
Coates' Canons Blog: Land Use Regulation of Internet Sweepstakes Cafes

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Regulating video gaming and gambling of one sort or another has vexed state and local governments in North Carolina for the better part of two decades. A recent court opinion held the current version of the state's ban on internet sweepstakes to be unconstitutional, violating First Amendment rights to free speech. A second case held that local governments may impose privilege license taxes on these businesses. But what about local land use regulation of these businesses? Can a small town zone them out? Can a city or county impose minimum separations between the businesses or between the business and other sensitive land uses?

Before addressing land use regulation, a quick recap on the current status of the law on the criminality and taxation of internet sweepstakes and video gaming businesses is in order.



The initial and most critical question is whether an internet sweepstakes operation is a lawful business or is illegal gambling. These operations provide video machines where customers pay for internet time to play a sweepstakes, with the machines revealing cash prizes.

Gaming machines have a colorful and largely illegal history in North Carolina and elsewhere. Slot machines have been illegal since the Depression era (G.S. 14-296). In the 1990s the question arose as to whether video game technology could be adapted to avoid this criminal ban. Initial video gaming restrictions were created by S.L. 2000-151. That law was enacted after South Carolina outlawed video poker gambling, prompting concern that this might result in an influx of video gaming machines into North Carolina. So G.S. 14-306.1 was created to ban all but those machines lawfully in operation and listed for taxes in the state in 2001 and that any location with machines had to be at least 300 feet from another location containing machines. There were also restrictions on the age of players, hours of operation, placement of machines, and advertising. This statute specified that it did not preempt more restrictive local ordinances.

This experiment in limited legalization of the machines did not last long. In 2006 the General Assembly shifted from regulation to an attempt to ban video gambling. S.L. 2006-6 repealed the limits on video poker and banned them effective July 1, 2007. **G.S. 14-306.1A**. The industry responded to the ban with a shift from video poker machines to video sweepstakes machines. So in 2010 the General Assembly expanded the prohibition to include video sweepstakes and similar devices. S.L. 2010-103 created **G.S. 14-306.4** to prohibit use of electronic machines and devices for playing sweepstake games (defined as any game you enter and for which you become eligible to receive a prize). The ban includes any use of electronic machines for real or simulated video poker (and any other card game), bingo, craps, keno, lotto, pot-of-gold, eight liner, and similar video games.

It was this 2010 legislation that was the subject of the recent North Carolina court opinion. On March 6, 2012 the state court of appeals held that the ban was unconstitutional in *Hest Technologies, Inc. v. North Carolina* (2012 WL 695984) and *Sandhill Amusements v. North Carolina* (2012 WL 705420). The cases are summarized by Jessica Smith [here](#)

(and Rich Ducker summarized the trial court's 2009 initial ruling [here](#)). The court held the restriction on displaying sweepstakes results through an "entertaining display" was an overly broad restriction of free speech. Further appeals of the case are likely. But for now the courts have invalidated the current legislative version of the ban these video gaming machines. This has prompted renewed efforts to open and operate "video sweepstakes" cafes and parlors around the state.

As long as the machines remain legal, the questions of local taxation and land use regulation arise. On the taxation front, on February 21, 2012 the court of appeals in *IMT, Inc. v. City of Lumberton* (2012 WL 540739) upheld Lumberton's imposition of a \$5,000 per establishment and \$2,500 per machine privilege license tax on internet sweepstakes businesses. That decision is summarized by Chris McLaughlin [here](#) (with additional links to his earlier posts on this topic). As with the criminal ban case, appeals are likely, as is additional litigation on the amount of the fees and taxes that can be imposed.

This leaves us with the question of the scope of permissible land use regulations of these businesses. Unlike the prior two issues, there is no appellate litigation pending challenging zoning or similar restrictions on these businesses. So for the foreseeable future we have to rely on general land use law principles as a guide to what can be done.

Here are some answers to questions that arise with land use regulation of internet sweepstakes cafes:

1. Do the rulings that the state criminal ban is unconstitutional mean the businesses are exempt from local land use regulation?

