rejected by a regulatory body (versus voluntarily withdrawing) can be devastating. Note that

1. 230 ILCS 40/1 *et seq.*

2. 230 ILCS 40/5.

3. 230 ILCS 40/25(a), 30.

4. 230 ILCS 40/25(b).

5. 11 Ill. Admin. Code § 1800.250.

6. For example, an operator with 50 locations would be considered to have a medium-sized route. Assuming four VGTs per Establishment, the operator would need to fund the purchase of 200 VGTs, along with ancillary equipment, at approximately \$12,500 each. That means that the operator would need to purchase \$2.5 million worth of equipment, in addition to covering overhead costs such as rent for office and warehouse space, labor, etc.

7. The gaming industry is highly regulated across the globe. A license application rejection in any jurisdiction must be reported in all other jurisdictions in which a company is licensed. Jurisdictions often investigate the reason for the rejection, which can lead to revocation of the company’s existing license(s) in some or all of these jurisdictions. Furthermore, there is such an emphasis in the gaming industry on the individuals and companies with which one associates that most gaming contracts contain provisions allowing for immediate termination if the other party to the contract is no longer deemed a “suitable association.” As such, news of a gaming company having a license application rejected or an existing license revoked often results in the termination of contracts to which the company is a party because the company is no longer seen as being a suitable association.

the Gaming Board has express authority to refuse a license applicant's request to withdraw an application.⁸ The Board might do so where its investigation uncovers information about an applicant that the Board wants all other gaming jurisdictions to know.

The vast majority of vending companies that have not obtained a terminal operator's license nonetheless entered into use agreements for placing VGTs at the bars with which they had vending relationships (commonly referred to as the company's "route"). What became of

Supplier. Suppliers are responsible for supplying major VGT components or parts to licensed operators.¹¹ In practice, manufacturers typically deliver the components required for the continued operation of their VGTs, so most companies that have bothered to obtain a supplier's license¹² provide ancillary products such as redemption devices, change machines, and ATMs.

Terminal handler. A terminal handler's license is required for any employee or independent contractor to access a VGT's "inner workings."¹³

Technician. The Act provides that a technician's license is required for an individual that is not an employee of a manufacturer, distributor, or terminal operator to repair or service VGTs, but does not permit the licensee to access the "inner workings" of a VGT.¹⁴ However, the Gaming Board has announced that terminal handlers

may repair and service VGTs, rendering the more expensive technician's license largely meaningless.¹⁵

VGT eligibility requirements for bars and restaurants

Only certain bars and restaurants are eligible for the placement of VGTs.

Must serve alcohol for consumption on the premises. For starters, only restaurants that serve alcohol for consumption on the premises are eligible.¹⁶ A bar or other eligible establishment may only operate VGTs during the hours for which the establishment is legally permitted to serve alcohol, subject to exceptions for certain licensed truck stops and veterans and fraternal organizations.¹⁷ If a restaurant or bar loses its liquor license, its gaming license is automatically revoked.

Must be in a municipality or unincorporated section of a county that hasn't opted out of the Act. Only establishments located in a municipality or unincorporated section of a county participating in the video gaming industry are eligible for licensure. The Act provides that a municipality may prohibit video gaming within its corporate boundaries and that a county board may prohibit video gaming within the unincorporated areas of the county.¹⁸ A number of municipalities and counties have exercised this "opt-out" right.¹⁹

The Gaming Board has interpreted a municipality or county that has passed a blanket prohibition of gambling to have "opted-out" of the Act, regardless of the age of the ordinance in question. Many municipalities were not aware of the existence of such ordinances, a number of which date back to the early twentieth century. Upon discovering them, leaders scrambled to convene a vote on whether or not to pass a new ordinance expressly excluding video gaming from the general prohibition under the existing ordinance. The overwhelming majority with "ancient" anti-gambling ordinances have formally elected to participate in the video gaming industry.

Cannot be located too close to protected places. An establishment is prohibited from participating in the industry if it is located either (i) within 1,000 feet of a horse racing facility, off-track betting parlor or riverboat casino or (ii) within 100 feet of a school or place of worship.²⁰ These distances are measured by drawing a straight line from the closest part of the outer walls of the building in which the establishment is located to the closest part of the building in which the horse racing track, off-track betting facility, casino, school or place of worship is located.²¹

For an establishment that leases only a portion of the building in which it is located, the line is drawn from the closest part of the leased premises.²² It is worth noting that these restrictions do not apply if the horse-racing facility, off-track betting parlor, casino, school, or place of worship opens within the restricted distance after the establishment has been granted a gaming license.²³

8. 11 Ill. Admin. Code § 1800.555.

