



## “Like Déjà vu All Over Again”

North Carolina’s “Groundhog Day” Experience with Video Sweepstakes

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**A**LMOST A YEAR AGO, *FAMILY NORTH CAROLINA* PUBLISHED AN ARTICLE ENTITLED “IT AIN’T OVER ‘TIL IT’S OVER”—VIDEO GAMBLING RETURNS TO NORTH CAROLINA.” THE ARTICLE ATTEMPTED TO USE THE MALAPROPISMS OF YOGI BERRA TO FRAME A DISCUSSION OF “VIDEO SWEEPSTAKES,”<sup>1</sup> THE LATEST FORM OF VIDEO GAMBLING TO PLAGUE NORTH CAROLINA. IT ARGUED THAT THESE SO-CALLED “SWEEPSTAKES” ARE NOT REALLY LEGAL SWEEPSTAKES AT ALL, BUT INSTEAD ARE ILLEGAL GAMES OF CHANCE, OPERATING IN DIRECT VIOLATION OF NORTH CAROLINA’S LONG STANDING LAWS AGAINST GAMBLING AND ILLEGAL LOTTERIES, INCLUDING A 2008 BAN ON SUCH DEVICES.<sup>2</sup> SO, ONE YEAR LATER, HOW DO THINGS STAND IN NORTH CAROLINA’S FIGHT AGAINST VIDEO SWEEPSTAKES?

Well, to borrow one more time from Mr. Berra, “it’s like déjà vu all over again.” In the summer of 2010, reacting to the ineffectiveness of the 2008 ban, the General Assembly passed a new law banning Video Sweepstakes that was codified as N.C.

GEN. STAT. 14-306.4, and went into effect on December 1, 2010. Lawmakers promised that the new law would finally rid the State of Video Sweepstakes.<sup>3</sup> But just a few months into 2011, Video Sweepstakes machines are in full operation throughout the State.<sup>4</sup> Meanwhile in Raleigh, enticed by the gambling lobby’s promise of new tax revenues, the Governor of North Carolina actually considered a regulatory scheme whereby the state lottery would license and regulate video gaming machines.<sup>5</sup>

Much like Bill Murray’s character in the film “Groundhog Day” reliving the same day over and over again, the General Assembly seems doomed to keep reliving North Carolina’s miserable video gambling story. As the General Assembly enters its 2011 long session, legislators are probably wondering whether their Video Sweepstakes “Groundhog Day” experience will ever end. A quick recap of North Carolina’s recurring video gambling nightmare, and a review of general sweepstakes law may help provide the possible answer.

## General Laws Relating to Sweepstakes

Video Sweepstakes are games of chance played using what are often loosely referred to as “sweepstakes machines.” These machines generally come in two forms: (1) stand-alone touch screen terminals that look like video poker or slot machines (or video arcade games), that can be found at bars, convenience stores and “sweepstakes parlors,” and (2) ordinary-looking desktop computer terminals that are linked to a special server offering the games, and that are found at “internet sweepstakes parlors” or “internet cafes.” In order to play the Video Sweepstakes games offered on sweepstakes machines, a player must either purchase a phone card or internet access time on the computer terminals offering the Video Sweepstakes games. With each purchase of phone card time or Internet time, a player obtains “credits,” or points which are used to play the Video Sweepstakes games. A Video Sweepstakes player bets his credits on chances to win more credits, which can be used to continue playing or can be turned in for a cash value. The games offered on sweepstakes machines are typically video poker and slot machine-type games, that look, sound and operate much like the Video gambling games found at the Cherokee casino.

From a legal standpoint, games of chance are considered to include any games where the winners are selected by a random process (and not by skill),<sup>6</sup> including via a random drawing, seeded winning game cards, or pre-selected winning numbers. Games of chance that amount to gambling or lotteries are prohibited in North Carolina, with the exception of the Cherokee casino games, the state-run lottery and certain bingo and raffle games.<sup>7</sup> N.C. GEN. STAT. §14-292 defines gambling as operating or playing or betting on “any game of chance at which any money, property or thing of value is bet.” North Carolina courts have defined a lottery “as any scheme for the distribution of prizes by lot or chance, by which one, on paying money or giving anything of value to another, obtains a token which entitles him to receive a larger or smaller value, or nothing, as some formula of chance may determine.”<sup>8</sup>

Prohibited games of chance have three basic components: chance, consideration (paying or risking something of value to play), and a prize (anything of value that goes beyond that which is provided to every player).<sup>9</sup> For a game of chance to be legal, one of the three elements must be removed. What is generally referred to as a “sweepstakes,” as opposed to a lottery or gambling, is a promotional game of chance where the element of consideration is eliminated, usually by offering a free alternate method of entry into the random drawing or game.<sup>10</sup> (This is why the words, “No Purchase Necessary,” always appear in sweepstakes ads and official rules.) For a sweepstakes to be legal, however, the free alternate

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method of entry must be on completely equal footing with the purchase method of play.

