

DRAWING A LINE IN THE SAND: HOW THE FEDERAL GOVERNMENT CAN WORK WITH THE STATES TO REGULATE INTERNET GAMBLING

INTRODUCTION

The new American dream. Invest \$39 and walk away with \$2.5 million. The aptly named Chris Moneymaker did just that in 2003.¹ Moneymaker entered an online poker tournament hosted by PokerStars² and was able to win a seat at the 2003 World Series of Poker.³ He subsequently won the entire tournament and in the process helped accelerate an already growing industry.⁴

Online poker is the fastest growing component of the Internet gambling industry.⁵ As an industry, Internet gambling has grown by leaps and bounds over the past few years. Although estimates of the size of the industry vary, in 2005, revenues reached approximately \$10 billion.⁶ Americans generated almost \$5 billion of those revenues.⁷

Internet gambling brings in a modest sum compared with the revenues generated by traditional brick-and-mortar casinos. In 2003, the United States gambling industry grossed over \$72 billion.⁸ Gambling is so prevalent in the United States that all but two states have legalized some form of gambling

¹ Larry Woody, *Chips Never Down Now for Moneymaker*, TENNESSEAN, Oct. 15, 2005, at 1C; Joe Rhodes, *Bull's-Eye: TV's Next No-Limit Wager*, N.Y. TIMES, Oct. 23, 2005, at AR1.

² PokerStars is a registered business located in San José, Costa Rica. PokerStars tries to distinguish itself from an Internet casino by explaining that “[y]ou always play against other real poker players” and “never against the house.” Poker Stars, <http://www.pokerstars.com/aboutus.html> (last visited Sept. 13, 2006).

³ Woody, *supra* note 1. The World Series of Poker is a \$10,000 buy-in tournament that takes place every year in Las Vegas, NV. Norman Chad, *Poker Goes Mainstream with 'The Main Event'*, HOUS. CHRON., June 28, 2005, at Sports, 2.

⁴ Woody, *supra* note 1.

⁵ John Mitchell, *Poker and Golf Go Hand in Hand*, TIMES (London), Dec. 5, 2005, at 11.

⁶ Diane Brady, *One High-Stakes Card Game: Can Cable TV's World Poker Tour Keep Making Money at Such a Crowded Table?*, BUS. WK., Mar. 21, 2005, at 72; *Jokers Wild*, ECONOMIST, Apr. 16, 2005, at 57.

⁷ See *Jokers Wild*, *supra* note 6. The term “Americans” is in reference to the geographical origination of the revenue stream rather than citizenship of the gamblers.

⁸ Jeffrey Kluger, *When Gambling Becomes Obsessive*, TIME, Aug. 1, 2005, at 52.

such as slots or lotteries.⁹ In fact, more than twenty states have land-based, riverboat, or Native American reservation casinos.¹⁰

Internet-based casinos have many advantages over brick-and-mortar operations. Traditional hotels and casinos can cost billions of dollars to construct,¹¹ whereas online casinos require only a few million.¹² Internet casinos are easily accessible from the home and do not require traveling considerable distances. This ease of access plays an enormous role in the vitality and growth of online gambling.¹³ As one former gambling addict remarked, the Internet is the “crack cocaine of gambling.”¹⁴

One of the biggest challenges facing state and federal governments is to create a cohesive framework that addresses concerns from both authorities. Traditional gambling, in general, always has been an area reserved for state regulation.¹⁵ The federal government, however, has decided to treat Internet gambling differently and deny states the right to regulate and create online casinos.¹⁶

In 2002, the chairman of the Nevada Gaming Control Board sent a letter to the Department of Justice (DOJ) to inquire into whether federal law would allow Nevada to legalize Internet gambling within its jurisdiction.¹⁷ Assistant Attorney General Michael Chertoff replied that Nevada regulators could not allow “interactive gaming” from outside the state under current federal law.¹⁸ Chertoff’s letter interpreted federal law to prohibit all types of Internet

