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GAMBLING AND THE LAW®:
Should Social Casino Games Be Regulated?

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One of the hottest issues in Europe and Australia among regulators is whether social casino games should be subjected to government controls.

Licensed land-based and Internet casino companies are spending hundreds of millions of dollars to get into this business. Caesars Entertainment Corp. has bought a half-dozen social gaming companies in the past couple of years. The most recent, as of mid-February, was Israel-based Pacific Interactive. Like many of its predecessors at Caesars, the main attraction is a slot machine-style game. House of Fun, which is less than three years old, already claims to have 700,000 daily users.

One of Caesars' first purchases was Playtika. Playtika was founded, also in Israel, in 2010 for about \$1 million. It immediately started to lose money. In fact, it never made any money during the 11 months that it was independent. Yet Caesars paid \$80 to \$90 million dollars for 51% of the company. Why? Because Playtika had invented Slotomania, the number one social casino game on Facebook.

It is still one of the most popular social games. Slotomania has 13 million "likes" on Facebook, twice the adult population of the entire state of New Jersey.

Casino companies like social games because they help spread their brand name and build customer lists. More importantly, they make money, potentially lots of money.

At the recent meeting of the International Masters of Gaming Law in Oslo, Norway, Internet gaming expert Melissa Blau created a stir when she reported that the "whales," players who spend the most on social casino games, pay an average of \$550 each, per month.

The news that people are ponying up nearly \$7,000 a year to play free Internet games was startling. But Blau topped that when she reported that the average spent on real-money online gambling sites was also \$550.

This is not really that surprising. Compulsive gamblers say that the best thing in the world is winning. But the next best thing is losing.

If state-licensed companies like Caesars are getting into the social casino gaming business, lawmakers and regulators in the U.S. are also going to start looking into these games.

I don't expect the result will be pretty. Legislators have trouble figuring out how to regulate real gambling – does anybody today think it was a good idea to require Mississippi's casinos to be floating without engines or crews in the Gulf of Mexico's hurricane alley?

And very few people understand the difference between gambling and social games. Or, that different forms of gaming create different risks.

In the U.S., gambling requires the presence of three elements: consideration, chance and prize. Players bet on the outcome of an uncertain event to win a larger amount. Social games are not gambling, if they eliminate one of the three elements.

If anyone can play a game for free, it does not matter if the outcome is determined more by luck than skill, and valuable prizes may be won. No-purchase-necessary sweepstakes have been common since at least 1954, when the U.S. Supreme Court ruled that the T.V. gameshow "Name That Tune" was not a lottery, even though contestants at home could enter by sending in a postcard.

Contests of skill can charge contestants money – the smarter operators call the payments "entry fees" than "wagers," to compete for valuable prizes.

Atari introduced millions of people to the idea of electronic video games. Players pay money to play. Even if the game is predominantly chance, not skill, the game is not gambling, if players cannot win anything of value.

So, how do social games make money, if they are not gambling?

Making a game free for anyone to enter does not mean that contestants are prohibited from spending money. Sweepstakes work because people do buy the product being promoted, perhaps thinking that subscribing to a magazine increases their chances of winning. Charities run "donation requested" raffles, knowing social pressure and guilt feelings make most individuals send in money, even though not required.

Subscription games, like "free" poker for money prizes, are profitable because most players prefer their credit cards being billed about \$20 every month, rather than having to fill out and mail postcards for free entries.

Most social games with a free alternative means of entry ("FAME") give players opportunities to play (I'll call these "chips" for convenience) when they sign up, and more every hour or every day. Operators sell additional chips for real money, but nobody is

required to buy them. Sites make their profits from players who have lost everything and do not have the patience to wait for additional free chips.

Because there is no consideration, a casino game with a FAME is not gambling. However, some old cases involving pinball games from the 1930s and '40s indicate that these social games actually would be considered gambling in about a half-dozen states.

Social games where players compete against each other are not gambling, if the outcome is determined primarily by skill. States sometimes have special rules, for example, that the prize cannot be composed of the entry fees.

There are about ten states that put restrictions on contests of skill, such as requiring 100% of the players' money to go to the winner, or limiting the maximum amount that can be won. Interestingly, if you look at the skill contests for real money sites, you'll find that there is no general agreement as to exactly which states should be avoided.

The most common way for social games to get around the prohibitions on gambling is by not offering valuable prizes. Then why would anyone play? Jurisdictions can differ widely on exactly what constitutes a "prize." The easiest case is where the winner can win real cash, or an item that can be quickly sold for cash. The F.B.I. raided Second Life because there were casinos which used the site's "linden dollars." Because the linden dollars could be transferred to other players, a secondary market developed where this play currency could be converted into real money.

