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# Gambling and Bankruptcy: Safe Bet or Fool's Wager

## I. History of Gambling.

A. Gambling was one of the earliest forms of entertainment. Examples:

- i. Dice have been found in Egyptian tombs dating back to 6000 B.C.
- ii. Chinese gambling dates back at least to 2300 B.C.
- iii. The Minoans played poker by at least 1000 B.C.
- i. Playing cards were invented by the Chinese
  - a) Our current deck was Europeanized to reflect the royal ranks of noblemen
  - b) The French altered the deck by replacing one of the men with a queen
- ii. The District of Hising
  - a) Dice used to determine ownership of disputed lands
  - b) Decided by the "Throw of Aphrodite"
- iii. Middle Ages
  - Soldiers were forbidden from gambling because they became so wrapped up they neglected their duties.

## B. Religious Beliefs on Gambling.

- i. 2011 study found that 28% of Americans believe gambling is morally wrong.
- ii. The Bible does not condemn gambling.
- iii. In the Koran, gambling is the 14<sup>th</sup> Greater Sin.
  - a) "Gross sin," 2:219-22.
  - b) "Avoid games of chance," 5:90-91.
- iv. Buddhism considers recreational gambling to be harmless.

- However, it describes gambling as comprising 6 Evils, including that the gambler's word is not relied upon in court.
- v. In Hinduism, as in Christianity, gambling is forbidden by the most strict of the practicing sects. Others permit gambling and look at motivations in evaluating it.
- vi. In Judaism, the Talmud refers to gambling as a sin.

## C. America's Favorite Pastime (if measured by revenue).

- i. Sports betting is the most widespread and popular form of gambling in the U.S.
  - a) \$80 Billion to \$308 Billion
  - b) There are more bets on the Super Bowl than any other single day sporting event.
  - c) Alabama is the biggest illegal sports betting state.

- Football comprises over 90% of total bets.

(Source: National Gambling Import Study Commission)

- iv. Americans spend more (50% more) on gambling than groceries.
- v. Americans spend more than on theme parks, video games, spectator sports and more tickets combined

## D. We Are Not Alone.

- i. America is the world's largest gambling market, but that share has fallen from nearly 1/3 to 1/4 over the past decade.
- ii. China has risen from the 10<sup>th</sup> to the 2<sup>nd</sup> largest market

- iii. Australians gamble and lose more than any other people, upon a per capita basis.
- iv. Singapore, Finland, and New Zealand all gamble more per capita than U.S. citizens. The U.S. is 5<sup>th</sup> in per capita gambling loss.

E. Regulation of Gambling.

- i. The U.S. Constitution does not include gambling regulation as an enumerated power granted to the Federal government.
- ii. Power to regulate gambling is reserved to the States under the 10<sup>th</sup> Amendment.
- iii. Congress has used its power under the Interstate Commerce Law to regulate:
  - a) Interstate gambling
  - b) International gambling
  - c) Native American regulation
- iv. Wisconsin legal history

1848 Constitution, Article IV, Section 24 provided that "the legislature shall never authorize any lottery..."

- excluded all forms of gambling

Constitutional Amendments:

1965 Constitutional Amendment/promotional contests authorized

1973 Constitutional Amendment/charitable bingo games

1975 Constitutional Amendment/raffles

1987 Constitutional Amendment/state lottery

Private pari-mutuel on-track betting

1987 U.S. Supreme Court rules states cannot restrict gaming on tribal land if it is allowed elsewhere in the state

1988 Congress enacts Indian Gaming Regulatory Act of 1988

1991 Tribal gaming rules tribes can conduct casinos

## F. Gambling Motivation.

Why do people gamble?

- i. Social interaction
- ii. The risk
- iii. Thrill of Anticipation
- iv. Settle disputes (remember the Good King Olafs?)

## G. Social Costs.

- i. Employment problems
- ii. Criminal behavior
- iii. Psychological issues
- iv. Interpersonal problems
- v. Financial problems and insolvency

(Source: National Gambling Import Study Commission)

## H. Gambling and Bankruptcy.

Gambling has grown exponentially, as have bankruptcy filings.