⁹ *Id.*

¹⁰ Yahoo! Finance, http://biz.yahoo.com/ic/profile/711_1431.html (last visited Sept. 13, 2006). Interestingly, Native American casinos account for a large percentage of the growth in the brick-and-mortar gambling industry with approximately \$16 billion in revenues every year. *Id.* Casinos are a big part of local economies. For example, after Hurricane Katrina demolished nine out of ten casinos in Biloxi, Mississippi, the Governor called a special session of the Legislature to change the existing law barring casinos from being built exclusively on land. George Penick & K. Jack Riley, *Mississippi Comeback*, L.A. TIMES, Aug. 20, 2006, at M3. Now casino operators can build on land instead of having to keep a portion of their casino offshore. *Id.* See, e.g., Mary Billard, *Letter from Biloxi; Casinos Rise Out of Katrina’s Wreckage*, N.Y. TIMES, Feb. 22, 2006, www.nytimes.com (search “Letter from Biloxi”; then follow first hyperlink).

¹¹ The new Wynn Hotel/Casino cost approximately \$2.7 billion. Adam Goldman, *Vegas Tycoons Fight for Dollars*, HAMILTON SPECTATOR (Ont. Can.), June 13, 2005, at A18.

¹² Brian Caulfield, *Online Gambling Still Province of Startups*, INTERNET WORLD, Sept. 7, 1998, at 58.

¹³ See Tom Mashberg, *You Bet! Gamblers Sweeten the Mass. Pot*, BOSTON HERALD, Mar. 13, 2005, at 4.

¹⁴ Dan Kelly, *Getting Hooked Is Easy . . . but Help Is a Long Shot*, READING EAGLE (Reading, Pa.), Oct. 27, 2005, at A1.

¹⁵ See *infra* note 26 and accompanying text.

¹⁶ See *infra* Part I.B.

¹⁷ Jeff Simpson, *Justice Official Deems Internet Bets Illegal*, LAS VEGAS REV. J., Sept. 4, 2002, at 1D.

¹⁸ *Id.*

gambling.¹⁹ Under this interpretation, the DOJ would presumably find any type of Internet gambling illegal even if both the state where the bettor originated and the state that operated the online casino had legalized Internet gambling.

The federal laws that govern gambling were passed by Congress pursuant to its Commerce Clause power.²⁰ There is no question whether the regulation of gambling, especially Internet gambling, is within the scope of Congress's power.²¹ The ultimate issue is whether Congress should use its Commerce Clause power to regulate Internet gambling irrespective of the needs and wants of the individual states. This Comment argues that the only way to deal effectively with Internet gambling is for the federal government to respect and, if necessary, enforce individual state policies.

Part I provides an overview of state and federal law governing Internet gambling. Rather than providing a comprehensive analysis of the law in all fifty states, this Comment will categorize the various approaches states have taken to Internet gambling. Part I will also discuss four federal laws and their applicability to Internet gambling: the Wire Act,²² Travel Act,²³ Illegal Gambling Business Act,²⁴ and the Unlawful Internet Gambling Enforcement Act of 2006.²⁵

Part II focuses on the social and economic harms commonly associated with gambling. The discussion will focus on how and to what extent Internet gambling either alleviates or aggravates these harms. Furthermore, this Part will argue that effective state tax policy may offset any negative costs associated with Internet gambling.

Part III discusses the various attempts by lawmakers to take a heavy-handed approach to regulation in other areas of quasi-illegal activity. This Part

¹⁹ Chertoff wrote that "federal law prohibits gambling over the Internet, including casino-style gambling." *E-Commerce*, NAT'L J. TECH. DAILY, Sept. 10, 2002.

²⁰ U.S. CONST. art. I, § 8, cl. 3 ("The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . .").

²¹ See generally Michael W. Loudenslager, *Allowing Another Policeman on the Information Superhighway: State Interests and Federalism on the Internet in the Face of the Dormant Commerce Clause*, 17 BYU J. PUB. L. 191, 240–41 (2003) (explaining that the dormant Commerce Clause may prevent state regulation of gambling in some cases).

²² 18 U.S.C. § 1084 (2000).

²³ § 1952.

²⁴ § 1955.

²⁵ Pub. L. No. 109-347, 120 Stat. 1884.

argues that Congress should not make the same mistakes in the Internet gambling context as it made trying to regulate Internet pornography. Specifically, Congress should avoid a “one-size-fits-all” approach to Internet gambling regulation.

Part IV deals with the hurdles both state governments and the federal government face when trying to curb Internet gambling. This Part focuses on the difficulties these governments have encountered when trying to enforce their existing laws with Internet technology.

