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Memorandum

April 26, 2003

TO: Class II Gaming Consortium

FROM: Hobbs, Straus, Dean & Walker, LLP

RE: Characteristics of Class II Technologic Aids – Supplemental Discussion.

This memorandum supplements the March 11, 2002, Memorandum on Characteristics of Class II Technologic Aids and Guidelines for Bingo and Pull-Tab Games Played With Class II Technologic Aids in light of the National Indian Gaming Commission's ("NIGC") new definition regulations published on June 17, 2002,[1] the Justice Department's analysis of the new definition regulations set forth in its brief in the MegaNanza case of July 18, 2002,[2] the recent decision by the Eighth Circuit Court of Appeals in United States v. Santee Sioux Tribe, __F.3d__, No. 02-1503 (8th Cir. Mar. 20, 2003), and the decision last week by the Tenth Circuit in Seneca Cayuga Tribe v. National Indian Gaming Com'n, __F.3d__, No. 01-5066 (10th Cir. April 17, 2003). As set forth below, we do not believe that the new definitions alter the conclusions expressed in our earlier memorandum and guidelines, but rather the changes significantly strengthen most of those conclusions by harmonizing the new NIGC regulations with applicable judicial precedent in a manner that is entirely consistent with our earlier analysis. Further, as discussed below nothing in the Justice Department's analysis causes us to change our views. In the case of the Eighth Circuit's decision, we note that although the court affirmed the district court's determination that the Lucky Tab II pull-tab dispenser is Class II, some aspects of the court's

[1] 67 Fed. Reg. 41,166, 41,172 (June 17, 2002) (amending 25 C.F.R. §§ 502.7 and 502.8, effective July 17, 2002). (The Federal Register Notice is attached hereto as Appendix A.)

[2] Multimedia Games, Inc., the manufacturer of MegaNanza, filed suit challenging the advisory opinion. The U.S. District Court for the Northern District of Oklahoma dismissed the case on procedural grounds on September 9, 2002. Multimedia Games Inc. v. United States *ex rel.* NIGC, No. 02-CV-296-P[J] (N.D. Okla. Sep. 9, 2002). Before that dismissal, the court had issued a preliminary injunction enjoining the NIGC from enforcing notices of violation requiring the discontinuance of the MegaNanza game. Multimedia Games Inc. v. United States *ex rel.* NIGC, Magistrate's Report and Recommendation (filed June 21, 2002); Multimedia Games Inc. v. United States *ex rel.* NIGC, Order (June 24, 2002). In recommending that the court issue a preliminary injunction, the magistrate in that case stated that "Plaintiff presents a cogent argument . . . that in accordance with current case law and the recently enacted regulations, the MegaNanza machines should be classified as a class II game." Magistrate's Report and Recommendation at 12. Multimedia appealed the dismissal to the Tenth Circuit Court of Appeals. However, prior to any decision on appeal, Multimedia entered into a settlement agreement with the NIGC and the Justice Department on March 11, 2003. Under that agreement, Multimedia agreed to dismiss its challenge to the NIGC's advisory opinion that MegaNanza is Class III in exchange for expedited review by the NIGC of a "substitute" game. Multimedia also agreed to withdraw all MegaNanza games within 45 days of the issuance of the classification opinion on the substitute game. We understand that discussions between Multimedia and the NIGC are ongoing.

analysis conflict with our analysis and the analysis of other federal courts. Significant differences between the Eighth Circuit's analysis and our analysis are noted below. With respect to the Tenth Circuit's decision, we note that the decision, which expressly upholds the NIGC's new definition regulations, is consistent with and provides strong support for our earlier analysis.

A. Definition Rules

The NIGC published its new definitions, effective July 17, 2002, for three key terms in determining the scope of allowable Class II gaming: (1) "Electronic, computer or other technologic aid;" (2) "Electronic or electromechanical facsimile;" and (3) "Other games similar to bingo."[3] The new rules provide as follows:

> **§ 502.7 Electronic, computer or other technologic aid.**
> (a) *Electronic, computer or other technologic aid* means any machine or device that:
> (1) Assists a player or the playing of a game;
> (2) Is not an electronic or electromechanical facsimile; and
> (3) Is operated in accordance with applicable Federal communications law.
> (b) Electronic, computer or other technologic aids include, but are not limited to, machines or devices that:
> (1) Broaden the participation levels in a common game;
> (2) Facilitate communication between and among gaming sites; or
> (3) Allow a player to play a game with or against other players rather than with or against a machine.
> (c) Examples of electronic, computer or other technologic aids include pull tab dispensers and/or readers, telephones, cables, televisions, screens, satellites, bingo blowers, electronic player stations, or electronic cards for participants in bingo games.
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> **§ 502.8 Electronic or electromechanical facsimile.**
> *Electronic or electromechanical facsimile* means a game played in an electronic or electromechanical format that replicates a game of chance by incorporating all of the characteristics of the game, except when, for bingo, lotto, and other games similar to bingo, the electronic or electromechanical format broadens participation by

