

Illinois Video Gaming Act and Emergency Rules: What You Need to Know

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I. INTRODUCTION

On July 13, 2009, Governor Patrick Quinn passed into law the Illinois Video Gaming Act, 230 ILCS 40/1 et al. (the "**Act**"), legalizing the operation of video gambling machines in "any licensed retail establishment where alcoholic liquor is drawn, poured, mixed, or otherwise served for consumption on the premises,"^[1] including bars, truck stops, and fraternal and veterans organizations ("**Establishments**") throughout the state.

Passage of the Act has created a great deal of both excitement and confusion among those individuals and business entities interested in participating in the burgeoning industry.

The Illinois Gaming Board (the "**Board**" or "**IGB**") is responsible for the administration and enforcement of the Act, including the promulgation of rules governing the operation and regulation of the video gaming terminals ("**VGTs**"). These VGTs are essentially the same state-of-the-art video poker, blackjack, and slot machines found in Las Vegas and Atlantic City casinos as well as in Illinois riverboat casinos. As required under the Act, the Board issued an initial set of emergency rules on October 19, 2009 (the "**Emergency Rules**"). The Emergency Rules are only effective for 150 days. Simultaneously with the issuance of the Emergency Rules, the IGB issued an identical (initial) set of rules to go through the administrative rulemaking process. Those rules were subject to public comment and the initial set of adopted rules, which will be in place upon expiration of the Emergency Rules, will reflect changes as outlined by the IGB at its January 13, 2010 meeting. While the Emergency Rules are unlikely to be identical to the Final Rules, they do shed significant light on how the Board will address various issues.

II. VIDEO GAME TERMINALS (VGTs)

A. General Overview

"Video Gaming Terminals" are defined in the Act as "any electronic video game machine that, upon insertion of cash, is available to play or simulate the play of a video game...utilizing a video display and microprocessors in which the player may receive free games or credits that can be redeemed for cash."^[2] VGTs do not include machines that directly dispense coins, cash, or tokens, or are for amusement purposes only. The only item of value that a VGT is permitted to dispense is receipt tickets. These tickets shall be dispensed by pressing the ticket dispensing button on the VGT at the end of one's turn of play.

The receipt tickets shall indicate the total amount of credits earned, the cash award therefor, the time of day

in a 24-hour format showing hours and minutes, the date, the terminal serial number, the sequential number of the ticket, and an encrypted validation number from which the validity of the prize may be determined. The player shall turn in his tickets to the appropriate person at the Establishment to receive his cash winnings.

The odds of winning each video game must be posted on or near each VGT. The manner in which these odds are calculated shall be determined by the Board. No VGT may be played except during the legal hours of operation allowed for the consumption of alcoholic beverages at the particular Establishment in which the VGT is located.

The maximum number of VGTs permitted in any one Establishment is five (5). The maximum wager on any one hand shall not exceed two dollars (\$2). The maximum payout on any one hand shall not exceed five hundred dollars (\$500).

B. Testing

Pursuant to the Act, the Board may utilize an independent test laboratory to establish minimum standards for the VGTs and to test the VGTs for satisfaction of these standards. The Board recently announced its selection of Gaming Laboratories International, LLC to serve as the independent test lab. The Act sets forth a number of additional requirements that each VGT must satisfy, including that they must:

- pay out at least 80% of all amounts played over the expected life of the machine;
- use a random selection process to determine the outcome of each play of a game which process must meet 99% confidence limits;
- display an accurate representation of the game outcome;
- not automatically alter pay tables or any function of the VGT based on internal computation of hold percentage or have any means of manipulation that affects the random selection process or probabilities of winning a game;
- be able to display complete play history for the 11 most recent games;
- have a payback percentage incapable of being changed without changing hardware or software; and
- have non-resettable meters housed in a locked area of the machine that keeps a permanent record of all cash inserted, winning receipts printed, credits played, and credits won.

III. PRODUCTION, DISTRIBUTION AND OPERATION OF VGTS

With respect to the production, distribution, and operation of the VGTs, the Act creates a four-tiered structure with the entities at each tier requiring licensure by the Board. The four tiers are: (i) manufacturers, (ii) distributors, (iii) terminal operators and (iv) Establishments.^[3] The manufacturers shall manufacture and assemble the VGTs and sell them to licensed distributors. The distributors shall sell, lease or distribute VGTs, or major components or parts thereof, to licensed terminal operators. The operators shall own the

VGTs and shall be responsible for installing them in licensed bars and other Establishments as well as for maintaining and repairing the VGTs.