### The 2007 Ban

The legislative history of North Carolina’s battle against Video Sweepstakes actually relates back to South Carolina’s successful shutdown of video poker machines in 1999. Fearing an influx of South Carolina’s recently banned video poker machines, the legislature enacted a law in 2000 that banned new “video gaming machines,” but permitted those already in operation to remain.<sup>11</sup> After several years it became clear that the ban on only new machines was ineffective, so the General Assembly repealed that statute, and enacted a new law, which went into effect in July 2007 and banned *all* video gaming machines.<sup>12</sup>

Almost as soon as the statewide ban on all video gaming machines went into effect, video gambling machine manufacturers began flooding North Carolina with sweepstakes machines. In order to deal with the ban on video gaming machines, the gambling industry simply renamed their video poker machines “sweepstakes machines,” and reprogrammed them to offer a purported free method of play.<sup>13</sup> In April, 2008, the gambling industry was emboldened by a ruling by Guilford County Superior Court Judge John Craig in the *Hest Technologies* case that found that the sweepstakes machines at issue in the case were not illegal under North Carolina’s slot machine and video gaming machine bans.<sup>14</sup>

### The 2008 Ban

The North Carolina legislature responded to the *Hest Technologies* ruling by banning “server-based electronic game promotions” through new legislation that became effective in December 2008. The 2008 statute has a very precise definition of “server-based electronic game promotions” that the video gambling industry was able to exploit by simply modifying their machines once again, this time by eliminating the use of prepaid cards and substituting the use of an id number.<sup>15</sup>

In the second round of the *Hest Technologies* case in December 2008, Judge Craig ruled that the sweepstakes machines at issue did not violate the new statute banning “electronic game promotions.” In a separate matter heard in June 2009, Wake County Superior Court Judge Paul Ridgeway ruled

in the *Sandhill Amusements* case that the sweepstakes machines at issue were not “server-based electronic game promotions,” and restrained the State from taking any enforcement action against the plaintiffs’ machines.<sup>16</sup>

## The 2010 Ban

The defeats in the Superior Court cases of *Hest Technologies* and *Sandhill Amusements* prompted legislators last year to enact the new statute banning Video Sweepstakes. The new statute makes it a misdemeanor “for any person to operate . . . an electronic machine or device to . . . [c]onduct a sweepstakes through the use of an entertaining display.” The term “entertaining display” is defined as “visual information, capable of being seen by a sweepstakes entrant, that takes the form of actual game play, or simulated game play,” and the statute provides several examples of such games “by way of illustration and not exclusion.”<sup>17</sup>

Nine examples of “entertaining displays” are found in subparts (a)–(i) of the definition. Eight of the examples are traditional gambling games, including video poker, video bingo, video craps, keno, lotto, eight liner, Pot-of-Gold, and “video games based on or involving the random or chance matching of different pictures, words, numbers, or symbols not dependent on the skill or dexterity of the player.” The ninth example, found in subpart (i), is a “catch all” definition, and defines “entertaining displays” to include “any other video game not dependent on skill or dexterity that is played while revealing a prize as the result of an entry into a sweepstakes.”

## Recent Court Decisions

Even before the 2010 ban went into effect, gambling industry manufacturers were already claiming that they had packages available for sweepstakes machine operators that would avoid the new statutory ban.<sup>18</sup> The gambling industry was also vigorously fighting the new Video Sweepstakes statute through both the *Sandhill Amusements* and *Hest Technologies* cases, by alleging that the new law violates the right

to free speech guaranteed under the First Amendment of the U.S. Constitution and the parallel provision of the North Carolina Constitution.

