

## THE PENDING DETERMINATION OF THE LEGALITY OF INTERNET GAMBLING IN THE UNITED STATES

*Internet gambling has been targeted on many fronts in the United States, including Congress, the courts, the Bush Administration and credit card agencies. This iBrief details recent trends in the regulation of online gaming, and concludes that while absolute prohibitions may be ineffective, the combined resistance of these institutions will prevent the industry from expanding its customer base.*

### An Overview

There can be little doubt that Internet gambling means big business around the world. Online gaming sites have won \$4.1 billion from bettors this year, and that number is expected to increase to an estimated \$6 billion next year.<sup>1</sup> Gamblers in the United States are responsible for between 50 percent and 65 percent of that amount.<sup>2</sup>

This iBrief will discuss four current developments that will determine the course of evolution of the Internet gambling industry:

- First, the Internet Gambling Enforcement Bill<sup>3</sup> passed last year in the United States House of Representatives.<sup>4</sup> This bill sought to prevent online gambling sites from using credit card instruments in their transactions.<sup>5</sup> The Senate never voted on the proposed legislation before the 107<sup>th</sup> Congress adjourned, so any attempt to regulate Internet gambling must begin again with the 108<sup>th</sup> Congress. Nonetheless, the House vote signaled interest by lawmakers in the issue of Internet gambling regulation.
- The second development is the move by credit card companies to prohibit the use of their cards in online gaming transactions.<sup>6</sup> This strategic move by the

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<sup>1</sup> Jeff Simpson, *Online Gaming Decision Panned: Official Deems Net Bets Illegal In Letter*, LAS VEGAS REV.-J., Sept. 4, 2002, at [http://www.lvrj.com/lvrj\\_home/2002/Sep-04-Wed-2002/business/19556668.html](http://www.lvrj.com/lvrj_home/2002/Sep-04-Wed-2002/business/19556668.html).

<sup>2</sup> *Id.*

<sup>3</sup> H.R. 556, 107th Cong. (2002).

<sup>4</sup> *House Passes Leach Bill*, GAMING MAG., Oct. 2, 2002, at <http://www.gamingmagazine.com/managearticle.asp?c=390&a=693>.

<sup>5</sup> Pamela Barnett, *E-Commerce: Army Urged to Act on Compromise Internet Gambling Bill*, NAT'L J.'S TECH. DAILY, PM ED., Sept. 4, 2002.

<sup>6</sup> Linda Punch, *Are All Bets Off for Online Gambling?*, 15 CREDIT CARD MGMT., MERCHANT ACQUIRING, No. 6, at 14.

credit card industry was prompted by pressure from state governments.<sup>7</sup> Along with major credit card services, online cash payment system PayPal has also announced that it will prohibit money transfers to online gambling sites, citing an uncertain regulatory environment.<sup>8</sup>

- Third, the Bush Administration has made its position known regarding the legality of Internet gambling in a letter from the Department of Justice to the Nevada Gaming Control Board, stating that “federal law prohibits gambling over the Internet, including casino-style gambling...”<sup>9</sup>
- Finally, the Second Circuit’s recent decision in *United States v. Cohen*<sup>10</sup> indicates that the federal judiciary is willing to use the 1961 Wire Act<sup>11</sup> to prosecute Internet gambling sites, even when they are operated offshore.<sup>12</sup>

Each of these developments casts a shadow of legal uncertainty on the future of Internet gambling in the United States. While past attempts in Congress to enact anti-Internet gaming legislation have failed,<sup>13</sup> the Leach bill represents a significant stride toward achieving consensus on the issue. Despite the fact that the Senate did not vote on the bill this session, the industry is likely to be stifled by legislative means and by credit card company anti-gaming policies in the near future. Furthermore, the recent Nevada decision by the Bush administration affirms the anti-Internet gaming stance formulated by the Clinton administration in its prosecution of Jay Cohen in the 1990s.<sup>14</sup> **Four Current Developments**

### *I. The Internet Gambling Enforcement Act*

The Internet Gambling Enforcement Act<sup>15</sup> passed in the House of Representatives in 2002, ending a streak of several failed attempts at passing Internet gambling legislation.<sup>16</sup> Its

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<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *E-Commerce*, NAT’L J.’S TECH. DAILY, PM ED., Sept. 10, 2002. (“In an Aug. 23 letter, Michael Chertoff, assistant attorney general and head of Justice’s criminal division, responded to inquiries from Nevada Gaming Control Board Chairman Dennis Neilander, listing federal statutes that prohibit online gaming activity.”)

