

THE RISE OF SKILL-BASED GAMING REGULATION

American GamingLawyer

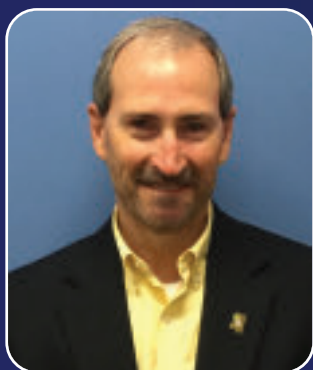
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eSports:
An exponentially
growing market,
but not without risk



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eSports

An Exponentially Growing Market, But Not Without Risk

By Jason Bacigalupi, Glenn Light
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In eSports or competitive gaming contestants compete against live opponents in video games, either online or in person. Players test their skills against friends and strangers alike to win prizes, but also for prestige and bragging rights. Although “eSports” is a recent buzz word in gaming and legal circles, these contests have been happening for over 20 years.

In 2015, industry estimates show that the eSports industry generated total revenue of \$325 million, a 67% revenue increase from 2014. This figure is expected to eclipse \$1 billion in 2019.⁴ Along with increased revenues, eSports spectators have steadily increased—from 204 million in 2014 to 226 million in 2015—and estimates that in 2019, approximately 345 million people will watch eSports. As can be expected with rapidly increasing popularity, notoriety, and revenues, the eSports industry has also faced increased scrutiny and legal challenges. This article will provide a brief overview of eSports, how they are generally analyzed in terms of legality in the United States, and the ancillary betting markets that have arisen from them.

I. eSports Contests

eSports includes a variety of game genres that are played via video game consoles and personal computers. These games include real-time strategy, fighting, first-person shooter, and multiplayer online battle arena. Like traditional sports, eSports has numerous tournament organizers and major tournaments, and total prize money in 2015 was estimated at over \$65 million, with the largest tournaments awarding prize pools over \$1 million.⁶ However, eSports is not just for professionals—anyone who wants to play competitively can challenge their friends (or strangers) in games ranging from Madden 2016 to League of Legends.

From a legal perspective, most jurisdictions in the United States define unlawful gambling as: (1) the award of a prize, (2) determined on the basis of chance or a future contingent event outside of the contestant's control, (3) that requires the payment of consideration. The legality of pay-to-play eSports competitions that award prizes typically depends on them being classified as skill games by removing the element of chance. Skill games have long been segregated from games of chance in American society, from carnival midways to bowling tournaments.

This determination is typically based on the relative degrees of skill and chance present in the game. Under the prevailing theory—the predominance test—one must envision a continuum with pure skill on one end and pure chance on the other. On this continuum, chess, for instance, would be closer to the pure skill end, and slot machines would be closer to the pure chance end. Under the predominance test, if chance predominates over skill in determining the outcome of the game, the activity would be unlawful gambling.

Unfortunately, although prevailing, the predominance test is not universal. Some states prohibit games if chance plays a “material element” in determining win or loss. This makes it more difficult to offer skill games if a chance component is involved in determining outcomes. A few states adhere to an even stricter “any chance” test, which prohibits games that have any element of chance that affects the outcome of the game. Nearly every game has some element of chance, so most skill games will not survive scrutiny in these states, unless another element (prize or consideration) is removed. Finally, some states prohibit pay-for-play skill games regardless of skill level.

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In addition to the above tests, operators must also recognize that several types of chance exist. Systemic chance is the most common, which occurs when the game itself includes chance-based factors, such as a random number generator, throw of a dice, ball draw, or card shuffle. Another type of chance is imperfect knowledge or information. If perfect, everyone would have the same access to information that may affect the outcome of the game—e.g. the rules of the game, factors that can impact the game outcome, and whether information regarding other contestants is instantaneously updated to allow a skilled response. Imperfect information emerges when there are factors that may affect the outcome that are unknown to the game players. For example, even if players had perfect knowledge of nearly every aspect of a game, if they need to make decisions based on unexposed icons or symbols, imperfect information (and chance) exists.