- The Bankruptcy Code was introduced in 1979 and 240,000 bankruptcies were filed in 1980.
- Nevada was the only state with legalized gambling until 1978, when New Jersey legalized.
- By 1989, 11 other states permitted gambling.
- Today, only Hawaii and Utah have no gambling.
- Only 6 states do not have lotteries.
- No precise measurements exist for the correlation of gambling and gambling debts to bankruptcy filings. Various studies find anywhere from 10% to 26% of problem gamblers filing bankruptcy.
- Various studies have found gambling to be a significant cause or contributing factor in bankruptcy filings.

*See SMR Research Corporation, "The Personal Bankruptcy Crisis, 1997: Demographics, Causes, Implications, & Solutions," Hackettstown, N.J., 1997, pp. 116-130.*

See John M. Barron, Michael E. Staten, Stephanie M. Wilshusen, "The Impact of Casino Gambling on Personal Bankruptcy Filing Rates," McDonough School of Business, Georgetown University, 18 August 2000, (5 December 2003).

- Others report that the evidence does not support that conclusion.

See Lynda de la Viña, David Bernstein, "The impact of gambling on personal bankruptcy rates," U.S. Treasury Department, 1500 Pennsylvania Avenue, NW, Room 5313, Washington, DC 20220, USA (12 March 2002). Abstract: Both access to casino gambling and the personal bankruptcy rate have risen substantially in recent years. A reported correlation between greater access to gambling might be an important factor explaining the increased national bankruptcy rate. A correlation between convenient access to gambling and high bankruptcy rates might also occur if distressed communities are more receptive to the introduction of casinos than prosperous communities. This paper utilizes panel data to investigate the impact of the introduction of casinos on county bankruptcy rates. The evidence reported here does not support the hypothesis that the introduction of gambling has impacted county bankruptcy rates.

- A 1996 by the Wisconsin Policy Research Institute found that 23% of Gamblers Anonymous members file bankruptcy.

(Source: Milwaukee Journal Sentinel, 2/7/04)

- Anecdotal evidence abounds
  - The Milwaukee Journal Sentinel article by Paul Gores quoting David Asbach and Virginia George

#### I. Criminal Offense?

- i. Bankruptcy seeks to distinguish the honest but unfortunate debtors from debtors guilty of various types of culpable conduct.
- ii. In Australia, it may be a criminal offense to have gambled within 2 years of filing a bankruptcy petition. (Section 271(a) of the Bankruptcy Act of 1966)
- iii. Similar in the U.K. until repealed in 2004
- iv. Early U.S. bankruptcy legislation had a similar provision, confined to gambling which occurred after filing of petition. See David S. Kennedy and James E. Bailey, "Gambling and the Bankruptcy Discharge: An Historical Exegesis and Case Survey" (1995) 11 *Bankruptcy Developments Journal* 49, 55-6.

## II. Trustee Powers with Respect to Gambling

### A. Preferences.

By signing a marker, a debtor becomes obligated to repay the amount stated. In return the debtor receives credit, often in the form of chips. If the debtor does not lose all of those chips and returns them to the casino, may a trustee recover?

This issue was addressed in Homann v. R.I.H. Acquisitions IN, LLC (In re Lewinski), 2008 Bankr., LEXIS 2596, No. 07-03082-hcd (Bankr. N.D. Ind. Sept. 30, 2008).

The trustee sought to avoid the transfer of the chips under §547, as a preference. The casino argued that the chips were not "an interest of the debtor," because they did not constitute currency and could not be used to satisfy the claims of the debtor's creditors. The chips had no economic value outside the casino.

The court rejected that argument, finding that the debtor incurred a debt by signing each marker and was obligated to repay the funds evidenced by that marker. The court found that the chips had value in the casino and were fungible tokens used as a substitute for cash. They could be cashed in or used to redeem a marker.

The 8<sup>th</sup> Circuit held similarly, in Harrah's Tunica Corp. v. Meeks (In re Armstrong), 291 F.3d 517, 2002 U.S. App. LEXIS 10034 (8<sup>th</sup> Cir. 2002), that because the casino in question agreed to hold the markers for thirty days before submitting them for payment, it became a short term loan. The casino even required the debtor to complete a "casino credit" application. Thus, it was an antecedent debt, and the court could turn to the exceptions enumerated in 11 U.S.C. §547(c). The court held that the markers constituted antecedent debt.

### B. Fraudulent Transfers.

Trustees have not been as successful with recovering gambling losses as fraudulent transfers. The 6<sup>th</sup> Circuit addressed this issue in In re Chamakos, 69 F.3d 769 (6<sup>th</sup> Cir. 1995). The trustee sought to recover approximately \$7,700 from a state-run casino. The trustee was proceeding under both 11 U.S.C.