On November 29, 2010, Judge Ridgeway in the *Sandhill Amusements* case<sup>19</sup> surprised the gambling industry by issuing an order that found no constitutional defects in the new law and that dissolved the court’s injunction that had allowed the plaintiffs to continue operating their sweepstakes machines. A day later, Judge Craig in the *Hest Technologies*<sup>20</sup> case ruled that the new statute was constitutional and serves as a permissible exercise of the State’s police powers to regulate gambling, except with respect to the “catch-all” definition of the phrase “entertaining display” found in N.C. GEN. STAT. 14-306.4(a)(3)(i). Judge Craig’s order stated that the “catch-all” provision as applied to such games was overly broad and constituted a prior restraint of speech. The *Hest Technologies* order did say, however, that law enforcement officials were free to take enforcement actions against all eight categories of traditional gambling games listed in subparts (a) – (h) of the “entertaining display” definition.

In a December 2010 Advisory Letter, the North Carolina Attorney General’s Office told law enforcement agencies that they were free to enforce all of the provisions of N.C. GEN. STAT. 14-306.4, other than with respect to the “catch-all” video games described in subpart (i) of the “entertaining display” definition that Judge Craig found unconstitutional. The letter said that law enforcement agencies should not attempt to enforce N.C. GEN. STAT. 14-306.4(a)(3)(i) until the appellate courts of North Carolina resolved the conflict between the *Hest Technologies* and the *Sandhill Amusements* orders concerning the constitutionality of that subpart of the new law.

The letter also noted that the Attorney General had appealed Judge Craig’s order in the *Hest Technologies* case relating to the unconstitutionality of the “catch-all” video games provision. On January 11, 2011, the North Carolina Court of Appeals denied the Attorney General’s request for a stay of that portion of Judge Craig’s decision. So for the time being, Judge Craig’s order remains in effect, and law enforcement agencies in North Carolina may not enforce the “catch all” games provision found in N.C. GEN. STAT. 14-306.4(a)(3)(i).

As one might expect from past experience, Video Sweepstakes operators are now sidestepping the current rules for enforcement by simply changing the names and software for their Video Sweepstakes games.<sup>21</sup> And that’s why, despite the 2010 ban on Video Sweepstakes, these games of chance are still a booming business in North Carolina.

## Breaking the Cycle

No matter what Bill Murray’s character did to change the events he experienced on Groundhog Day, the next day he was doomed to keep repeating



the previous day. The movie provides no explanation for how, at the end of the film, Murray's character finally is able to live a new day. North Carolina's Video Sweepstakes story parallels "Groundhog Day" again in that respect, because it provides no easy explanation for how the State can end the cycle and free itself from this form of gambling. Nevertheless, like the film, North Carolina's Video Sweepstakes story provides some clues as to how the cycle might finally be broken.

First, it is important to remember that the appellate courts in North Carolina have not yet directly addressed the question of whether Video Sweepstakes and sweepstakes machines are legal "sweepstakes." When appellate courts in other states have addressed the legality of Video Sweepstakes, they have consistently ruled that Video Sweepstakes games are NOT legal sweepstakes but illegal games of chance.<sup>22</sup> The Supreme Courts of both Alabama<sup>23</sup> and South Carolina<sup>24</sup> have held Video Sweepstakes to be illegal, and these courts based their rulings on traditional, long existing, gambling and lottery laws, rather than on special statutes aimed at Video Sweepstakes.

Second, it should be noted that the North Carolina Court of Appeals in *American Treasures, Inc. v. State*<sup>25</sup> has already addressed a situation where a phone card company was selling phone cards that each contained a game piece with a scratch off area that revealed whether the customer had won a prize. The *American Treasures* court found that where pre-paid telephone cards *can be considered to be a genuine product and the associated sweepstakes can be considered a valid promotional tool designed to increase the sale of the product*, the game at issue will not be deemed to violate North Carolina's lottery laws. The court noted, however, that certain promotions and devices would be illegal if they were a "mere subterfuge to engage in an illegal lottery scheme, whereby consideration is paid merely to engage in a game of chance." The *American Treasures* court also agreed with the State that there are situations where games of chance would be illegal when "it is clear that the product being 'sold' is merely ancillary and incidental to the accompanying game of chance."<sup>26</sup>