The mere existence of systemic chance and imperfect information do not necessarily make a game chance-based. For example, imperfect information can actually increase the degree that skill affects the game, if users can use skill to assess the situation and respond in a way that increases their chance of winning. A more skilled Tetris player can better adapt his strategy as the Tetriminos are revealed. On the other end of the spectrum, if a skilled player faces two decisions with equal probabilities, where one decision will lead to defeat and the other to success, imperfect information has a

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much larger impact on the game. For example, in Minesweeper, a skilled player may have to guess between two possible mine locations—one of which will end the game. The greater the impact of imperfect information on the result of the game, the greater the risk the game may be found as one of chance.

Therefore, eSports operators, whether at the casual or professional level, must understand the different evaluations of chance under state gaming laws in order to minimize the risk that their operations are found to be illegal gambling.

II. eSports Wagering

In addition to the eSports contests, a multi-billion dollar eSports wagering market has emerged. This includes traditional sports book type wagering and fantasy eSports contests using real money (“Cash Market”), as well as similar types of betting that use “skins” from popular eSports platforms (“Skins Market”).

a. The Cash Market

In the Cash Market, traditional sports book betting accounts for approximately 92.59% of the Cash Market.⁷ Spectators can make straight bets, parlay or proposition bets, and some operators even offer in-game wagering. Several foreign jurisdictions regulate this type of betting, and operators include traditional sports books, such as Bet365 and Ladbrokes, and other eSports-only operators, such as Unikrn. Recent projections of the total handle at these regulated sites is approximately \$550M in 2016.⁸

Currently, there is no regulated eSports wagering offered in the United States. However, Nevada, the largest regulated gambling market in the U.S., is contemplating the expansion of eSports offerings. Nevada has previously limited its eSports involvement to hosting massive eSports tournaments, such as the League of Legends Championship Series Spring Finals and the Street Fighter V World Championship. However, the Downtown Grand, located in the redeveloping Fremont Street area, recently opened an eSports lounge, and hosted the LA Renegades, an eSports professional team, for a two-month period.

Additionally, Governor Brian Sandoval reconvened the Nevada Gaming Policy Committee, a special committee of legal, regulatory, and industry experts that had not been active since 2012, to discuss, among other things, the possibility of eSports wagering. March and May 2016 meetings were held to educate the Committee members on the industry and discuss effective regulation. During the May meeting Governor Sandoval, a former chairman of the Nevada Gaming Commission, acknowledged that eSports wagering is likely allowed under existing gaming regulations. In fact, the CEO of the Downtown Grand indicated that the property had a pending request to approve such wagers. The Committee scheduled a follow-up meeting in August 2016 to discuss the topic further.

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Each of these cases provides some clarity and guidance for game designers on how ‘free play’ and ‘pay-to-play’ can coexist without running afoul of some state laws prohibiting gambling. These lines however are still somewhat blurred when they involve regulated gaming companies, particularly those that are licensed in Nevada.
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the participants must be considered.

b. The Skins Market

The unregulated Skins Market is estimated to be nearly twelve times the size of Cash Market.¹⁰ While recent actions by Valve may have a large negative impact on the Skins Market, at least for the short term, experts suggest the market will continue to grow.¹¹

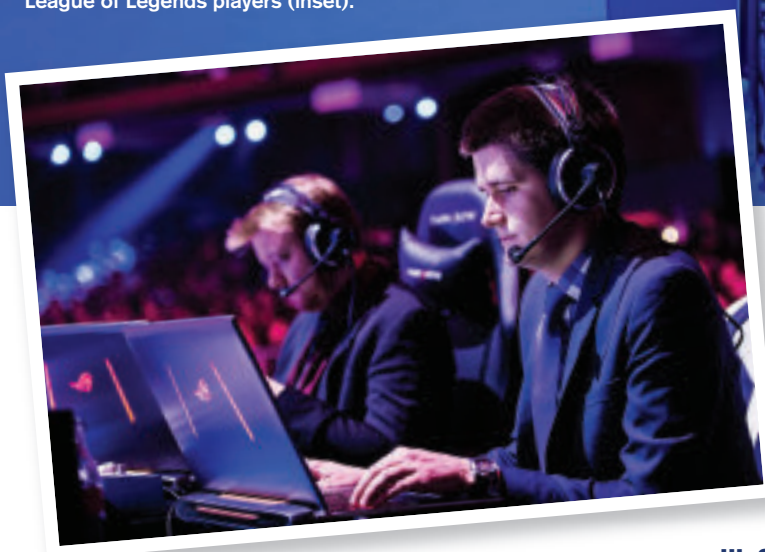
Skins are virtual items that can be used to change the appearance of a player’s in-game avatar, weapons, or equipment. Players acquire these skins through gameplay, promotional giveaways, trading with other players, and purchasing the skins on certain marketplaces. Players can deposit these skins with a skin betting site, and then place sports book style bets, or play lotteries, roulette, or other chance-based games. If they win, the players can request that the site operator transfer their skins back to their accounts. Then the players may use the skins in games, trade them with other players, sell the skins for credits that can be used to buy other skins or games, or exchange skins for cash on third-party website marketplaces.