<sup>10</sup> *United States v. Cohen*, 260 F.3d 68 (2nd Cir. 2001).

<sup>11</sup> Wire Act, 18 U.S.C. § 1084 (1961).

<sup>12</sup> *Cohen*, 260 F.3d at 278.

<sup>13</sup> Maureen Sirhal, *Outlook: E-Gambling: GOP House Bills Have a Chance*, NAT’L J.’S TECH. DAILY, PM ED., Aug. 22, 2002.

<sup>14</sup> Simpson, *supra* note 1.

<sup>15</sup> H.R. 556, 107th Cong. (2002).

<sup>16</sup> Sirhal, *supra* note 13.

sponsors, Rep. Jim Leach (R-Iowa) and John DeFalce (D-NY), introduced the bill in order to limit U.S. access to Internet gambling sites hosted on offshore servers. The bill aims to achieve this goal by prohibiting Internet gambling businesses from accepting credit, electronic funds transfers, checks or drafts from would-be U.S. Internet gamblers.<sup>17</sup> Additionally, the bill implicates financial institutions that may knowingly act as intermediate agents between gamblers and the Internet gaming business.<sup>18</sup>

Money laundering and “problem gaming” are the two reasons most often cited in support of a prohibition on Internet gambling.<sup>19</sup> Money laundering became a prime issue when Rep. Leach introduced a similar prohibition of Internet gambling that was included in early drafts of the USA Patriot Act.<sup>20</sup> In order to connect the gambling prohibition to the post-September 11th anti-terrorism legislation, Rep. Leach and his supporters argued that Internet gambling provided a forum for terrorists to launder money.<sup>21</sup> This position was criticized when no evidence was produced to show that there was any connection between online gambling and the funding of terrorist cells, and the measure was dropped from the final draft of the USA Patriot Act.<sup>22</sup> Still, this history remains embedded in the language of the Leach Bill as an observation: “Internet gambling conducted through offshore jurisdictions has been identified by United States law enforcement officials as a significant money laundering vulnerability.”<sup>23</sup>

Second, supporters of the bill argue that Internet gambling amplifies what is known in the industry as “problem gaming.”<sup>24</sup> In brick-and-mortar gambling establishments, safeguards against gambling addiction and underage gambling have been established. Online gamblers remain anonymous and often use credit cards when placing bets. Addicted players can lose a life savings or create thousands of dollars of debt without leaving their home. The Internet Gambling Enforcement Act addresses problem gaming over the Internet by eliminating common paths where money might flow from the gambler to the Internet site.

Unfortunately, Rep. Leach’s success in the House would have had to have been repeated in the Senate before the end of the 2002 session if the Bill were to have become law under the current Congress. Sen. Jon Kyl (R-Ariz.), had also hoped to hold a vote on a bill identical to Rep.

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<sup>17</sup> H.R. 556, 107th Cong. § 3 (2002).

<sup>18</sup> *Id.* § 3(e).

<sup>19</sup> Punch, *supra* note 6, at 14.

<sup>20</sup> Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107- 56, 115 Stat. 272 (Oct. 26, 2001).

<sup>21</sup> Frank J. Fahrenkopf, Jr., *State of the Gaming Industry*, AM. GAMING ASSOC., Dec. 11, 2001, at [http://www.americangaming.org/media\\_update/speeches/speech.cfm/id/33](http://www.americangaming.org/media_update/speeches/speech.cfm/id/33).

<sup>22</sup> *Id.*

<sup>23</sup> H.R. 556, 107th Cong. § 2(4) (2002).

Leach's Internet Gambling Enforcement Act. He had the support of Sen. Tim Johnson (D-S.D.), who previously introduced his own bill that would amend the 1961 Wire Act to prohibit Internet gambling.<sup>25</sup> However, with many other issues pending in the gridlocked Senate, the issue of Internet gambling was never put to a vote.