The Act expressly prohibits manufacturers and distributors from being licensed as operators or owning, managing or controlling an Establishment.^[4] Operators are prohibited from being licensed as manufacturers or distributors, and from owning, managing or controlling an Establishment. Establishment owners or managers are prohibited from being licensed as manufacturers, distributors or operators. It is noteworthy that there is no express prohibition in the Act on manufacturers also being licensed as distributors.

All licensees must comply with the Act, the Rules and all other federal, state and local laws and regulations. In addition to such general duties applicable to all licensees, each type of licensee must also comply with certain specific requirements.

A. Manufacturers

Manufacturers' responsibilities include^[5]:

- maintaining an inventory of equipment to ensure the timely repair and continued operation and play of the VGTs; and
- providing technical assistance and training.

B. Distributors

Distributors' responsibilities include^[6]:

- selling, distributing, leasing and/or marketing only VGTs that have been tested and certified for use in Illinois by the independent test lab; and
- providing technical assistance and training.

C. Terminal Operators

(1) Responsibilities

Operators' responsibilities include the following^[7]:

- primary responsibility for the operation and maintenance of the VGTs;
- primary responsibility for payment to the State of VGT revenue taxes;
- maintaining a bank account for the deposit of VGT revenues that allows for tax payments to the State to be made by electronic fund transfer;^[8]
- providing, directly or through a licensed manufacturer, distributor, supplier or technician, an inventory of

- equipment to ensure the timely repair and continued, approved operation of its VGTs;
- maintaining an approved method of payout for valid receipt tickets;
- assuming responsibility for VGT malfunctions, including any claim for the payment of credits arising therefrom;
- entering into a written use agreement with each licensed Establishment in which it places VGTs, and keeping the use agreements on file in the operator's place of business and available for inspection by individuals authorized by the Board;
- obtaining and installing all hardware, software and related accessories necessary to connect its VGTs to a central communications system (the '**Central Server**');
- responding to service calls within a reasonable time;
- immediately removing all VGTs (i) upon order of the IGB or an IGB agent; or (ii) that have been inoperable for more than 72 hours; and
- not installing, removing or relocating any VGT without the prior approval of the IGB's Administrator or his designee.

(2) Prohibition on Inducements

Operators are expressly prohibited from offering or providing anything of value to an Establishment, or an agent or representative thereof, as an incentive or inducement to place VGTs at the Establishment. For example, providing a loan or other financing to an Establishment would run afoul of this prohibition..

(3) Cap on Market Share

The Act currently prohibits any single operator from owning or having a substantial interest in more than five percent (5%) of the VGTs licensed in the State.

D. Establishments

(1) Responsibilities

Establishments' responsibilities include the following^[9]:

- maintaining its liquor license in good standing;
- providing a secure area for the placement, operation and play of VGTs;
- ensuring that VGTs are placed in a designated, approved location, with restricted visibility from areas outside the business, which location must be within the view of at least one employee over 21 years of age;
- if minors are allowed to enter the Establishment, placing the VGTs in a separate area inaccessible by minors;
- preventing access to and play of VGTs by persons under 21 or who are visibly intoxicated;

- ensuring that all connections with the Central Server are maintained and preventing any tampering or interference therewith;
- accepting nothing of value from an operator or an agent or representative thereof as an incentive or inducement for the placement of VGTs at the Establishment;
- immediately removing all VGTs (i) upon order of the IGB or an IGB agent; or (ii) that have been inoperable for more than 72 hours;
- entering into written use agreements with licensed operators;
- promptly reporting all VGT malfunctions and out-of-service VGTs to the operator;
- promptly notifying the IGB of an operator's failure to service and repair VGTs within 24 hours after notice of malfunction from the Establishment;
- promptly notifying the IGB of any unauthorized or illegal VGTs (i.e. "grey machines");
- maintaining an approved method of payout for valid receipt tickets;
- maintaining insurance coverage on all VGTs in an amount set by the IGB; and
- allowing maintenance and/or service of VGTs and associated equipment only by licensed technicians and licensed terminal handlers.

(2) Valid Liquor License Required

In order to obtain and maintain a video gaming license, an Establishment must possess a valid liquor license issued by the Illinois Liquor Commission that is in good standing at the time the gaming license application is filed and at all times thereafter during which one or more VGTs are operated at the Establishment. As such, if an Establishment loses its liquor license, even on a temporary basis, the VGTs in the Establishment must be immediately shut down until the liquor license is reissued or reinstated.