9. It is not unusual for the purchaser of the contracts to subsequently withdraw its application or have the application denied, resulting in use agreements that have been transferred several times over, much to the consternation of the Gaming Board and the establishments themselves.

10. 11 Ill. Admin. Code § 1800.270.

11. 230 ILCS 40/5.

12. See <http://www.igb.illinois.gov/VideoGaming/LicensedApplicants.pdf>.

13. 11 Ill. Admin. Code § 1800.110.

14. 11 Ill. Admin. Code § 1800.110.

15. See <http://www.igb.illinois.gov/VideoGaming/FAQsforVideoGaming.pdf>.

16. 230 ILCS 40/5.

17. 230 ILCS 40/55.

18. 230 ILCS 40/27.

19. See <http://www.igb.illinois.gov/VideoGaming/prohibit.aspx>.

20. 230 ILCS 40/25(h).

21. 11 Ill. Admin. Code § 1800.820.

22. See <http://www.igb.illinois.gov/VideoGaming/FAQsforVideoGaming.pdf>.

23. 230 ILCS 40/25(h).

Establishments that introduce video gaming tap a new revenue source that can significantly boost their bottom line.

these contracts? They were sold at up to \$75,000 per contract to other terminal operator licensees or license applicants, often companies from one of the two categories below.⁹

2. Out-of-state gaming companies. Several of the licensed terminal operators, including some of the biggest, are gaming companies from other jurisdictions with experience operating VGT routes in other states where such operations are legal or operating casinos.

3. Entrepreneurs. A handful of licensed terminal operators, including some of the largest, are owned by serial entrepreneurs, many of whom were heavily involved in real estate investments prior to the economic downturn.

As noted above, the out-of-state gaming companies and entrepreneurs, lacking the critical relationships with local Illinois bars, have had to purchase use agreements from vending companies looking to sell their routes. Often, these purchasers have hired the principals of the vending company as employees or consultants to continue managing the relationships with their establishments.

Establishment. Establishments are responsible for providing a secure area for the placement, operation, and play of VGTs and for limiting access to and play of the machines in accordance with the Act.¹⁰

Must withstand Gaming Board scrutiny. Each establishment must successfully withstand the scrutiny of the Gaming Board licensing process, although that review pales in comparison to the exhaustive process required of manufacturers, distributors, operators, and suppliers. For each establishment located in an eligible municipality or unincorporated area of a county that satisfactorily completes the license application forms, the Gaming Board conducts a background check on the individuals and entities disclosed in the application, including the following:

- Conducting a criminal record check;
- Conducting a tax compliance check with the Illinois Department of Revenue;
- Conducting a compliance check with the Illinois Liquor Control Commission;
- Contacting the establishment's local liquor licensing authority and law enforcement agency; and
- Inspecting the establishment to ensure that it satisfies the requirements under the Act and rules and that no illegal games (commonly referred to as "gray games") are present.²⁴

My client was granted a gaming license – now what?

Use agreements with operators. Before having VGTs delivered or activated, the establishment must enter into a use agreement with a licensed terminal operator pursuant to which the operator agrees to install no more than five machines (the maximum permitted under the Act).²⁵ An establishment can only be party to a use agreement with one operator at a time. The VGTs are owned by the operator. An establishment cannot hold title to a VGT. The establishment pays nothing to the operator for installing the VGTs.

The Act and Rules provide such detailed requirements for operators and establishments that these use agreements have become standardized. One of the few oft-negotiated provisions is the length of the initial term, something about which neither the Act nor Rules provide any requirements or restrictions.

In my experience having reviewed hundreds of these agreements, the most common initial term is five years, often with an "evergreen" provision for an automatic five-year renewal unless either party provides notice of termination within 90 to 120 days prior to the

expiration of the initial term. However, three-year terms are not uncommon for an establishment that wants to "dip its toes into the water" of video gaming or using a particular operator. On the other hand, I've seen my share of use agreements with 10-year terms.

Each side has a strong argument. The establishment often points out that the operator has no track record in this new industry. Operators typically cite the substantial start-up costs of purchasing VGTs. Without a commitment to operate these VGTs for a sufficiently long term, subject to the establishment remaining in business and maintaining its license with the Board, it doesn't make sense for the operator to undertake the massive investment.²⁶

Location of games within establishment; build-out of gaming area. Establishments must prevent access to or play of VGTs by anyone under age 21 or who is visibly intoxicated.²⁷ Establishments that admit customers under 21 must locate VGTs in a restricted area, the entrance to which must be monitored by an employee that is at least 21.²⁸ The monitoring cannot be conducted solely via closed circuit television.²⁹

In addition, establishments that admit underage customers must also install a physical barrier to the gaming area such as a short partition, gate or rope.³⁰ However, the barrier must not visually obscure the entrance to the gaming area from the employee charged with monitoring it.³¹ In addition, all VGTs must be located in an area that is not readily visible from outside the establishment.³²

Central server; collection and reporting of gaming revenues; payment of taxes. All VGTs are connected to a central communications system known as the "central server," which gives comprehensive information about the operation of each VGT. Through the central server, individual VGTs across the state can be activated or deactivated remotely. The Gaming Board awarded the contract to develop and operate the central server to Scientific Games International, Inc.

