



Sports Betting In California: Two Initiatives On The Ballot

When voters in the worlds 5th-largest economy go to the polls in November 2022, their choices will shape the future of sports betting as John K Maloney outlines.

Voters in California have the opportunity in the general election on November 1st to approve sports betting in California. There will be two sports betting initiatives for them to decide on: Proposition 26, backed by many Native American Tribes (the “Tribes”), which does not permit mobile and online sports betting, and Proposition 27 which is backed by some of the largest sports betting operators in the US, and which does permit mobile and online sports betting. The following discussion will review these two initiatives. Is either one in the best interest of the consumers and taxpayers in California? In order to properly answer this fundamental question, it is imperative first to understand the sports betting market.

Overview

California is the 5th-largest economy in the world. It is the most populous state in the United States, with approximately 40 million residents. California has a GSP (“Gross State Product”) of US\$3.4 trillion. There is a great opportunity

to offer to the consumer in California a sports betting infrastructure that is sophisticated, entertaining and is user friendly. There is an opportunity to ensure that the billions of dollars that are bet with offshore books stay in California. It is a rare opportunity to become the number one sports betting jurisdiction in the world.

In a perfect world, sports betting in California would offer the consumer both in person and mobile and online sports betting. This is not conjecture. One only needs to look at New Jersey as an example of how mobile and online sports betting creates a dramatic increase in handle. Mobile and online sports betting is user friendly and offers a convenient, hassle free form of entertainment. Many sports bettors enjoy the atmosphere of the big screen televisions and the opportunity to relax and maybe enjoy a meal that a brick and mortar venue provides. However, in California many tribal casinos and horse race tracks are in remote locations or otherwise inconvenient to travel to placing an effective limit on the opportunities to wager. As a result, from the perspective of the California taxpayer, millions of dollars

of tax revenues will continue to leak without mobile and online sports betting. Very simply, if one of the goals is to maximize handle and keep wagers from going offshore, then mobile and online sports betting should be an option for the consumer; mobile is money and money is mobile.

The argument against mobile and online sports betting is that it will increase the likelihood of underage and problem gambling. It goes without question that the consumer must be protected in order to maintain the integrity of the sports betting industry. The opportunity to place unregulated wagers with sports books offshore currently exists: that is a fact. It is also a fact that the unregulated offshore sports books provide absolutely no protection for their players. A legal, regulatory infrastructure in California would offer the consumer infinitely better protection than the offshore sports books.

The sports betting companies that will enter California will be some of the best sports betting companies in the world. Sophisticated compliance plans that incorporate Know Your Customer (“KYC”) and Anti-Money Laundering (AML) policies are required by every licensed sports betting company. Every state that has legalized sports betting has regulations requiring sports betting companies to comply with their respective KYC and AML procedures. The sports betting operators are licensed in a “privileged industry” and the key to ongoing success is maintaining those licenses in good standing. One only has to review their regulatory backgrounds to understand that the sports betting companies involved with the initiative in California are very sophisticated. Maintaining gaming licenses in jurisdictions like Nevada and New Jersey is not easy and the compliance requirements in these jurisdictions are sophisticated and costly to maintain.

The California sports bettor will be looking for betting options from the sports book operators and artificial barriers to entry may limit competition driving the sports bettors to the offshore sports books. There are many tribal casinos in California and this indicates there are opportunities for sports book operators in California. There are also well-regulated cardrooms in California and in many cases the cardrooms are the biggest taxpayers to the local cities they operate in. If cardrooms were allowed to operate sports books further possibilities are added for operators who are ultimately licensed in California. There are also the horse race tracks who would add a third tier to the groups allowed

to operate sports books in California. Another option would be to allow sports books to operate solely mobile and online operations and have the option of being associated with a brick-and-mortar casino. Sports events are different from casino games that fall under the strict rules and surveillance of the casinos. Every slot machine and table game has some sort of surveillance oversight. In contrast, the sporting events may not even occur in the same state and take place outside of the casino surveillance systems. If this is the case, why then do sports books have to be tied to an existing licensee such as a tribal casino in California?

There are many possible locations to operate sports books even if the online option without any nexus to a brick and mortar is not available. The issue then is whether there are going to be enough licensed qualified operators to fill all the available opportunities in California. Even if only the tribal casinos and horse race tracks are locations where sports books can operate, will there be enough operators? The high costs of entry into the market will keep out smaller operators who may be just as qualified to run a sports book in California. There are many companies in Europe and Latin America who have been operating sports books for decades arguably gaining experience of much more sophisticated operations than the sports books currently operating in the US market. Is it in the best interest of the California sports bettor to have limited choices?