Social games have discovered that some players will spend a lot of real money to get avatars and virtual gifts that cannot be sold. Opponents have argued that these games do have all three elements, since the prizes are of value to the players. But only a few jurisdictions would agree that a non-material item is a "prize of value" if it cannot be sold.

Social gaming is obviously very big. And very volatile. Zynga, the leading company, was valued at one point at \$9 billion. In 2013, it announced it was laying off 18% of its workforce and closing its New York, Dallas and even Los Angeles offices.

A controversy has exploded mainly because it is casino and other real-money gambling companies that are getting into the social gaming field.

During last year's 15th International Conference on Gambling and Risk Taking in Las Vegas, I agreed to act as one of the trial lawyers for a moot court on whether social gaming should be regulated. The mock trial was extremely lively and entertaining. But it did have a serious side, and raised these issues:

Social casino games are not always social. There is a big difference between contests in which players interact and play against each other, and games in which the patron is one against the house. Lawmakers have long recognized that banking games

are more dangerous than non-banking games. We regulate blackjack, craps and roulette more strictly than poker and bingo. A FAME slot game on an iPad is closer to a real slot machine than it is to Angry Birds®.

Social casino games may be inherently misleading. Because the games are not regulated, they are free to set the odds at any level they want. In fact, they are almost never truly random. Game manufacturers don't want players to get bored, so they make the game easier if a player is stuck at one level, or harder if the player is winning too handily. This Dynamic Game Balancing ("DGB") is done automatically, because game designers want players to be hooked. Obviously, with real gambling, operators can't change the odds mid-game. And casinos do not brag about a game being "addictive."

Because they are not regulated, social casino games are available to children and potential compulsive gamblers. No one should care, if the games are harmless. But, are they? Should an online or land-based real-money casino be allowed to offer games indistinguishable from slot machines, with no restrictions? If a child is playing a social casino game that is set for 120%, will he realize the difference when he plays a real slot machine set at 95%? If an adult is playing a social casino game with DGM and spending money on additional chips, will she realize the reason she is losing is that the game automatically set longer odds when she had a winning streak?

Social casino games have millions of players, many spending as much as they do on real-money online gambling. Studies are beginning to show exactly how much people do pay to play supposedly free games online.

The most common model is "Freemium." Players can participate for free. They only have to pay to get additional goodies, like avatars. But the most common commodity sold is time. Once players have lost the free chips given at the beginning of each hour, they can wait for more free chips. Or they can pay and get them right away. So, a social poker player who has lost all his chips can sit out a few dozen hands, or buy additional chips, for real money. The lure of the freemium is so great that people will pay for more time, even when they cannot win money or a prize that can be sold.

And the games are good. Better than the best slot machine available on a casino floor.

MIT cultural anthropologist Natasha Dow Schüll has written about the terrestrial gaming devices in her book, *ADDICTION BY DESIGN: MACHINE GAMBLING IN LAS VEGAS* (Princeton University Press 2012). She describes how some players enter "the zone," a pleasurable other-world experience. It is gambling for gambling's sake, like getting drunk or high. Players in the zone really do not care whether they win or lose, as long as the game is fun to play.

Brain scans have shown that near misses, which are programmed to be part of every real-money and social gaming site, stimulate the same parts of the brain as wins.

The pleasure centers of the brain don't really care whether you are winning, or losing, real money or just virtual chips.

But, doesn't it make a difference that on many social gaming sites you can't win anything, at least nothing that can be sold for real money? The people who ask that question have obviously never played games where getting to the next level is a bigger kick than winning ten dollars. And players can win avatars and other non-physical items that are of value to them.

All gambling requires chance, consideration and a prize of value. In most jurisdictions, even if a person values what he wins so much that he would be willing to pay for it, it is not a prize of value, unless the item can be sold. However, there are some states that have laws dating from the 1930's, when pinball began to be big, declaring that even a free replay is a prize of value. If winning more time is enough, awards of electronic items that bring prestige or can be sent to friends are surely prizes.

The landbased casinos understand that they may know how to operate banking table games and slot machines. But they are smart enough to know they don't have the time to learn how to attract real money players to the Internet, protect themselves from hackers, and make sure their sites never crash.

Borgata partnered with bwin.party, the online giant created by the merger of bwin, which started with sports betting and then expanded to poker and casino games, and Party Gaming, the world's largest real-money operator, when it was Party Poker.