This Comment ultimately concludes that the federal government should allow each state to decide whether to ban or regulate online gaming.

I. OVERVIEW OF STATE AND FEDERAL LAW

A. *Various State Approaches*

Gambling has traditionally been an activity regulated by the states.²⁶ Antigambling laws were common in early America when gambling was “a topic that could not be mentioned in polite society.”²⁷ As the law developed, the states took various approaches to regulating gambling. Some states prohibit all forms of gambling while others allow land-based casinos to offer all types of different games.²⁸ State regulation falls into four broad categories:

- (1) Absolute prohibition: No games of chance allowed.
- (2) State-run or state-sponsored gambling: Lotteries, raffles, and other games run by the state.
- (3) Nontraditional forms of gambling: Horse racing, bingo, and other games that do not involve a “house.”
- (4) All forms of gambling: Land-based casinos, sportsbooks, and more.

²⁶ Under the Interstate Horseracing Act, Congress specifically found that gambling is the primary responsibility of the States. See 15 U.S.C. § 3001 (2000) (“The Congress finds that . . . the States should have the primary responsibility of determining what forms of gambling may legally take place within their borders.”).

²⁷ See Nelson I. Rose, *Gambling and the Law—Update 1993*, 15 HASTINGS COMM. & ENT. L.J. 93, 94 (1992); see also, N. Bruce Duthu, *Crow Dog and Oliphant Fistfight at the Tribal Casino: Political Power, Storytelling, and Games of Chance*, 29 ARIZ. ST. L.J. 171, 185 (1997).

²⁸ See Eugene Martin Christiansen, *Socioeconomic Impacts and Public Policy: Gambling and the American Economy*, 556 ANNALS AM. ACAD. POL. & SOC. SCI. 36, 43–44 (1998) (explaining how some land-based casinos allow Class III games which includes all types of casino games).

Only two states fall into the first category of absolute prohibition: Utah and Hawaii.²⁹ Utah's ban on all forms of gambling is codified in its Constitution.³⁰ Utah's statutes are also very clear that regardless of whether the participant is the bettor or the "house," any gambling-related activity is illegal under State law.³¹ Hawaii's statutes are less clear as they seem to apply only to those who engage in "promoting gambling."³² A literal reading of the statutes banning gambling in these two states shows that any Internet-based gambling is prohibited.³³

The second category includes more states than the first. Tennessee, until recently a resident of the first category, moved into the second category at the turn of the century.³⁴ In 2001, an amendment to the Tennessee Constitution allowed the legislature to authorize a state lottery.³⁵ The voters approved the amendment in November 2002.³⁶ The constitutional amendment specifically allocates the net proceeds from the lottery to school-related projects.³⁷ In total, approximately forty states have a lottery.³⁸ There is some speculation that the prevalence of state lotteries is due in large part to the notion that it is a "painless tax."³⁹

²⁹ Corey D. Hinshaw, *Taking a Gamble: Applying Therapeutic Jurisprudence to Compulsive Gambling and Establishing Gambling Treatment Courts*, 9 GAMING L. REV. 333, 333 (2005).

³⁰ UTAH CONST. art 6, § 27 ("The Legislature shall not authorize any game of chance, lottery or gift enterprise under any pretense or for any purpose.").

³¹ See UTAH CODE ANN. § 76-10-1102 (1996) ("A person is guilty of gambling if he . . . participates in gambling.").

³² See HAW. REV. STAT. § 712-1221(1) (2004). One recent case out of Hawaii affirmed a conviction where the defendant was a mere participant in a game of chance. See *State v. Yip*, 987 P.2d 996, 1000 (Haw. Ct. App. 1999) (citing § 712-1221(1)). This subsection has catchall language that can be used to prosecute any gambler. § 712-1221(1)(c) ("[r]eceiving or having become due and payable in connection with a . . . gambling scheme . . . more than \$1,000 in any seven-day period"). Unfortunately for the gambler, winning is not a necessary element of the offense. See *Yip*, 987 P.2d at 1000 (affirming a conviction of a defendant who lost over \$1,000 dollars in a game of chance). But see § 712-1231 (allowing social gambling).