Another barrier to entry is a proposed requirement that the sports book operators are currently conducting business in a specified number of states. The primary California gaming regulatory authority is currently the Tribal Gaming Agency that is tasked with the gaming regulatory oversight for each tribal casino. There are examples in California whereby a tribal gaming agency had the authority to grant transactional approvals if a certain vendor for the tribal casino was licensed, for example, in Nevada. After all, a review conducted by the regulators in Nevada is very comprehensive and recognized by many as the most difficult in the gaming industry. This is fair and rewards quicker access to those entities that have successfully navigated the regulatory review process in Nevada. However, to bar other operators from entering the sports betting market in California because they do not currently operate in a certain number of jurisdictions makes no business sense except to the big operators. In fact, many smaller operators have attempted to gain access to sports betting markets in the

US, but the limited number of opportunities makes it very difficult to meet an arbitrary standard that big operators know cannot be met except by a few, namely themselves. It is also, quite frankly, insulting to the regulatory review process in California, the taxpayer, and the consumer. Competition breeds creativity and innovation and the opportunities for sports betting operators in California are endless. This in turn creates a rich robust market for the consumer.

Still another barrier to entry would be language that takes the discretion away from the regulatory review process and under certain circumstance bars entry based on prior bad events.

Discussion of the proposed initiatives

After considering the aforementioned discussion, it is important to understand what the voters in California are going to be presented with in the November ballot. At the outset there were four initiatives but that has been reduced to two. The cardrooms had an initiative but were unable to generate enough signatures to appear on the November ballot. The cardrooms are not included as potential sports betting locations in either of the two surviving initiatives. In fact, Proposition 26, the tribal initiative, appears to place restrictions on the current operations of the cardrooms. This is disappointing as the cardrooms are vital from a tax and employment perspective to the local communities they serve.

Proposition 26

The *California Sports Wagering Regulation and Unlawful Gambling Enforcement Act* (known as Proposition 26) is supported by many Native American Tribes. Passage of Proposition 26 would allow the tribal casinos and the four horse race tracks in California to offer sports betting. In addition, it would allow the tribal casinos to offer *roulette and games played with dice* which are currently prohibited in tribal casinos.

There is also discussion of allowing civil suits to be brought against entities for violations beginning with Section 330 of the Penal Code. This is an interesting addition because it appears the underlying purpose is to make it easier to bring lawsuits against the cardrooms if it appears the cardrooms are offering banking games.

The initiative requires sports bettors to physically go to the race track or tribal casino to place wagers. There is no mobile or online wagering component.

The approved race track operators would pay a 10 percent

tax based on wagers placed minus payouts. The tracks are operated by private entities and are located in Alameda County, Los Angeles County, Orange County and San Diego County. The approved race tracks do not include tracks at state designated fairs.

The Tribes would be required to reimburse the State of California for the costs to enforce and regulate the sports betting industry. The 10 percent tax does not apply to the Tribes, only the race track operators. The initiative prohibits the placing of wagers on college teams located in California.

Proposition 27

The *California Solutions to Homelessness and Mental Health Act* (known as Proposition 27) is supported by large sportsbook operators currently operating in many other states. The sportsbook operators include DraftKings, BetMGM, and FanDuel.

Proposition 27 would allow sports betting over the internet and on mobile devices for persons aged 21 years or older physically present in the state but outside of Indian lands. It is state regulated in contrast to current regulation over the tribal casinos. Nothing will change with the current regulation over the tribal casinos, the respective Tribal Gaming Agencies are still the primary regulatory body.

In contrast to Proposition 26, sports betting would be done remotely and will not occur on Indian lands. Registration for an online account can also be done remotely. The race tracks are not included in the online sports betting bill. The California gaming Tribes currently do not have exclusivity over sports betting, unlike casino style gaming.

The gaming Tribe that wants to offer sports betting under their name would pay a one-time fee of US\$10 million dollars and a renewal fee of US\$1 million dollars every five years. Under this scenario, the gaming tribe would be issued an online sports betting operator license, tribal operator license.

Each of the gaming companies that qualifies to be an online sports betting operator in California would pay a one-time fee of US\$100 million dollars and a renewal fee of US\$10 million dollars every 5 years. Under this scenario, the sportsbook operators would be issued an online sports betting operator license, would need to negotiate a market access agreement with a gaming Tribe to operate a sportsbook, and would receive a qualified gaming entity operator license.

It must be noted that a Qualified Gaming Entity must also



be currently operating online sports betting in ten (10) US States or Territories or operating online sports betting in at least five (5) US States or Territories and operate or manage at least twelve (12) casinos (equivalent of Class III gaming) physically located in the US.

A third option for an online sports betting operator license is an online sports betting platform provider operator license. Under this scenario, the platform provider would need to enter into an operating agreement with a gaming Tribe and would provide to the Tribe an online sports betting platform.

An online sports betting operator license would authorize the holder to operate one online sports betting platform. A 10 percent tax would be paid by the tribal casino offering sports betting under its name and a 10 percent tax would be paid by the sports betting companies that are operating the sports book at the tribal casino.

The initial licensing application fee would be a minimum of US\$150,000, but not to exceed US\$250,000. Once certain requirements are met and information is confirmed by the state regulators, a temporary license shall be issued by the regulators within 30 days of the request. Such requirements include, but are not limited to, payment of the application fee, payment of the one-time fee and provision of a complete application to the regulators confirming a history of compliance in the sports betting gaming industry. The applications would also cover issues such as criminal history and bankruptcy. The renewal licensing application fee is US\$50,000 after the initial five-year period.