The central server provides detailed data regarding the net terminal income generated by each VGT. "Net terminal income" is defined under the Act as the money gambled on a VGT minus the payouts to players.³³

Under the Act, the Gaming Board is entitled to collect tax revenue equal to 30 percent of all net terminal income.³⁴ Five-sixths of the tax revenue goes to the

state (25 percent of the total net terminal income) and one-sixth is passed on to the applicable municipality or county (five percent of the total net terminal income).³⁵

The remaining net terminal income after paying the state and local taxes, along with a central server tax amounting to less than one percent of the net terminal income, must be evenly divided between the applicable terminal operator and the establishment.³⁶ The Gaming Board collects tax revenues through twice-monthly electronic fund transfers from the bank accounts designated by the terminal operators.³⁷

No inducement policy. Under the Act, operators are prohibited from offering anything of value to an establishment, including cash, merchandise (e.g., flat screen televisions), or even a loan, as an inducement to enter into a use agreement.³⁸ The Gaming Board has interpreted this broadly, holding that an operator "winning and dining" an establishment owner or taking them to a sporting event is prohibited.³⁹

Payout devices. Each establishment is required to have a payout or "redemption" device on the premises, so that a winning player can immediately trade the ticket for cash.⁴⁰ There are two primary types of payout machines: those kept behind the bar in an area off-limits to patrons and "kiosk-style" self-service devices in an area accessible to customers. The "behind the bar" devices must be operated by an employee of the establishment who is at least 21 and require the player to provide the winning ticket to the employee, who then puts it into the machine and gives the player the winnings.⁴¹ The kiosk-style payout devices function like ATMs and are per-

24. See <http://www.igb.illinois.gov/VideoGaming/InvestigativeOverviewForLocations.pdf>.

25. 11 Ill. Admin. Code § 1800.270(g); 230 ILCS 40/25(e).

26. VGTs generally run \$10,000 to \$13,000 each.

27. 11 Ill. Admin. Code § 1800.270(i).

28. 230 ILCS 40/58.

29. See <http://www.igb.illinois.gov/VideoGaming/FAQsforVideoGaming.pdf>.

30. *Id.*

31. *Id.*

32. 11 Ill. Admin. Code § 1800.810.

33. 230 ILCS 40/5.

34. 230 ILCS 40/60(a).

35. 230 ILCS 40/60(b).

36. 230 ILCS 40/25(c).

37. 230 ILCS 40/60(c) and (e).

38. 11 Ill. Admin. Code § 1800.250(l).

39. See <http://www.igb.illinois.gov/VideoGaming/VGInducementPolicy.pdf>.

40. 11 Ill. Admin. Code § 1800.250(a).

41. 11 Ill. Admin. Code § 1800.250(c).

mitted to offer ATM functionality in addition to the payout services.⁴²

Game play; loyalty programs. Under the Act, all VGTs are required to have a payout percentage of at least 80 percent.⁴³ The maximum wager on any one hand must not exceed \$2, while the maximum payout on any hand must not exceed \$500.⁴⁴

When a player wins, the VGT dispenses a ticket indicating the amount won, the terminal serial number, and the date and time issued.⁴⁵ Tracking systems,

“players” clubs and similar loyalty programs cannot be used.⁴⁶ However, the Gaming Board has left the door open to allowing such programs as the industry matures.⁴⁷

Conclusion

Before they can participate in the industry, establishments must navigate an unfamiliar regulatory process. However, with proper guidance from knowledgeable gaming counsel, establishments can successfully traverse the video gaming

industry’s challenging legal and regulatory terrain. In so doing, they can tap a new revenue source that can significantly boost their bottom line, making video gaming a gamble that really pays off. ■

42. See <http://www.igb.illinois.gov/VideoGaming/FAQsforVideoGaming.pdf>.

43. 230 ILCS 40/15(2).

44. 230 ILCS 40/20.

45. *Id.*

46. See <http://www.igb.illinois.gov/VideoGaming/FAQsforVideoGaming.pdf>.

47. *Id.*

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