As things stand today in North Carolina, two Superior Court judges that in the past have consistently ruled in favor of the gambling lobby, have now ruled that the 2010 ban on Video Sweepstakes is (at least for the most part) constitutional.<sup>27</sup> On appeal of the *Hest Technologies* case, it is reasonable to believe that a properly briefed Court of Appeals would try to rule in favor of the State, especially if the court takes into account the clear intention of the legislature with respect to the ban. It is also reasonable to believe that the State Court of Appeals might also rule in a manner consistent with the appellate courts of several other states and with its own reasoning in *American Treasure*, by holding that Video Sweepstakes are illegal under the State's gambling and lottery laws because the game of

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chance (and not the phone card or internet time) is the item truly being purchased.<sup>28</sup>

In this year's session, the General Assembly could simply wait for the matter of Video Sweepstakes to be played out in the North Carolina appellate courts before it makes another legislative move, or it could take a cue from the recent Superior Court rulings, and simply tweak the "catch all" definition of "entertaining display" that Judge Craig has found unconstitutional.

Any new legislation could simply delete the "catch all" definition found at N.C. GEN. STAT. § 14-306.4(a)(3)(i), and replace it with the following two new subparts that might better clarify a definition of "entertaining display:"

"i. Any other video game not dependent on skill or dexterity that is a mere subterfuge to engage in an illegal lottery scheme, whereby consideration is paid merely to engage in a game of chance.

j. Any other video game not dependent on skill or dexterity that is offered in connection with the sale of a product or service if the product or service being promoted is only ancillary and incidental to the accompanying game of chance."

An amendment to N.C. GEN. STAT. § 14-306.4(a)(3) in this manner would remove the objectionable language found in the 2010 ban and replace it with language describing games that the State Court of Appeals has said would violate the gambling and lottery laws. The proposed new language would also be consistent with the holdings of appellate courts in other states that have found Video Sweepstakes to be illegal. The movie was unclear as to how many repeats of Groundhog Day it took for Bill Murray's character to break free into a new day. The film actually shows him reliving 34 such days, but many more are implied, and some movie reviewers estimate that at least ten years passed. Whether North Carolina ever breaks out of its "Groundhog Day" experience with Video Sweepstakes remains to be seen, but perhaps this year's events in the Court of Appeals and the General Assembly will tell us. Keep watching—this movie's got to end sometime. ❖

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ENDNOTES:

- 1) These games have also been frequently referred to as “Internet Sweepstakes.”
- 2) N.C. GEN. STAT. §14-306.3.
- 3) Matt Ehlers, Raleigh News and Observer, “Game over, law tells sweepstakes parlors,” Nov. 30, 2010.
- 4) Lynn Bonner, Raleigh News and Observer, “Perdue considers tax on video gaming,” Feb. 3, 2011.
- 5) Lynn Bonner, Raleigh News and Observer, “Perdue considers tax on video gaming,” Feb. 3, 2011.
- 6) See Joker Club, LLC v. Hardin, 183 N.C.App. 92 (2007).
- 7) N.C. GEN. STAT. §14-292; N.C. GEN. STAT. §14-290.
- 8) State v. Lipkin, 169 N.C. 265, 271, 84 S.E. 340, 343 (1915); State v. Simmons, 59 N.C. App. 287, 296 S.E.2d 805 (1982); American Treasures, Inc. v. State, 173 N.C.App.170, 617 S.E.2d 346 (N.C.App. 2005).
- 9) State v. Lipkin, 169 N.C. 265, 271, 84 S.E. 340, 343 (1915).
- 10) The free alternate method of entry (the “AMOE”) must ensure that participants utilizing the method are on “equal footing” with the paying participants. Any material disparity in opportunity to win between the payment method of entry and the AMOE can render a sweepstakes illegal, such as where there is a real or perceived disadvantage to those who enter for free and where there are more burdensome entry requirements on non-purchase entrants. In the case of many North Carolina Video Sweepstakes internet cafés, customers are limited to one set of 100 free credits per day, but can receive unlimited credits via the purchase method. Given the limitations on free entries, the AMOE provided is arguably not equal to the purchase method of entry, and this form of AMOE would likely fail under sweepstakes law principles.
- 11) N.C. GEN. STAT. § 14-306
- 12) N.C. GEN. STAT. §14-306.1A
- 13) See Richard Drucker, “Cyber Sweepstakes Anyone?” Coates Canon: NC Local Government Law Blog, <http://sogweb.sog.unc.edu/blogs/localgovt>, posted October 12, 2009.
- 14) Hest Technologies, Inc. v. State of North Carolina, Preliminary Injunction, No. 08 CVS 457 (Guilford County Superior Ct. April 16, 2008).
- 15) Matt Tomsic, “Sweepstakes machine owners find way around ban,” Star-News, January 12, 2009.
- 16) Sandhill Amusements v. State of North Carolina, Order for Preliminary Injunction, No. 09 CVS 5719 (Wake County Superior Court, June 26, 2009).
- 17) N.C. GEN. STAT. 14-306.4
- 18) Raleigh News and Observer, “Sweepstakes scuffle,” December 1, 2010; Joe Swartz, Independent Weekly, “Internet sweepstakes cafes likely to sidestep ban,” December 1, 2010.
- 19) Sandhill Amusements v. State of North Carolina, Order, No. 09 CVS 5719 (Wake County Superior Court, Nov. 29, 2010).
- 20) Hest Technologies, Inc. v. State of North Carolina, Order and Final Judgment, No. 08 CVS 457 (Guilford County Superior Ct., Nov. 30, 2010).
- 21) Anne Blye, Raleigh News and Observer, “Sweepstakes Ban is hobbled for now,” Dec. 3, 2010.
- 22) See generally, e.g., Barber v. Jefferson County Racing Assoc., Inc., 960 So.2d 599 (Ala. 2006), cert. denied, 127 S.Ct. 2975 (2007); Sun Light Prepaid Phone Card Co. v. State, 360 S.C. 49, 600 S.E.2d 61 (S.C. 2004), cert. denied sub nom Phonedcards R Us, Inc. v. South Carolina, 543 U.S. 1120, 125 S.Ct. 1069, 160 L.Ed.2d 1068, (2005); Jester v. State, 64 S.W.3d 553 (Tex. App. 2001); Midwestern Enterprises, Inc. v. Stenhjem, 2001 N.D. 67, 625 N.W.2d 234 (N.D. 2001); Pre-Paid Solutions, Inc. v. City of Little Rock, 343 Ark. 317, 34 S.W.3d 360 (Ark. 2001).
- 23) In Barber v. Jefferson County Racing Assoc., Inc., 960 So.2d 599 (Ala. 2006), cert. denied, 127 S.Ct. 2975 (2007), the Supreme Court of Alabama addressed a sweepstakes system very similar to the ones found in Video Sweepstakes internet cafes in North Carolina and held that the system constituted a slot machine under Alabama law. The Barber court said that the MegaSweeps game at issue was easily distinguished from a traditional instant cash promotion run by a soft drink company, because the MegaSweeps game was a permanent, high stakes game that involved the use of an alleged gambling device.
- 24) Sun Light Prepaid Phone Card Co. v. State, 360 S.C. 49, 600 S.E.2d 61 (S.C. 2004), cert. denied sub nom Phonedcards R Us, Inc. v. South Carolina, 543 U.S. 1120, 125 S.Ct. 1069, 160 L.Ed.2d 1068, (2005). In Sun Light Prepaid Phonedcard Co., Inc. v. State of South Carolina, the seller of pre-paid phone cards sought the return of its calling/instant win cards and electronic dispensers that had been seized as illegal gambling devices, although free game pieces were available upon request. In denying the seller’s request, the South Carolina Supreme Court concluded that the game at issue was a game of chance and that the phone time being sold was “mere surplusage to the game piece,” so the phone card itself was a gambling device. The court ruled that the phone card machine was also an illegal gambling device, noting that the machine had a gambling themed video screen and celebratory music when winning cards were dispensed.
- 25) American Treasures, Inc. v. State, 173 N.C.App.170, 179, 617 S.E.2d 346, 351 (N.C.App. 2005).
- 26) Id. Following such reasoning, the Commonwealth Court of Pennsylvania distinguished the situation before it from the one in American Treasures, and held that discount coupons and coupon dispenser machines that included a chance to win cash prizes using a rub off section were gambling devices and a “mere subterfuge” for unlawful gambling. Lindsey v. Pennsylvania State Police, 916 A.2d 703 (Pa. Commw. Ct. 2007).
- 27) While Judge Ridgeway said the new law is entirely constitutional, Judge Craig said the ban is completely constitutional except for the “catch all” definition of “entertaining display found in N.C. GEN. STAT. § 14-306.4(a)(3)(i).
- 28) American Treasures, Inc. v. State, 173 N.C.App.170, 178, 617 S.E.2d 346, 351 (N.C.App. 2005).