§548(a) and also under Michigan's version of the Uniform Fraudulent Conveyance Act.

The court found that the debtors were deemed to have been insolvent during the relevant period and the issue revolved around whether or not the debtors received reasonably equivalent value or fair consideration in exchange for their transfers to the casino.

The trustee argued that gambling odds favor the house and that gambling could not constitute "an 'investment' that can have economic value." The argument was basically that the debtors left the casino "with nothing in exchange for the monies they gambled away." The court viewed the critical time of the transfer as when the bet was placed. At that time, the debtors had a contractual right to collect if the bet were won.

The court compared such a bet to an investment in an FCC license application. It pointed out, though, that gamblers may also be receiving entertainment value. Another example along those same lines would be debtors who spend money at upscale restaurants. The value is consumed or lost, and the creditors fare no better.

The casino presented evidence that its gambling business is closely regulated by the state, and that such regulation requires minimum payout ratios for gamblers. It also pointed out that gambling is a competitive industry and that casinos rely upon repeat business.

Interestingly, the decision educates us, that Flamingo's slot machines pay out 94% in winnings. Blackjack is an even better bet, though, as the house advantage is no more than 1%.

### **III. Property of the Estate.**

#### A. Includes:

- "all legal or equitable interests of the debtor in property as of the commencement of the case." [Section 541(a)(1)]
- Also includes post-petition funds by bequest, devise, or inheritance; property settlement agreements with spouses, and becoming a beneficiary of a life

insurance policy or death benefit plan with 180 days after the filing of the petition. [Section 541(a)(5)]

B. Filing after winning.

- Asset of estate even if the winnings have not yet been claimed or if they are to come in the form of future payments.
- The only likely exemption will be the federal wild card, 11 U.S.C. §522(d)(5).

C. Filing after buying lottery ticket, but before the drawing.

- The winnings still remain an asset of the estate. The ticket should have been listed in the bankruptcy schedules.
- The only likely exemption will be the federal wild card, 11 U.S.C. §522(d)(5).

D. Filing bankruptcy before purchasing lottery ticket.

- In Chapter 7, the lottery winnings belong to the debtor and are not an asset of the estate.
- In Chapter 13, the ticket and any winnings are an asset of the estate. See In re Wetzel, 381 BR 247 (Bankr. E.D. Wis 2008)

In Wetzel, the debtors had an inheritance of about \$100,000 post-petition and also developed a business. They sent in tax returns to the trustee, but the trustee did not immediately seek an increase in the plan payment. The trustee ultimately viewed the tax returns, noticed the reported income, and filed a motion to modify the plan under Section 1329 to increase both the plan length and the dividend.

The court reviewed Section 541(a), Section 1306, and Section 1327(b) to analyze whether the new business income and inheritance constituted property of the estate. Although the plan stated that title to property should vest in the debtor upon confirmation, it was unclear whether that did or could apply to post-petition property.

Three approaches:

1. If property vests at confirmation, that extinguishes estate.
2. All property or earnings after confirmation remain property of the estate.



3. Middle ground – only post-confirmation property needed to fund plan remains property of the estate.

The court's policy argument led it to side with the trustee in the case. Ultimately, the court concluded that the new business and inheritance earnings were property of the estate and set a hearing on the Best Interest of Creditors test and feasibility.

#### **IV. Means Test**

Enacted in 2005 under BAPCPA, and required by 11 U.S.C. §707(b), the means test applies in both Chapter 7 and Chapter 13 cases.

##### A. Chapter 7

- The means test is conducted using Form 22A. The first portion of the test determines whether or not the debtor's household income is above or below the median income for a household of that size.
- The USTP position is that net gambling income should be included on Line 10.

##### B. Chapter 13

- In Chapter 13, the means test is utilized, through Form B22C, to determine the amount which must be paid into the plan by the debtor for unsecured claims.
- This determination also begins the calculation of current monthly income.
- USTP position is that net gambling income should be included on Line 9 (note: under current forms, this would be line 10).

##### C. Three primary sources of earnings to review:

- Sports book sites like FanDuel, Bovada, and DraftKings (fantasy sports);
- Lottery proceeds;
- In-person casinos.