What does bwin.party get out of the deal? New Jersey has limited its permits to the dozen brick and mortar casinos in Atlantic City. And, as the suppliers to state lotteries have shown, the first companies to be successful in one state have a step up in getting contracts and licenses when other states join the games.

Caesars Entertainment, the nation's largest landbased gambling operator, realized that it lacked the expertise to get into the social casino gaming field. So it bought Playtika.

Caesars and the other brick and mortar casinos watched with envy as individuals became billionaires offering poker online. Caesars, then named Harrah's, couldn't get into the game, because it would have lost its licenses everywhere it had casinos.

The land-based operators are not about to let that happen again. They saw, before anyone else, that social casino games are the next Internet poker. The games make fantastic amounts of money, and they are basically unregulated.

The potential for growth is fantastic. About one-quarter of all Internet users play social games regularly. No one laughs when experts predict that there will be one billion users within three years.

But the games are beginning to get the attention of regulators. The reasons are obvious, once you realize we are not talking about Farmville®.

True casino games always have some form of random number generator: reels or dice or internal computers. Slot machines, for example, are completely random. And the law often sets the minimum and maximum payouts. In Nevada, a slot machine has to pay out at least 85% and no more than 100% over time.

A social casino games may look like a slot machine, but the mechanics are completely different. Chance is a factor. But the games are never completely random.

Payouts can be varied, even during the middle of a game. There is no law preventing a social casino game from paying out 75% or 125%.

In fact, that is exactly what they do with Dynamic Game Balancing. If a player seems to be losing too much, and they might leave, the game automatically makes winning easier. And if the game seems too easy, so, again, players might get bored and leave, it is programmed to make winning harder.

Games like Candy Crush, the most popular non-casino social game, brag about being addictive. Because they are. But, almost everyone plays for free, so what's the harm?

One concern is "grooming." If non-gamblers play a game that looks like a slot machine but pays out 125%, will they become more likely to gamble for real money? And how long will it take before they realize what the odds are on a true slot machine?

Another concern is the lack of transparency. The European Union looks like it is going to require operators to tell players that the games are not what they seem. Right now, not a single social casino game informs players that the games are not really random.

Age verification can be a problem. Facebook puts its minimum age at 13. But it checks by merely asking people how old they are when they sign up. Reputable social casino games put the minimum age at 18, though most real-money casinos require players to be at least 21. But the checking again is minimal. After all, the games are technically not gambling and can be played for free.

The addictive nature of the games can tempt unscrupulous operators to take advantage of players. The operators have nearly perfect knowledge of their patrons. Once a player has paid money to continue after losing all her chips, it is easy to make the game so attractive that the player will always be close to winning, but will have to pay more and more to continue.

The player's world will be filled with near-misses. And the only way out is to run out of money or time.

END

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Professor I. Nelson Rose is a Full Professor with Tenure at Whittier Law School in California and a Visiting Professor at the University of Macau, an internationally known scholar, author and public speaker, and is recognized as one of the world's leading experts on gaming law.

Prof. Rose is best known for his internationally syndicated column and 1986 landmark book, "GAMBLING AND THE LAW®." He is the co-author of INTERNET GAMING LAW (1st and 2nd editions); BLACKJACK AND THE LAW; GAMING LAW: CASES AND MATERIALS (LexisNexis 2003), the first casebook on the subject; and GAMING LAW IN A NUTSHELL (West 2012). Prof. Rose is co-editor-in-chief of the *Gaming Law Review & Economics*.

Harvard Law School educated, Prof. Rose is a consultant to governments and industry. He has testified as an expert witness in administrative, civil and criminal cases throughout the United States, in Australia and New Zealand, including the first NAFTA tribunal on gaming issues. Prof. Rose has acted as a consultant to major law firms, international corporations, licensed casinos, tribes and local, state and national governments, including the provinces of Ontario and Québec, the District of Columbia, the states of Arizona, California, Delaware, Florida, Illinois, Michigan, New Jersey, Texas, and the federal governments of Canada, Mexico and the United States.

With the rising interest in gambling throughout the world, Prof. Rose has addressed such diverse groups as the National Conference of State Legislatures, Congress of State Lotteries of Europe and the National Academy of Sciences. He has taught classes on gaming law to the F.B.I.; at universities in Spain, France and China; and as a Visiting Scholar for the University of Nevada-Reno's Institute for the Study of Gambling and Commercial Gaming. Prof. Rose has presented scholarly papers on gambling in Nevada, New Jersey, Puerto Rico, Canada, England, Australia, Antigua, Portugal, Italy, Argentina and the Czech Republic.

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