## *II. Self-Regulation in the Credit Card Industry*

Many of the financial institutions targeted in the Internet Gambling Enforcement Act have taken independent steps to prohibit transactions between gamblers and Internet gambling businesses.<sup>26</sup> American Express, Discover, Citibank, MasterCard, and Visa prohibit Internet gambling transactions due to the uncertain legal climate of the industry.<sup>27</sup> In addition to the liability problems, credit transaction companies claim that risks of fraud and bad debt are higher for internet gambling compared with other transactions.<sup>28</sup> In Citibank's case, the New York Attorney General, Eliot Spitzer, heavily influenced its decision. Spitzer accused the credit card company of knowingly profiting from an illegal activity. This allegation, if prosecuted, could have resulted in criminal liability under New York law. Citibank denied any wrongdoing, but agreed to contribute \$400,000 to compulsive gambler counseling services.<sup>29</sup>

Gamblers adapted quickly by learning to make payments through digital money services such as PayPal, a service that facilitates online money transfers by disbursing payments between members via email. However, Spitzer also pursued PayPal after the success of its confrontation with Citibank. PayPal declared that it had already agreed to prohibit gambling transactions due to its acquisition by eBay. Still, PayPal settled with the State of New York for \$200,000 in disgorged profits.<sup>30</sup> Other online money services similar to PayPal have stepped in to fill in the void, but each prohibition adds to the frustration of online gambling and creates barriers that may prove to be too high to attract new customers. In light of this trend toward prohibition of credit card and digital money transactions, only the most die-hard gamblers will resort to the use of unregulated foreign online banks and non-Internet based forms of money transfer.

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<sup>24</sup> Punch, *supra* note 6, at 14.

<sup>25</sup> Tony Batt, *Online Gambling: Kyl to Push Web Bet Ban in Senate*, LAS VEGAS REV.-J., Oct. 3, 2002, at [http://www.lvrj.com/lvrj\\_home/2002/Oct-03-Thu-2002/business/19764978.html](http://www.lvrj.com/lvrj_home/2002/Oct-03-Thu-2002/business/19764978.html).

<sup>26</sup> Punch, *supra* note 6, at 14.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *States*, WASH. INTERNET DAILY, Aug. 22, 2002.

### *III. Nevada Gaming Control Board*

Internet gambling in the United States seemingly is under attack from all angles. In August, the Justice Department signaled its opinion in a letter to the Nevada Gaming Control Board that current federal law prohibits Internet gambling.<sup>31</sup> This statement was made in response to an inquiry by the Control Board on the legality of a rule change that would legalize Internet gambling in Nevada.<sup>32</sup> Before the Department of Justice gave its opinion, there was some uncertainty as to where the activity of online gambling actually occurred, since bettors are frequently in different jurisdictions than the websites they contact. The letter makes it clear that the Justice Department considers gambling to have occurred in both the jurisdiction of the gambler and in the jurisdiction of the gambling business.<sup>33</sup> Under this approach, gamblers in Nevada could be held liable for their activities in cyberspace even if the web server was located offshore. This interpretation of current federal law signals the executive branch's current approach to the legality of Internet gambling, reinforcing the Clinton administration's position on Internet gambling.

It has been noted by gaming industry leaders that the Department of Justice relies too much on the Wire Act in its determination that online gambling is against federal law.<sup>34</sup> This legislation was enacted in order to prohibit sports betting, and it remains silent on other gambling activities.<sup>35</sup> While the Wire Act may not have been drafted with the Internet in mind, the Nevada decision shows the Justice Department's willingness to enforce the spirit of the 1961 gambling legislation. If Congress has changed its policy toward telephone and Internet gambling over the last forty years, it must make its intentions clear in the form of new legislation.

#### *The Cohen Case*

The judiciary took a strong stand against Internet gambling in the Second Circuit decision against offshore bookmaker Jay Cohen.<sup>36</sup> Cohen moved from California to the Caribbean island of Antigua to start World Sports Exchange (WSE), a sports-betting company that specifically targeted customers in the United States through advertisements in newspapers and on television and the radio.<sup>37</sup> Cohen's business was very successful, garnering \$5.3 million in wired U.S. funds over a fifteen-month period. The FBI investigated Cohen and his venture, placing bets of

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<sup>31</sup> *E-Commerce*, NAT'L J.'S TECH. DAILY, PM ED., Sept. 10, 2002.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> Simpson, *supra* note 1.

<sup>35</sup> *Id.*

<sup>36</sup> *United States v. Cohen*, 260 F.3d 68, 68 (2nd Cir. 2001).