[3] Former NIGC Chairman Montie Deer voted against the new definitions, writing a separate dissent to the adoption of new regulations (included in the Federal Register notice).

> allowing multiple players to play with or against each other rather than with or against a machine.
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> § **502.9 Other games similar to bingo.**
> *Other games similar to bingo* means any game played in the same location as bingo (as defined in 25 USC 2703(7)(A)(i) constituting a variant on the game of bingo, provided that such game is not house banked and permits players to compete against each other for a common prize or prizes.

67 Fed. Reg. 41,166 at 41,172 (to be codified at 25 C.F.R. Part 502).

B. The IGRA and the Johnson Act

The relationship between the IGRA's classification scheme and the federal Johnson Act has been the source of substantial federal court litigation since the NIGC published its first definitions regulations in 1992. In attempting to reconcile these provisions, the NIGC's earlier regulations had defined "electronic or electromechanical facsimile" broadly to include any "gambling device" within the scope of the federal Johnson Act.[4] As discussed in the March memorandum at 12-13, federal courts in various jurisdictions have uniformly rejected the Justice Department argument that Class II games that utilize technologic aids are Class III because they may also meet the definition of "gambling devices" under the federal Johnson Act.[5]

In the preamble to the rules, the NIGC acknowledged the inconsistency in its former definitions, noting "these courts have implicitly rejected the Commission's definition of 'electromechanical facsimile,' which incorporates the Johnson Act, and have instead used a plain meaning approach to interpret this key term." 67 Fed. Reg. 41,168. Citing the MegaMania cases, the Commission specifically determined that the Johnson Act does not apply if the game at issue fits within the definition of a Class II game and the game is played with a technologic aid. Id. at 41,169. By changing its definition regulations[6] to reverse its earlier view that Johnson Act devices can never be lawful Class II technologic aids, the NIGC acted to bring its regulations into compliance with governing court decisions that had rejected its initial approach.[7]

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[4] The Johnson Act (15 U.S.C. §§ 1171(a)(2)-(3)) defines gaming devices to include devices: "…designed and manufactured primarily for use in connection with gambling, and (A) which when operated may deliver, as the result of the application of an element of chance, any money or property, or (B) by the operation of which a person may become entitled to receive, as the result of the application of an element of chance, any money or property… ."

[5] More recently, the Eighth Circuit in Santee Sioux rejected the argument that the IGRA implicitly repealed the Johnson Act with respect to Class II aids. However, that court narrowly construed the reach of the Johnson Act and concluded that the Lucky Tab II pull-tab dispenser is not a Johnson Act device

[6] 25 C.F.R. § 502.8.

[7] It must be noted that the Department of Justice takes an even more restrictive view of the law and continues to argue in court that no Johnson Act device can qualify as a lawful Class II aid.

C. Technologic Aid

Consistent with this interpretation, the Commission revised its definition of "electronic, computer or other technologic aid" to make clear that a broad range of technologic aids are available to tribes in the conduct of Class II gaming. The Commission determined that these revisions were required in the definition regulations in order to bring them into compliance with the court cases which upheld various forms of technologic aids to bingo and pull-tabs as Class II.

As noted above, the NIGC specifically rejected its earlier definition that classified all gambling devices covered by the Johnson Act as facsimiles. 67 Fed. Reg. 41,169 ("IGRA does not in fact require an across-the-board treatment of all Johnson Act gambling devices as class III games."); id. at 41,170 ("Congress intended to permit the use of electronic technology in class II gaming (even if the device might otherwise fall within the ambit of the Johnson Act) . . .").[8] The NIGC determined that a device, such as a bingo blower, when used to aid the play of a Class II game, should not be treated as prohibited by the Johnson Act, even though that same device might be elsewhere used to assist in Class III activities (such as keno). Thus, the NIGC concluded that the game itself, rather than the physical features of its components, define whether it is a permitted technological aid or subject to Johnson Act prohibitions. Significantly, the NIGC rejected the Justice Department's position that the Johnson Act overrides any authorization in IGRA to utilize such technological aids.[9] With the exception of the Santee Sioux decision, recent cases have rejected the Justice Department's position.[10]