##### D. How to Identify

- Many casinos have cards that give rewards and keep track of gamblers' play. Potawatomi Bingo Casino in Milwaukee has the Fire Keeper's card. Ho-Chunk in Wisconsin Dells has its Rewards Club. Nearly every casino has a similar program.
- Questioning the debtors.

- Reviewing documents like tax returns, credit card statements, and bank records. Tax returns would list substantial gambling earnings from the prior year(s).
  - Online records. While many online fantasy sites are week-to-week, there may be ways to track earnings on there as well.
- E. Adjustments may be subject to an adjustment under Hamilton v. Lanning if the income is certain, or virtually certain, not to occur again. Given the unlikely nature of winning multiple jackpots, there is a case to be made for backing out some earnings if they are once-in-a-lifetime jackpots or if the gambling has ceased due to a court order, a check-in to Gamblers Anonymous, or some other reason.

**V. Schedule Preparation Issues**

- Debtors holding lottery tickets or similar gambling assets must disclose them on Schedule B.
- Gambling winnings held at the time of filing are an asset of the estate and must be disclosed on Schedule B.
- Gambling winnings must also be disclosed on Statement of Affairs question No. 1. The number used should be gross winnings.
- Gambling losses are disclosed at Statement of Affairs No. 8 and include both dates and descriptions
- The Todd Max Havilland Story.

**VI. Chapter 13 Issues**

Gambling and Chapter 13 are inconsistent. Judge Kelly commented on debtors' use of post-petition gambling as follows:

“The Debtors’ use of postconfirmation income to gamble for personal entertainment while claiming that they cannot dedicate an additional \$700 per month in repayment of their creditors does not comport with the Court’s understanding of the philosophy of Chapter 13.” In re Wetzel, 381 BR 247 (Bankr. E.D. Wis 2008)

Trustee Mary Grossman advises debtors that gambling is inappropriate.

The following language appears upon her website:

*"Gambling During Your Chapter 13 Plan*

Any gambling during the time you are in a Chapter 13 case is inappropriate. You should avoid all types of gambling.

If gambling is a problem for you, you may contact Hotline for Problem Gamblers at 1-888-238-7633 or Gamblers

Anonymous on the Web at [www.gamblersanonymous.org](http://www.gamblersanonymous.org)."

**VII. Choice of Law**

May a casino which holds a debtor's marker enforce that claim in a bankruptcy filed by the debtor?

Note that gaming contracts are void under Wisconsin Statute 895.055, which provides:

Gaming contracts void. (1) All promises, agreements, notes, bills, bonds, or other contracts, mortgages, conveyances or other securities, where the whole or any part of the consideration of the promise, agreement, note, bill, bond, mortgage, conveyance or other security shall be for money or other valuable thing whatsoever won or lost, laid or staked, or betted at or upon any game of any kind or under any name whatsoever, or by any means, or upon any race, fight, sport or pastime, or any wager, or for the repayment of money or other thing of value, lent or advanced at the time and for the purpose, of any game, play, bet or wager, or of being laid, staked, betted or wagered thereon shall be void.

In In re Jafari, 378 B.R. 575 (Bankr. W.D. Wis. 2007), Judge Thomas Utschig determined that this statute and common law justify disallowance of the claims filed by casinos.

On appeal, District Judge Crabb reversed and remanded. In re Jafari, 385 B.R. 262 (W.D. Wis. 2008). Judge Crabb found that the credit was requested and received in Nevada, and that Wisconsin's only contact to the debt was that the debtor happened to live in Wisconsin at the time he entered into the agreements. Substantive Nevada law would apply to determine the enforceability of the contracts.

On remand, Judge Utschig allowed the claims. The debtors and the trustee then appealed to the 7<sup>th</sup> Circuit. That court affirmed the decision allowing the claims. The court relied in large measure upon the fact that all significant contacts in the case were with Nevada, excepting only that Jafari resided in Wisconsin at the time he entered into the agreements. 569 F. 3d 644 (7<sup>th</sup> Cir. 2009).

#### **VIII. Ethics**

- "Don't Be This Guy."

Earlier this year the Ohio Supreme Court permanently disbarred Lima, Ohio lawyer Stephen L. Becker for misappropriating funds from relatives and clients. In a unanimous decision, the court found that gambling was a primary factor in many of the misappropriations. Uncontested testimony from a psychologist documented that Attorney Becker was a pathological gambler, but while Becker may have been addicted to gambling, he had failed to seek help.