³³ In 1998, Utah's Assistant Attorney General Steve Morrissett warned Utah residents that gambling on cyberspace was illegal and that "anyone who does it should be aware they are breaking the law." Steven Oberbeck, *Gambling in Utah: Are Cybercasinos on a Roll?*, SALT LAKE TRIB., May 24, 1998, at A1.

³⁴ See TENN. CONST. art. 11, § 5.

³⁵ See *id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ Citizen Link: Focus on Social Issues, <http://www.citizenlink.org/FOSI/gambling/lottery/> (last visited Feb. 14, 2007).

³⁹ See Stephen C. Fink et al., *Lotto Nothing? The Budgetary Impact of State Lotteries*, APPLIED ECON., Dec. 10, 2004, at 2357 (noting that the lottery has often been called a "tax on people who are bad at math") (internal quotation marks omitted). Some researchers believe that overall tax revenues decline with increased lottery sales. See *id.*; see also *infra* Part II.C.

The third category includes states that have lotteries and other forms of gambling. For example, Massachusetts has legalized dog and horse racing.⁴⁰ Massachusetts' state lottery contains many games under the umbrella of lottery. These games include "statewide lotteries, scratch tickets, pull-tabs, beano, raffles by certain organizations, and keno."⁴¹ New York also fits into this third category. New York has legalized state lotteries and certain types of pari-mutuel betting on horse races⁴² and local games of chance.⁴³ With the exception of these types of games, betting or gambling is illegal in New York.⁴⁴

The fourth category includes states that one normally associates with gambling, such as Nevada and New Jersey. Nevada has many traditional brick-and-mortar casinos,⁴⁵ a reality that is in line with its state public policy: "[The] gaming industry is vitally important to the economy of the state and the general welfare of the inhabitants."⁴⁶ Nevada is concerned with the strict regulation of the gaming industry to ensure that "public confidence and trust" is maintained.⁴⁷ In New Jersey, land-based casinos are allowed only in Atlantic City.⁴⁸ New Jersey also allows state lotteries, horse racing, and bingo.⁴⁹ To legalize additional games of chance, a voter referendum is required.⁵⁰

The number of states in each category shows that the states have different approaches to the legalization of gambling. Some states only allow a few games, whereas others, like Nevada, legalize almost every form of gambling. The disparity in treatment of land-based casinos indicates that a demand exists for states to choose how to regulate Internet casinos individually.

⁴⁰ See U.S. GEN. ACCOUNTING OFFICE, GAO REP. 02-1101R, INTERIM REPORT ON INTERNET GAMBLING 18 (2002) (citing MASS. ANN. LAWS ch. 6, § 48 (2002)).

⁴¹ *Id.*

⁴² "[A] form of betting . . . on horse races at racetracks, in which those holding winning tickets divide the total amount bet in proportion to their wagers, less a percentage for the management, taxes, etc." RANDOM HOUSE WEBSTER'S UNABRIDGED DICTIONARY (2d ed. 2001).

⁴³ See UNITED STATES GENERAL ACCOUNTING OFFICE, *supra* note 40, at 21–22.

⁴⁴ N.Y. PENAL LAW § 225.00 (2000).

⁴⁵ See Jeff Simpson, *Nevada Casinos Report Higher Gaming Revenue in October*, LAS VEGAS REV. J., Dec. 13, 2002, at 1D.

⁴⁶ NEV. REV. STAT. § 463.0129(a) (2004).

⁴⁷ § 463.0129(c).

⁴⁸ See UNITED STATES GENERAL ACCOUNTING OFFICE, *supra* note 40, at 4, 20.

⁴⁹ *Id.* at 4.

⁵⁰ N.J. CONST. art. IV, § 7, para. 2 (1947) ("No gambling of any kind shall be authorized by the Legislature unless the specific kind [has been] . . . submitted to, and authorized by a majority of the votes cast . . . at a special election . . . and authorized by a majority of the votes cast . . . at a general election.").