In substance, under the new rules, the classification focus is no longer on the type of the equipment, but rather on the game being played. In other words, the primary determination is whether the game being played is a Class II game, and if so, then the inquiry shifts to whether the device assisting the play of the game is otherwise impermissible as a "facsimile." This change in focus is a complete reversal of the old regulations, under which the bar against use of Johnson Act devices effectively precluded consideration of whether a game was, in fact, Class II,

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[8] As the NIGC noted, however, that the Department of Justice, which enforces the Johnson Act, takes the position that "the Johnson Act prohibits any technology that meets its terms, including technologic aids to class II gaming." 67 Fed. Reg. 41,168.

[9] Then-Chairman Montie Deer's dissent expressly disagreed with that conclusion, arguing that the old rules should not be altered. 67 Fed. Reg. 41,173-74.

[10] Most courts have held that Congress simply did not intend for the Johnson Act to reach aids to Class II games. See Seneca-Cayuga Tribe v. National Indian Gaming Com'n, Slip. Op. ("we hold that *if* a piece of equipment is a technologic aid to an IGRA Class II game, its use, sale, possession or transportation within Indian country is then necessarily not prescribed as a gambling device under the Johnson Act."); Diamond Game Enterprises v. Reno, 230 F.3d 365, 367 (D.C. Cir. 2000) ("Class II aids, permitted under IGRA, do not run afoul of the Johnson Act." (citing Cabazon Band of Mission Indians v. National Indian Gaming Com'n, 14 F.3d 633, 635 (D.C. Cir. 1994))); United States v. 162 Megamania Gambling Devices, 231 F.3d 713, 725 (10th Cir. 2000)("Congress did not intend the Johnson Act to apply if the game at issue fits within the definition of a Class II game, and is played with the use of an electronic aid."); United States v. 103 Electronic Gambling Devices, 223 F.3d 1091, 1101(9th Cir. 2000)("The text of IGRA quite explicitly indicates that Congress did not intend to allow the Johnson Act to reach bingo aids."); United States v. Santee Sioux Tribe, 174 F. Supp. 2d. 1001, 1005 (D. Neb. 2001)("I conclude that the Johnson Act is not applicable to Class II devices."), aff'd on other grounds, __F.3d__, No. 02-1503 (8th Cir. Mar. 20, 2003).

and whether, therefore technological aids could legally be employed. In our view, the reversal is consistent with developing case law and supports our earlier analysis.

D. Facsimile

The new NIGC definition of facsimile makes clear (at least in the case of bingo, lotto and other games similar to bingo)[11] that a Class II game cannot be played in a wholly electronic format unless the use of that format "broadens participation by allowing multiple players to play with or against each other rather than with or against a machine." This change is consistent with the legislative intent of the IGRA and is fully supported by the MegaMania decisions, upholding the play of a wholly electronic Class II game.

While the courts and the NIGC recognize that electronic aids can be used with paper pull-tabs[12], the question of whether a wholly electronic pull-tab game (where the electronic format broadens participation) is permissible as a Class II game has not been settled and is unclear under the new definition regulations. In the proposed rule, the definition of "games similar to bingo" would have required the use "of paper or other tangible medium" for pull-tabs and all other games similar to bingo. In the preamble to the final rule, the NIGC states that it "agrees that the proposed language was overly broad and inconsistent with both case law and legislative history. These requirements have therefore been removed." 67 Fed. Reg. at 41, 171. In our opinion, there is no basis in the IGRA or the legislative history to prohibit electronic pull-tabs. However, as detailed in our March memorandum, early court decisions (which in many respects are inconsistent with later cases) have held electronic pull-tab games to be Class III facsimiles.

E. Games Similar to Bingo

Finally, the Commission provided new guidance on the statutory provision that broadly authorizes the play of "other games similar to bingo."[13] The Commission's original regulation provided that "games similar to bingo" must satisfy all the statutory requirements for bingo in order to be lawful, an interpretation that made the statutory provision meaningless. The new regulation[14] recognizes the validity of a game that is a "variant" of the game of bingo, so long as it is not "house banked," and, as in all bingo games, "permits players to compete against each other for a common prize or prizes." As explained by the NIGC, the new definition clarifies that

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[11] The new definition of facsimile states that bingo, lotto and games similar to bingo can be played in a wholly electronic format. Pull-tabs, punch boards and tip jars are not separately listed in that permission.