<sup>37</sup> *Id.* at 70.

its own on the World Sports Exchange system over the telephone and on the Internet from October 1997 to March 1998.<sup>38</sup> In March 1998, Cohen was arrested under the Wire Act of 1961, which makes it illegal for businesses to take bets from gamblers over telephone lines or through other wired devices.<sup>39</sup>

Cohen was convicted in February 2000 at a jury trial for violation of three prohibition clauses in § 1084(a) of the Wire Act: “(1) transmission in interstate or foreign commerce of bets or wagers, (2) transmission of a wire communication which entitles the recipient to receive money or credit as a result of bets or wagers, (3) information assisting in the placement of bets or wagers.”<sup>40</sup> He appealed this decision to the Second Circuit Court of Appeals, arguing, *inter alia*, that the jury was improperly instructed to disregard the safe-harbor provision set forth in § 1084(b). In order for the safe-harbor to apply, § 1084(b) requires two conditions to exist. First, the betting must be legal in both the origin and the destination of the transmission. Second, the transmission must be limited to information that merely assists in the placing of the bets.<sup>41</sup> The court found that betting was illegal in New York, and went on to discuss the transmission of a bet. Cohen argued that his system was designed so that “the transmissions between WSE and its customers contained only information that enabled WSE itself to place bets entirely from customer accounts located in Antigua.”<sup>42</sup> Thus, the transmissions never involved the actual placement of bets. The court ruled that the trial court’s instructions to the jury were not improper when it declared that a transmission between a bettor and WSE over the telephone or Internet to signal the placement of a bet and an affirmation that the bet was accepted constituted a transmission under § 1084.<sup>43</sup> “By making those requests and have them accepted, WSE’s customers were placing bets.”<sup>44</sup>

The court’s decision sends a strong message to the Internet gambling industry: when determining whether a gambling transmission took place, the Second Circuit will pierce through mechanical means of placing bets such as the Internet to prevent the safe-harbor for “assisting information” from applying. Opponents of this opinion might note that the court’s interpretation on this point may be dicta. After all, the court had already ruled that gambling was illegal in New York, so it did not need to address the transmission portion of the safe-harbor subsection to show that it did not apply. Nonetheless, the court has made its intentions clear, and in the absence of

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<sup>38</sup> *Id.* at 71.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* (citing 18 U.S.C. § 1084(a)).

<sup>41</sup> *Id.* at 73.

<sup>42</sup> *Id.* at 74.

<sup>43</sup> *Id.* at 74-75.

other case law on the matter, all offshore Internet gambling businesses should be on notice that they may be criminally liable if they accept bets transmitted from within the U.S. Finally, it should be noted that this decision involved sports betting only. As discussed above, it is not clear that the Wire Act applies to other forms of gambling. **Conclusions**

Though the underlying reasons for the multi-faceted resistance to Internet gambling lie outside the scope of this iBrief, the future effects of such opposition on the industry are easy to predict. Gambling sites will continue to operate offshore, but may refuse to take bets from gamblers located in the United States. Committed gamblers in the United States will maintain bank accounts in foreign countries and only associate with businesses well outside the grasp of American jurisdiction. In the end, the protectionist measures described above may never completely put a halt to Internet gambling in the United States. However, the actions of Congress, the Bush Administration, and the courts may very well achieve success in preventing the spread of casual gambling, underage gambling, and credit-based gambling that have proliferated since the growth of the World Wide Web.

The resulting curtailment of Internet gambling shifts the balance between individual freedom so often associated with the Internet and government paternalism. On one hand, Internet gambling has allowed an individual to make informed decisions regarding personal monetary resources. In contrast, the recent trend toward Internet gambling opposition suggests that gambling has not shaken its reputation as a stigmatized activity, subject to the prohibition by the government authorities, regardless of the manner in which the transactions are executed. The current situation splits the difference: government leaders are simply maintaining the status quo of the role of gambling in the context of society. Before the Internet, gambling was a tolerated activity in a highly regulated sector of the economy. The Internet opened the floodgates on the ability of gambling to thrive as an industry, and frustrated the intent of antiquated legislation designed to confine gambling activity to a narrow domain. Now that the glow of the new technology of the Internet has faded, the government is in the process of returning gambling to its regulated corner of the economy.

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<sup>44</sup> *Id.* at 75.