B. *The Federal Regime*

Despite this demand, the federal government clearly interprets its laws to outlaw all forms of online gambling within the United States.⁵¹ Online casinos operated by a U.S. citizen are contrary to the laws of the United States as well.⁵² However, it is equally clear that an individual bettor cannot be prosecuted for gambling on an offshore casino under federal law.⁵³ Before the Unlawful Internet Gambling Enforcement Act of 2006, the federal laws banning most forms of gambling were enacted as part of a regime to deter organized crime.⁵⁴ However, the organized crime rationale does not apply today.⁵⁵ In fact, by 1976 the influence of organized crime on the gambling industry was “significantly reduced” because of the influx of legitimate corporate investors and the efficacy of federal regulation.⁵⁶ To understand the organized crime rationale for, and the reach of, federal law, this section will focus on the four main laws that are applicable to Internet gambling: the Wire Act, the Travel Act, the Illegal Gambling Business Act, and the Unlawful Internet Gambling Enforcement Act.

1. *The Wire Act*

The Wire Act, enacted in 1961, prohibits gamblers from using a wire communication facility to receive bets or to send gambling information.⁵⁷ Two elements must be present for a violation of the Wire Act: (1) the information transmitted over the wire must assist “in the placing of bets or wagers on any sporting event or contest,” and (2) during the time of transmission, the defendant must have been engaged in the business of wagering.⁵⁸ The case

⁵¹ See *E-Commerce*, *supra* note 19 and accompanying text.

⁵² See Simpson, *supra* note 17 and accompanying text.

⁵³ Cf. Bruce P. Keller, Essay, *The Game's the Same: Why Gambling in Cyberspace Violates Federal Law*, 108 YALE L.J. 1569, 1574 (1999) (arguing that federal law prohibits all forms of gambling yet does not necessarily hold individuals criminally liable). However, individual state laws may prohibit an individual from playing on any online casino. *Id.* at 1576.

⁵⁴ See Duthu, *supra* note 27, at 191.

⁵⁵ *Id.* But see James Frey, *Gambling: Socioeconomic Impacts and Public Policy*, Preface, 556 ANNALS AM. ACAD. POL. & SOC. SCI. 8, 9–10 (1998) (noting that many people still feel that despite corporate ownership, organized crime syndicates still run the casinos).

⁵⁶ See Duthu, *supra* note 27, at 190 (internal quotation marks omitted).

⁵⁷ Federal Interstate Wire Act, Pub. L. No. 87-216, 75 Stat. 491 (1961) (codified as amended at 18 U.S.C. § 1084 (2000)).

⁵⁸ § 1084; Megan E. Frese, Note, *Rolling the Dice: Are Online Gambling Advertisers “Aiding and Abetting” Criminal Activity or Exercising First Amendment-Protected Commercial Speech*, 15 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 547, 560–61 (2005) (citing *Truchinski v. United States*, 393 F.2d 627, 630 (1968)).

law interpreting the Act is sparse and somewhat conflicting.⁵⁹ Generally, courts have construed the word “transmission” to include gamblers who make and receive calls in the course of gambling.⁶⁰ One court held that the Wire Act is only applicable to sports-related betting.⁶¹ However, other courts have extended the literal language of the Wire Act to encompass casino-type gambling as well.⁶² The DOJ’s view is that the Wire Act is not limited to sports-related events or activities.⁶³

The Wire Act was originally designed to serve two distinct purposes. According to former U.S. Attorney General Robert F. Kennedy, the dual purpose of the Wire Act was to (1) assist the states in “the enforcement of their laws pertaining to gambling, bookmaking, and like offenses” and (2) “aid in the suppression of organized gambling activities by prohibiting the use of . . . wire communication facilities which are or will be used for the transmission of certain gambling information in interstate and foreign commerce.”⁶⁴ At the time of the adoption of the Wire Act, state and federal authorities needed new tools to combat gambling by organized crime syndicates.⁶⁵ In fact, one could argue that the Wire Act had less to do with helping states enforce their ban on gambling than it did with halting the growth of the criminal empires and organized crime syndicates that fed off gambling.⁶⁶

The application of the Wire Act to Internet-based gambling activities is fairly straightforward. Although the statute was passed before the advent of the Internet,⁶⁷ one court had no trouble in applying the Wire Act to Internet-based gambling in sentencing an entrepreneur to twenty-one months in jail.⁶⁸

⁵⁹ CHARLES DOYLE, INTERNET GAMBLING: OVERVIEW OF FEDERAL CRIMINAL LAW 7 (2003).