[12] We note that the Eighth Circuit rejected the Justice Department's position that, since it depicts pull-tab outcomes using video slot graphics, the Lucky Tab II is a facsimile of a slot machine. According to the court, there are a number of functional differences between a slot machine and the Lucky Tab II, thus "they are not exact copies (the commonly understood definition of a facsimile, see Cabazon, 14 F.3d at 636) of a slot machine." Slip Op. at 12, n.3. In reaching this conclusion, the court cited with approval the NIGC's new definition regulations. Slip Op. at 13-14. The Tenth Circuit in Seneca-Cayuga expressly upheld the NIGC's new definition regulations.

[13] 25 U.S.C. § 2703(7) (A).

[14] 25 C.F.R. § 502.

"'other games similar to bingo' constitute a 'variant' on the game and do not necessarily meet each of the elements specified in the statutory definition of bingo."[15]

The new rules, therefore, acknowledge that so long as a player is competing against others for common prize or prizes, it may now be argued that a game is "similar to bingo" even if it does not satisfy all three of the statutory bingo criteria. And, according to the new definitions, a technological device may be used to aid in the play of such Class II game, even if that device might otherwise fall within the ambit of the Johnson Act.

F. Department of Justice Position on New NIGC Regulations

In a brief filed by the Justice Department in the MegaNanza litigation (discussed above) on July 18, 2002, the Department set forth a restrictive interpretation of the scope of Class II aids permissible under the NIGC's new definition regulations.[16] We note that the Justice Department brief admits that a final government position on the new regulations does not exist, and its arguments provide only a "reasonable basis" for the MegaNanza Advisory Opinion and the subsequent NOV.[17] Brief at 8. Most of the Department's arguments are addressed in our March memorandum. However, several of the Department's arguments merit separate treatment and are addressed below.

First, the Justice Department suggests that the IGRA requires that the game winning prize in a bingo game must be larger than the interim prizes available in the game. However, the IGRA does not require a certain magnitude of win and the courts have held that multiple prizes, interim winners and progressive jackpots are all acceptable. The preamble to the 1992 Definition rules recognize that jackpot, progressive and guaranteed prizes are permissible in the play of Class II bingo.

Second, the Department questions the use of a video screen that displays both the game card and an additional, but physically larger, entertaining video display. According to the Department, "it is arguable" that no cards are in play, because the video reels are the "focal point of the game," rather than the "small electronically generated bingo cards that are displayed in an attempt to justify the game as constituting the game of a bingo like game." That requirement, wholly unsupported by IGRA, was set forth previously in the NIGC's Evergreen Advisory

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[15] There are only three bingo requirements. A player must:

1) play for prizes with cards bearing numbers or other designations;
2) cover numbers or designations when objects, similarly numbered or designated, are drawn or electronically determined; and
3) win a game by being the first person to cover a designated pattern on the cards.

25 U.S.C. § 2703(7)(A) and 25 C.F.R. § 502.3.

[16] One NIGC staff attorney appeared as of counsel on the Justice Department brief.

[17] The Justice Department brief correctly recites that the new regulations "'simply codify and adopt previous holdings by the federal courts' . . . do not change the existing law, nor are they an attempt to amend IGRA." Brief at 15.

Opinion, but is neither a final position of the NIGC nor supported by any other legal basis. As detailed in our memorandum of March 11, 2002, the use of entertaining video displays has been upheld (in the context of pull-tab games) in the Lucky Tab II and Magical Irish cases, as well as in the NIGC's Tab Force advisory opinion. There is no legal basis to bar the use of such displays in other Class II games.

Third, the Justice Department brief asserts that the sequence of play, in which the cards are assigned after numbers are drawn, improperly confers a value on each card before it is assigned to a player. Brief at 13. However, the statute fixes a requirement of only three elements for a game to constitute "bingo." None of these elements prohibit drawing numbers before cards are distributed to players.

Finally, the Justice Department argues for a limited scope of "games similar to bingo," based on its overly broad view of what constitutes a house banked game under the IGRA.[18] The Department's argument ignores distinctions in the NIGC definition – that house banking involve the house as a participant and previous court holdings that have upheld, as non-banked, the use of mathematical formulas to ensure the retention of a fixed percentage over time in the play of the game, even if the immediate win percentage varies throughout the play of a series of games.