No. The state law challenged in the *Hest* case deals only with the question of whether the regulation on the means of revealing sweepstakes "wins" were legal. The constitutional issue involved was whether the machines can use a particular means to reveal results (here an "entertaining display," such as simulated poker hands). The state law that was invalidated only addressed this narrow issue, not the location or regulation of businesses featuring these or similar machines. They don't violate the criminal laws of the state, but they can be regulated

2. Can a local government use its land use regulatory authority to ban location of these businesses throughout their entire jurisdiction?

Maybe. In an earlier [post](#) I discussed the legality of banning an otherwise lawful use from an entire jurisdiction. The law is not entirely clear on this point, but absent some constitutional or statutory protection of the use itself, it is unlikely that every city and county must provide some space for every conceivable lawful land use. It is likely a court would examine a ban with an "arbitrary and capricious standard." This would entail examining whether there is any legitimate rationale for an exclusion and whether it is reasonable in the context employed (considering the potential impacts on neighbors and the community, the size of the jurisdiction, and so forth). Certainly a total jurisdiction-wide ban is a serious step and should be carefully discussed with legal counsel before enactment. But it may be possible in some circumstances.

The fact that the court of appeals found some First Amendment protection for the means of display of sweepstakes wins raises a cautionary note about a total ban. In the adult entertainment context, the courts have held that a jurisdiction may not totally ban protected speech, but can severely restrict its location as long as "reasonable alternative avenues" for expression are provided. For more on this, see my earlier post on adult business limits [here](#). Here the court held the restriction on display of sweepstakes results was overlybroad, not that a particular form of internet gaming was protected speech per se. But caution on a total ban is advisable.

3. Can minimum separation requirements and other restrictions be applied to these businesses?

Yes. A local government can certainly consider the land use impacts of these businesses and craft appropriate restrictions. Local regulations can address typical land use issues such as parking and traffic considerations. They can also address compatibility with surrounding land uses. Three alternative zoning approaches have been used around the state. First, some local governments treat these businesses the same as other commercial recreational operations of similar size and nature, such as video arcades or bowling alleys (recognizing that despite the name, these "internet cafes" are far more similar to entertainment uses than business centers). A second approach is to treat them similarly to other businesses with a predominately adult clientele or where there are large cash

transactions, such as bars, nightclubs, or pawn shops. A third alternative is to treat them similarly to adult entertainment businesses with reasonable separations from each other and from other sensitive land uses. In addition to regulations on where the businesses can locate, it may also be reasonable to consider operational restrictions, such as limits on hours of operation or limits on co-location with facilities with ABC licenses. If these restrictions are applied to existing businesses, existing zoning limits on nonconformities could be imposed (such as limits on expansion). It would also be possible to require existing nonconforming operations to come into compliance with a reasonable grace period (such as moving to an authorized location).

Local governments crafting restrictions must focus on the land use impacts of the business, not a moral disdain for the use itself. There are certainly those who object to the presence of the business as a form of thinly disguised gambling. That consideration, however, is best addressed in debates, legislation, and litigation about the legality of the use, not through land use regulations. The courts have been clear that any use of the zoning and other land use regulatory power must be limited to addressing the purposes stated in the authorizing statute. Noise, traffic, safety, negative impacts on neighbors, and the like certainly constitute legitimate grounds for land use regulation, but enforcement of community morality likely does not.

Finally, jurisdictions with no zoning or only partial zoning may use their general police power authority for these regulations. However, if locational restrictions are involved it will be necessary to cite zoning authority as an additional basis for the regulations. The jurisdiction should also follow mandated procedures for adoption and amendment of land use regulations (such as planning board referral and a public hearing on the ordinance with two published notices).

So, for now internet sweepstakes cafes are legal and may be taxed locally. They can also be required to comply with reasonable local land use regulations regarding where they are located and how they are operated.

Links

- canons.sog.unc.edu/land-use-regulation-of-internet-sweepstakes-cafes/sweepstakes-cafe-1/
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_14/GS_14-306.1A.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_14/GS_14-306.4.html
- appellate.nccourts.org/opinions/?c=2&pdf=MjAxMi8xMS00NTktMS5wZGY=
- appellate.nccourts.org/opinions/?c=2&pdf=MjAxMi8xMS0zMDEtMS5wZGY=
- appellate.nccourts.org/opinions/?c=2&pdf=MjAxMi8xMS04MTMtMS5wZGY=