As evidenced by Valve’s cease and desist letters, there is a growing legal concern that is likely the result of two recent lawsuits filed against Valve accusing the game maker of allowing an “illegal online gambling market” to arise, related to the popular eSports game, *Counter-Strike: Global Offensive*. These suits allege that Valve and third-party sites (CSGO Diamonds, CSGO Lounge and OPSkins) “knowingly allowed, supported, and/or sponsored illegal gambling by allowing millions of Americans to link their individual Steam accounts to third-party websites.”¹² Therefore, skins which can be purchased from Valve, “can ... easily be traded and used as collateral for bets.”¹³

As outlined above, most states define illegal gambling as activities involving prize, chance, and consideration. While skins can be earned, many skins may be purchased directly or by paying money to win skins as a result of random chance, which meets the consideration element. Additionally, as players are able



Main stage at Intel Extreme Masters Electronic Sports World Cup and League of Legends players (inset).



argument that the virtual items do not have monetary value; therefore, there is no prize.¹⁴ However, this argument may fail if the items can be sold or exchanged during gameplay, or if the operator is involved in a secondary market for these virtual items. Therefore, the issue may come down to whether skins are not “pure bragging rights,” and if so, whether the value of the skins would be considered a “prize” under state gambling laws.

III. Conclusion

The eSports market, in both the contest and wagering venues, is a rapidly developing segment of the gaming landscape, poised for continued exponential growth. As such, it is essential that operators, as well as regulators and legal practitioners, remain aware of potential legal and regulatory issues in numerous jurisdictions to mitigate risks of potential criminal gambling liability. ♣

to risk the skins in chance-based activities (sports book type wagering, lotteries, roulette), the element of chance is also satisfied. Therefore, the crucial issue is whether a prize is awarded.

Under state gambling laws, whether a virtual item is a prize remains an unsettled issue. Recent court decisions, which did not involve skins betting, have noted that virtual items that are purely “bragging rights” with no independent value, support a strong

⁴ <https://newzoo.com/insights/articles/global-esports-market-report-revenues-to-jump-to-463-million-in-2016-as-us-leads-the-way/>

⁵ *Id.*

⁶ <http://www.esportsearnings.com/history/2015/games>

⁷ <http://www.esportsbettingreport.com/guide/>. According to this site, the other portions of the Cash Market are made up of fantasy eSports (2.69%), which is similar to DFS, and head-to-head wagering (4.71%), where players wager on the outcomes of eSports matches they participate in.

⁸ *Id.*

⁹ Examples include a prominent eSports company, Valve, permanently banning 21 Counter-Strike professionals, and the indictment of 10 persons by South Korean authorities for alleged match-fixing in StarCraft competitions, where the sums paid to the alleged cheaters were larger than the prize pools.

¹⁰ <http://www.esportsbettingreport.com/guide/> (Showing a projected Cash Market in 2016 of \$590M vs. a projected Skins Market of ~\$7B)

¹¹ *Id.* In July 2016, Valve issued cease-and-desist notices to 23 skin gambling sites. At the time of writing, a handful of the sites have closed, but most continue to operate.

¹² <http://arstechnica.com/gaming/2016/07/mom-takes-on-valve-third-party-trading-sites-alleges-illegal-scheme/#p3>

¹³ *Id.*

¹⁴ See e.g. *Phillips v. Double Down Interactive LLC*, No. 15 C 04301, 2016 WL 1169522, at *1 (N.D. Ill. Mar. 25, 2016)(alleging Double Down Casino games were unlawful gambling devices under Illinois law) *Kater v. Churchill Downs Inc.*, No. C15-612 MJP, 2015 WL 9839755, at 1 (W.D. Wash. Nov. 19, 2015)(seeking recovery of monies paid to a social casino game provider because the monies were lost to an “illegal gambling operation.”)