The NIGC has defined house banking to mean "any game of chance that is played with the house as a participant in the game, where the house takes on all players, collects from all losers, and pays all winners, and the house can win." 25 C.F.R. § 502.11 (emphasis added).[19] The courts have interpreted participation to mean that the house actually plays a card in the game that the other players must beat. 162 Megamania Gambling Devices, 231 F.3d at 721 ("The house, in this case the Tribes and Multimedia, is not a 'participant' because it does not play a bingo card which players must beat, nor is it ever a 'winner' in the game."); 103 Electronic Gaming Devices, 223 F.3d at 1099 ("In MegaMania, however, the house is not a participant in the game the way it is in blackjack, for example, where the house plays a hand, and the success of the players depends on the success of the house.").

If the house is not a "participant" in the game, then the fact that the house may pay out more than is wagered in a game or series of games is not determinative. In the MegaMania cases, the courts expressly upheld the use of a mathematical formula to ensure that the house received a fixed return over time, even though the return in a particular game or series of game could vary widely. The Ninth Circuit held that it was permissible to use a system where "payouts do not hinge on the success of other players but are instead based on a mathematical formula that ensures that over time the house will net fifteen percent of players' antes." 223 F.3d at 1099. Similarly, the Tenth Circuit stated that a game is not house banking as defined by 25

[18] The regulations provide that a "game similar to bingo" is a "variant on the game of bingo, provided that such game is not house banked and permits players to compete against each other for a common prize or prizes." 25 C.F.R. § 502.9 (emphasis added).

[19] The NIGC's definition regulations provide that house banking games are Class III. 25 C.F.R. 502.4(a). However, this limitation does not apply to games that Congress specifically listed as Class II in the IGRA.

C.F.R. § 502.11 merely because "'the house may have to pay out more in winnings than it receives in bets' in a 'particular game or series of games.'" 231 F.3d at 721.

We note that the house banking limitation is not applicable to games that Congress specifically listed as Class II in the IGRA. When promulgating its definition regulations, the NIGC clarified that the general rule that house banking games are Class III does not apply to games, such as bingo, that Congress has specifically listed as Class II. 57 Fed. Reg. 12,388 (April 9, 1992)("whether a game is a house banking game ... is not relevant to the classification of games that Congress expressly placed in class II: Bingo, lotto, pull-tabs, instant bingo, and tip jars."). [20] Thus, if a game otherwise satisfies the three statutory bingo requirements, it is not necessary to further show that the game is outside the NIGC's definition of house banking game. See 103 Electronic Gaming Devices, 223 F.3d at 1096 ("IGRA's three explicit criteria, we hold, constitute the sole *legal* requirements for a game to count as class II bingo.")(emphasis in original); 162 Megamania Gambling Devices, 231 F.3d at 720-23.

It is our opinion that the Justice Department's brief is based on flawed reasoning. Our analysis of these flaws is discussed in greater detail in our previous memorandum. While the new Justice Department brief does not change our analysis, it gives some indication that the Justice Department, assisted by NIGC staff, is prepared to continue its path of limiting the play of Class II games through the use of technological aids.[21] It is not known what policy and practice will result from the seating of three new Commissioners at the NIGC

Conclusion

In our previous memorandum, we discussed the requirements for Class II technological aids to the games of bingo and pull-tabs under the IGRA. Further, and in accordance with case precedent, we concluded that the Johnson Act does not apply to devices that otherwise qualify as technological aids under the IGRA. The NIGC regulations now further support those conclusions, despite the Department of Justice's attempt to demonstrate otherwise. In addition, by removing the prior limitations on "games similar to bingo," the NIGC has expanded the scope of games subject to play with the assistance of technological aids. As a result, the regulatory environment is now more consistent with the conclusions of our March memorandum on technologic aids.

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[20] The Commission further explained:

> One commenter suggested that all class II games … should be games in which players compete against one another as opposed to playing against the house. As stated above, Congress enumerated those games that are classified as class II gaming with the exception of games similar to bingo. Adding to the statutory criteria would serve to confuse rather than clarify.

Id. at 12,382.

[21] Significantly, the Justice Department brief expressly reserves its option of separately enforcing the Johnson Act through an independent proceeding. Brief at 25 n.11.

We have provided a new set of model regulations (which are included herewith as Attachment B) to reflect the amended NIGC rules.[22] Please let us know if we can be of further assistance.

[22] We also have changed Game Ending Pattern (for Bingo) to Game Winning Pattern, to clarify that it is permissible to award consolation prizes after the game has been "won."