(3) Restrictions on Location of Establishments

VGTs are prohibited in any Establishment that is:

- within 1,000 feet of any casino, riverboat casino, racetrack or off-track betting parlor; or
- within 100 feet of any school or place of worship.

IV. LICENSING

A. Background Investigation of Applicants

Each entity seeking to be licensed as a VGT manufacturer, distributor, operator, Establishment or otherwise must submit to a background investigation conducted by the IGB. This investigation shall include each partner of a partnership and each director and officer and all stockholders owning five percent or more of the outstanding shares of a corporation. The burden is on each applicant to demonstrate his suitability for

licensure.

Each applicant must disclose the identity of every person, association, trust, or corporation having a greater than one percent (1%) direct or indirect monetary interest in the entity. If the applicable entity is a partnership, the names and addresses of all general and limited partners must be disclosed. If the applicable entity is a corporation, the names and addresses of all directors and stockholders must be disclosed^[10]

In addition, the Board may not grant any license until it is convinced that the applicant has satisfied a number of additional qualifications, including that said applicant:

- is a person of good character, honesty and integrity;
- is a person whose background, including criminal record, reputation and associations, (i) is not injurious to the public health, safety, morals, good order and general welfare of the people of the state, (ii) does not tend to discredit the Illinois gaming industry or the state, (iii) does not adversely affect public confidence and trust in gaming or pose a threat to the security and integrity of video gaming;
- does not present questionable business practices and financial arrangements incidental to the conduct of video gaming activities or otherwise;
- does not associate with, either socially or in business affairs, or employ persons of notorious or unsavory reputation;
- demonstrates that it has adequate financing for the proposed business and that the source of financing satisfies the same list of qualifications; and
- that the applicant has disclosed all persons with significant influence or control over it.

B. Residency Requirement

Under the Act, each distributor and operator, as well as anyone with a "substantial interest" therein, must be an Illinois resident; provided, however, that if an out-of-state distributor or operator has performed its respective business within Illinois for at least 48 months prior to the effective date of the Act, the out-of-state person may be eligible for licensing, upon IGB approval. The "substantial interest" threshold is relatively low. With respect to a partnership, participation in the partnership profits by a person or his spouse constitutes a "substantial interest." For a corporation, if a person or his spouse holds five percent (5%) or more of any class of stock, or serves as an officer or director of the corporation, that constitutes a "substantial interest." For any other type of organization, if an individual or his spouse owns or controls ten percent (10%) or more of its assets, serves as an officer, or manages the business affairs of the organization, the individual is deemed to have a "substantial interest" in said organization. Even if not considered someone with a "substantial interest" based on the applicable tests set forth above, any individual or spouse that provides five percent (5%) or more of the capital for the operation of a business during any calendar year, whether in the form of cash, goods or services, is deemed to have a "substantial interest" in the business.

The residency requirement set forth in the Act has been a source of significant confusion among companies intending to participate in the Illinois VGT industry. The IGB attempted to clarify the requirement in the Emergency Rules. The definition of "Illinois Resident" in the Emergency Rules is as follows:

(1) With respect to an individual, an individual who maintains a bona fide full time primary place of abode in this state, and does not claim to be a resident of any other state for any purpose whatsoever. Evidence of residency may include affidavits, voter registration, automobile registration or driver's license, filing of income tax returns as a resident of this state for the preceding calendar year, home ownership or rental agreements, club and/or organizational memberships and participation, and telephone or utility usage.

(2) With respect to a corporation, any corporation organized under the laws of this state and any foreign corporation with a certificate of authority to transact business in Illinois. A foreign corporation not authorized to transact business in this state is a nonresident of this state.

(3) With respect to a partnership, a partnership in which any partner is an Illinois resident, or where the partnership has an office and is doing business in Illinois.

(4) With respect to an irrevocable trust, a trust where the grantor was an Illinois resident individual at the time such trust became irrevocable. [\[11\]](#)

However, based on public comments it received, the IGB approved a broader residency definition for individuals in its adopted rules at its January 2010 meeting. Specifically, the IGB decided that if an individual has a home in Illinois or is subject to filing a tax return in Illinois (on a going forward basis), said individual shall be considered an "Illinois Resident" for purposes of the Act. As such, it appears that where an out-of-state company forms an Illinois entity to conduct business under the Act, the Illinois entity may have out-of-state owners as long as those individuals file an Illinois tax return with respect to income earned in Illinois.