⁶⁰ *Id.* (citing *United States v. Pezzion*, 535 F.2d 483, 484 (9th Cir. 1976)).

⁶¹ *In re Mastercard Int’l*, 132 F. Supp. 2d 468, 479 (E.D. La. 2001) (holding that a plain reading of the Wire Act requires that the gambling occur over a sports event or contest).

⁶² *People v. World Interactive Gaming*, 714 N.Y.S.2d 844, 862 (N.Y. Sup. Ct. 1999) (enjoining an Antigua company from offering casino gambling over the Internet).

⁶³ See UNITED STATES GENERAL ACCOUNTING OFFICE, *supra* note 40, at 6.

⁶⁴ David B. McGinty, *The Near-Regulation of Online Sports Wagering by United States v. Cohen*, 7 GAMING L. REV. 205, 209 (2003) (citing H.R. REP. NO. 87-967 (1961), reprinted in 1961 U.S.C.C.A.N. 2631, 2633–34) (letter from Attorney General Robert F. Kennedy to Speaker of the House of Representatives)); see also Joel Michael Schwarz, *The Internet Gambling Fallacy Craps Out*, 14 BERKELEY TECH. L.J. 1021, 1030 (1999).

⁶⁵ H.R. REP. NO. 107-591, pt. 1 (2002).

⁶⁶ Tony Glover, *Will Online Gaming Turn Out to Be a Busted Flush?*, BUSINESS, Sept. 11, 2005, at 1.

⁶⁷ Michael E. Allen, Note, *Analyzing Minimum Contacts Through the Internet: Should the World Wide Web Mean World Wide Jurisdiction?*, 31 IND. L. REV. 385, 388 (1998) (stating that the Defense Department started funding what is known today as the Internet in 1969).

⁶⁸ See *United States v. Cohen*, 260 F.3d 68, 71 (2d Cir. 2001); see also Glover, *supra* note 66, at 1.

In 1998, Jay Cohen, the creator of an online sports book⁶⁹ called World Sports Exchange (WSE), located in Antigua,⁷⁰ was indicted for conspiracy and substantive offenses in violation of the Wire Act.⁷¹ After his indictment, Cohen, an American citizen, voluntarily returned to the United States to prove that the Wire Act did not apply to Internet gambling.⁷² Unfortunately for Cohen, the Second Circuit did not agree with his analysis and affirmed his jury trial conviction in *United States v. Cohen*.⁷³

The two main issues before the court were whether WSE's activities fell within the ambit of the Wire Act and whether the Wire Act's "safe harbor" provision applied.⁷⁴ The court easily answered the first issue by noting that Cohen's activities implicated two forms of wire facilities, the Internet and the telephone, which he used for the express purpose of transmitting bets and betting information.⁷⁵ Specifically, customers placed bets with WSE either through the Internet or by making a toll-free call; WSE would transmit information back to the customers in the form of confirmation notices.⁷⁶

The Wire Act contains a safe harbor provision codified in 18 U.S.C. § 1084(b). Simply stated, § 1084(b) does not apply to transmissions that occur when "(1) betting is legal in both the place of origin and the destination of the transmission; and (2) the transmission is limited to mere information that assists in the placing of bets, as opposed to including the bets themselves."⁷⁷ The court denied Cohen's safe harbor argument by finding that betting is expressly illegal in New York and that WSE's operation did not fall under any New York statutory exception.⁷⁸ The court then unnecessarily went on to determine whether WSE's operation was merely limited to the transmission of

⁶⁹ A sports book is a place where people can wager on various sport competitions. The method of betting varies with the sport and the type of game. Anthony N. Cabot & Robert D. Faiss, *Sports Gambling in the Cyberspace Era*, 5 CHAP. L. REV. 1, 7 (2002).

⁷⁰ The sole business of World Sports Exchange involved bookmaking for sports events in the United States. *See Cohen*, 260 F.3d at 70.

⁷¹ *Id.* at 71.

⁷² Glover, *supra* note 65, at 1. Cohen, however, was not being rash in judgment that the Wire Act did not apply to his situation. He apparently researched international law and was advised by U.S. law firms and consultants. Cohen believed that the New York laws allowing off-track horse betting would legitimize his endeavor. *See* Michael Kirkland, *Court Rejects Offshore 'Net Gambling Case*, HAWAII REP., June 19, 2002, <http://www.hawaiireporter.com/story.aspx?ce13ef47-043d-44a7-a970-f959a1b81151>.