A supplier would need to obtain an *online sports betting supplier license*. The initial licensing application fee is US\$25,000, but not to exceed US\$40,000. There is a one-time fee of US\$100,000 for the supplier license and the license is valid for five years. The renewal fee would be US\$10,000 after the initial five-year period. There would also be a temporary license option if the supplier submits a completed application and can demonstrate that it is offering the same services to online operators in two other states. Once a temporary license is requested after meeting the prerequisites, the regulators shall issue a temporary license within 30 days of the request.

Key persons would be required to pay a minimum application fee of US\$2,400, but not to exceed US\$10,000. A licensing fee of US\$750 would also be required. If the key person is licensed in another jurisdiction with online gaming, it is possible the key person will receive a temporary

license. The multijurisdictional form used in other jurisdictions would be used by the regulators in California. The renewal fee would be US\$500 and the license fee US\$750.

There is discussion of approvals by independent testing labs. Companies such as GLI and BMM have vast experience in testing, not only in the US but around the world.

A Division of Online Sports Betting Control (the “Division”) would be established under the California Department of Justice to regulate mobile and online sports betting. The Division would issue the online sports betting operator licenses, sports betting platform provider operator licenses, supplier licenses and approve key persons under the categories described above. The Division would have exclusive power, authority and jurisdiction over sports betting in California.

An Online Sports Betting Independent Advisory Committee (the “Committee”) within the Division would be created. The Committee would, among other things, recommend technology to prevent wagers being placed by persons under 21, best online practices and drafting new regulations. Compensation of Committee members would be US\$150 per diem, not to exceed 40 days in a calendar year.

The effective date of Proposition 27 would be January 1 following the approval of California voters.

Conclusion

The Proposition 27 initiative from the sports betting operators is very detailed and clearly lays out what it takes to enter the sports betting market in California. It is also solely regulated by a new Division of the California Department of Justice. There would be no primary jurisdiction given to the Tribes as there is under the current compacts in California. Wagers cannot be accepted from tribal lands.

That said, the Proposition 27 initiative has exclusionary language which will keep out competitors. The US\$100 million dollar license fee is huge and severely restricts competition. The requirement to have a Qualified Gaming Entity operating in a certain number of jurisdictions present is an onerous one. Only a small number of sports betting operators can meet that burden due to the fact that competition is fierce for existing skins in states that have legalized mobile and online sports betting. This also cuts out the many operators that have been successfully operating mobile and online sports betting businesses in overseas jurisdictions.

The language that requires licensing fees to be capped is interesting. It is best to leave discretion in the statute and allow the regulators to do their jobs, including costs to investigate respective applicants.

From a pure compliance point of view, approval of Proposition 27 would mean that California would be getting some of the most compliant sports betting operators on the planet and that bodes well for the state. The customer is important, and these companies understand that. The online and mobile sports betting component is critical to keeping future sports betting tax dollars in California.

The Proposition 26 tribal initiative is very straight forward and does not have the same detail as Proposition 27. Most significantly, there would be no online and mobile gaming and the race tracks are included. The sports bettor would be forced to physically place wagers in person at the respective race tracks or tribal casinos. The Bureau of Gambling Control would have oversight from the state perspective, and it appears the Tribal Gaming Agencies would still be the primary regulatory body for the tribal casinos.

Only the race tracks would pay a 10 percent tax and the tribal casinos would reimburse the Bureau of Gambling Control for the state regulatory oversight of sports betting. There is no provision for one time licensing fees in Proposition 26.

The artificial barriers discussed in Proposition 27, such as very high licensing fees and requirements that sports betting operators be currently operating in other jurisdictions, are not present. It appears that the tribal casinos and race tracks can negotiate contracts without such disqualifiers.

The mobile and online option will provide significantly greater tax revenues (many

millions of dollars) than the in-person option. It is difficult to comprehend how a debate can exist on this particular issue.

In all events, the big losers are the California cardrooms. This is important because the cardrooms exist in a highly regulated environment in California and, as noted already, are in some cases the biggest taxpayers to the local communities. They are also employers providing real wages to employees.

It is possible that both Propositions could be approved by the California voters. If so, what happens then? Will there be ensuing litigation? The big issue is if the initiatives are in conflict with each other; if not and both Propositions are approved then both could become law. In that case, do some of the tribal casinos enter into contracts with the sports betting operators? The answer is in all likelihood yes.

In a perfect world, California voters should have the option to approve both on site and mobile and online sports betting at the tribal casinos, race tracks and cardrooms as well as on independent mobile and online sports books. Moreover, the US\$100 million license fee should be reduced to a more reasonable level to open up competition for the licenses. This would maximize California's tax revenues from sports betting and establish a well-regulated sports betting industry that would effectively compete with and largely eliminate the unregulated offshore sports betting industry in California. But that is not what the California voters have before them in the November election. Nonetheless, passage of both Proposition 26 and Proposition 27 would be a clear message that California voters want to have a broad spectrum of on site and mobile and online sports betting venues available for placing legal, well-regulated sports bets in California.



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