C. Grey Market Issues

The Act provides that any Establishment used for the conduct of gambling games in violation of this Act shall be considered a gambling place in violation of Section 28-3 of the Criminal Code of 1961. Any license issued under the Liquor Control Act of 1934 to any owner or operator of an Establishment that operates or permits the operation of a VGT in its Establishment in violation of this Act shall be immediately revoked.

The Act provides that no person may own, operate, have in his or her possession, custody or control, or permit to be kept in any place under his or her possession or control, any device that awards credits and contains a circuit, meter, or switch capable of removing and recording the removal of credits when the award of credits is dependent upon chance. Any VGT licensed under the Act is excluded from said prohibition. A

violation of this prohibition constitutes a Class 4 felony.

A VGT operated for amusement only and bearing a valid amusement tax sticker issued prior to the effective date of the Act shall not be subject to the above-referenced prohibition until the sooner of (i) the expiration of the amusement tax sticker, or (ii) 30 days after the Board establishes that the Central Server is functional. As always, a pure amusement game without the above-mentioned equipment shall remain legal even following the expiration of the tax sticker.

D. Renewal; Transfer; Revocation

Unless sooner cancelled or terminated, all licenses issued by the IGB are renewable annually. No license under the Act is transferable or assignable. A person who has had his or her license revoked by the IGB may not reapply for a license without permission from the IGB.

V. TAXES; DISTRIBUTION OF REVENUES

The State imposes a tax of thirty percent (30%) on VGT revenues. Five-sixths (5/6) of the VGT revenue taxes (which amounts to 25% of the VGT revenues) shall be deposited into the state's Capital Projects Fund. The remaining one-sixth (1/6) of the taxes (which amounts to 5% of the VGT revenues) shall be deposited with the Local Government Video Gaming Distributive Fund. While the tax obligations are borne equally by the operator and Establishment, the operator is responsible for setting up the bank account which shall allow the tax payments to be made by electronic fund transfer.

The tax on VGT revenues shall be reported and remitted to the IGB by the applicable operator within 15 days after (i) the 15th day of each month, and (ii) the end of each month. All tax payments not timely paid by the operator shall accrue interest at a rate of 1.5% per month. The 70% of VGT revenues remaining after payment of the above-referenced taxes shall be divided evenly between the operator and Establishment.

VI. CENTRAL SERVER

All VGTs in the State shall be linked by a central communication system (the "**Central Server**") to provide auditing program information as approved by the IGB. The Central Server shall be capable of enabling the Board or its designee to activate or deactivate individual VGTs from the Central Server.

On December 30, 2009, the IGB issues the Central Server RFP. The proposals were due on February 16, 2010. The IGB recently announced that it has received proposals responding to the RFP from (i) New Way Gaming Corp., (ii) Scientific Games International, Inc., (iii) Technology Exclusive, Inc., (iv) GTECH Corporation and (v) INTRALOT, Inc.

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[1] 230 ILCS 40/5

[2] Id.

[3] In addition to the four primary types of video gaming licenses, the Act also provides for the issuance of a technician's license and a terminal handler's license. Technician's License. A person may not service, maintain, or repair a VGT in the State unless he or she (i) has a valid technician's license issued under the Act, (ii) is a terminal operator, or (iii) is employed by a terminal operator, distributor or manufacturer. Terminal Handler's License. No person shall have possession or control of a VGT, or access to the inner workings of a VGT, unless the person possesses a valid terminal handler's license issued under the Act.

[4] 230 ILCS 40/30

[5] §1800.230 of the Emergency Rules.

[6] §1800.240 of the Emergency Rules.

[7] §1800.250 of the Emergency Rules.

[8] The Emergency Rules provided that operators would need to maintain a separate bank account for each Establishment. However, at its January, 2010 meeting, and pursuant to public comment, the IGB determined that this would be unduly burdensome and revised this requirement accordingly.

[9] §1800.270 of the Emergency Rules.

[10] There has been some confusion as to whether a limited liability company ("**LLC**") is eligible for licensure under the Act. The language of the Act consistently refers to the different requirements for applicants that are corporations, partnerships or irrevocable trusts, without mentioning the requirements for an LLC. In addition, in a question and answer session posted by the IGB on their website, the Board makes clear that "the Video Gaming Act does not allow a limited liability company to hold a license."

[11] §1800.110 of the Emergency Rules.