⁷³ 260 F.3d at 68.

⁷⁴ *Id.* at 71.

⁷⁵ *Id.* at 76.

⁷⁶ *Id.* at 70.

⁷⁷ *Id.* at 73 (internal citations omitted).

⁷⁸ *Id.* at 74.

information necessary to place bets rather than placing the bets themselves.⁷⁹ The court explained that WSE was actually taking bets and that its operation did not fall within the second condition of the safe harbor provision.⁸⁰ Under this court's interpretation of the second safe harbor provision, even if New York had legalized sports gambling, the Wire Act would still prohibit WSE from accepting New York customers.

2. *The Travel Act*

The Travel Act, passed in 1961, was intended to help states effectively handle criminal conduct that extends beyond the state's borders.⁸¹ Attorney General Robert Kennedy recommended the passage of the Travel Act to assist local law enforcement by denying interstate facilities to individuals engaged in certain illegal business enterprises.⁸² The Act, along with the Wire Act, was part of Kennedy's program to curb organized crime and racketeering.⁸³ To defeat and combat organized crime, local enforcement officials needed a way to prosecute crime organization members who resided in one state but conducted their criminal operations in another.⁸⁴ Although the Travel Act's express purpose was to attack organized crime, the Supreme Court noted in *Erlenbaugh v. United States*⁸⁵ that the statute is not limited to prosecution of organized crime.⁸⁶

The government must prove three elements to prosecute successfully under the Travel Act. Specifically, the government must prove: "(1) interstate travel or use of a facility in commerce (2) with the intent to promote an unlawful activity and (3) that the defendant *thereafter* performed or attempted to perform or facilitated the performance of an overt act in furtherance of the unlawful activity."⁸⁷ A literal reading of the Travel Act precludes its use against bettors or mere customers because they are not engaged in the

⁷⁹ *Id.* (the court's determination here is unnecessary because Cohen would have already lost his appeal given the presence of the first statutory element).

⁸⁰ *Id.* at 75.

⁸¹ Pub. L. No. 87-228, § 1(a), 75 Stat. 498 (1961) (codified as amended at 18 U.S.C. § 1952 (2000 & Supp. II 2002)); *United States v. Nardello*, 393 U.S. 286, 290-91 (1969).

⁸² See H.R. REP. NO. 87-966 (1961); see also 113 A.L.R. FED. 625 (1993).

⁸³ Randy J. Curato et al., *Government Fraud, Waste, and Abuse: A Practical Guide to Fighting Official Corruption*, 58 NOTRE DAME L. REV. 1027, 1027 (1983).

⁸⁴ *Id.* at 1028.

⁸⁵ 409 U.S. 239 (1972).

⁸⁶ *Id.* at 247 n.21; see also *United States v. Roselli*, 432 F.2d 879, 885 n.5 (9th Cir. 1970) (explaining that the "statute applies to all persons and not only to persons engaged in organized crime").

⁸⁷ *United States v. Childress*, 58 F.3d 693, 719 (D.C. Cir. 1995).

gambling business either substantively or as accomplices.⁸⁸ The case law, however, is relatively clear that the Travel Act can be applied to gambling enterprises in general.⁸⁹

For the Travel Act to apply to Internet gambling, the two key sections are the jurisdictional element and the phrase “business enterprises.” The jurisdictional element can be satisfied “by reference to the telecommunications component of the Internet” or to “any interstate or foreign nexus [of] payment of the debts resulting from the gambling.”⁹⁰ The two critical characteristics of the “business enterprise” element are its continuity and its prerequisite of an activity outlawed by a state or federal statute.⁹¹ Since most gamblers remain mere customers of a gambling enterprise, they would not be subject to prosecution under the Travel Act even though they may be violating their own state’s laws.⁹²

3. *The Illegal Gambling Business Act*

Congress promulgated the Illegal Gambling Business Act (ILBA) as part of the Organized Crime Control Act of 1970.⁹³ The purpose of the ILBA is to target organized crime.⁹⁴ The House Report on the ILBA states that the purpose of the statute is to deal only with large-scale illegal gambling activities and with corrupt state officials that allow them to operate.⁹⁵ Thus, Congress anticipated the ILBA to be used against large business-type operations that violated local state law.⁹⁶

The ILBA makes it a crime to operate an illegal gambling business.⁹⁷ The ILBA defines an illegal gambling business as any operation that

⁸⁸ DOYLE, *supra* note 59, at 11 (citing *Rewis v. United States*, 401 U.S. 808, 811 (1971)).

⁸⁹ See *United States v. LeFaivre*, 507 F.2d 1288 (4th Cir. 1974) (affirming convictions for gambling operators because they used a facility in interstate commerce even though their entire operation was confined to the State of Maryland); see also Schwarz, *supra* note 64, at 1030–31.

⁹⁰ DOYLE, *supra* note 59, at 12 (citing *Rewis*, 401 U.S. at 811).

⁹¹ *Id.* at 11.

⁹² *Id.*

⁹³ Pub. L. No. 91-452, § 803(a), 84 Stat. 937 (codified as amended at 18 U.S.C. § 1955 (2000)).

⁹⁴ H.R. REP. NO. 91-1549, at 4007, 4029 (1970); see also Richard P. Shafer, *Requirement of 18 U.S.C.A. § 1955, Prohibiting Illegal Gambling Businesses, That Such Businesses Involve Five or More Persons*, 55 A.L.R. FED. 778 (2006).

⁹⁵ Shafer, *supra* note 94, at 2.

⁹⁶ *Id.*

⁹⁷ 18 U.S.C. § 1955 (2000).

(1) is a violation of the law of a State or political subdivision in which it is conducted; (2) involves five or more persons who conduct, finance, manage, supervise, direct, or own all or part of such business; and (3) has been or remains in substantially continuous operation for a period in excess of thirty days or has a gross revenue of \$2000 in any single day.⁹⁸

Similar to the Wire Act, the ILBA applies only to gambling businesses or operations⁹⁹ and not individual gamblers.

It seems possible for the government to prosecute Internet-based gambling under the ILBA.¹⁰⁰ The evidence necessary to satisfy the elements of the offense would be similar to the evidence required in a conventional prosecution. The only difficult requirement would be to implicate five or more people in the operation. Internet operations, by their very nature, can be run with a skeleton workforce. A gambling operation may potentially contract out all the work necessary to run the operation. For example, customer service, information technology (IT) specialists, and security consultants might not be considered part of the operation.¹⁰¹ Normally, they could still be held liable under the aiding and abetting provisions.¹⁰² However, before someone can be found guilty of aiding and abetting under the ILBA, a violation of the statute must exist.¹⁰³ And it is clear from case law that “aiders and abettors cannot be counted as one of the statutorily required five persons.”¹⁰⁴ However, the government may be able to satisfy the five-person requirement because courts have generally adopted an expansive interpretation of the terms “conduct” and “finance.”¹⁰⁵ Specifically, only customers of the gambling business are excluded from the count. In fact, some courts have held that all other participants, regardless of how minor their role or the label used to describe their function, may be used to satisfy the five-person statutory requirement.¹⁰⁶

⁹⁸ § 1955(b).

⁹⁹ See UNITED STATES GENERAL ACCOUNTING OFFICE, *supra* note 40, at 5.

¹⁰⁰ See Shafer, *supra* note 94.

¹⁰¹ A court could hold that this job role, although in a contract form, is necessary to “conduct” the operation and therefore falls within the plain text of the statute. See generally Shafer, *supra* note 94.

¹⁰² See 18 U.S.C. § 2 (2000).

¹⁰³ *United States v. Hill*, 55 F.3d 1197, 1204 (6th Cir. 1995).

¹⁰⁴ *Id.*

¹⁰⁵ *United States v. Schullo*, 363 F. Supp. 246, 250 (D. Minn. 1973).

¹⁰⁶ *Id.*; see also *United States v. Rotchford*, 575 F.2d 166, 174–75 (8th Cir. 1978).

4. *Unlawful Internet Gambling Enforcement Act of 2006*

Congress passed the SAFE Port Act of 2006 to tighten maritime and port security along the nation's coast.¹⁰⁷ Title VIII of the SAFE Port Act entitled "Unlawful Internet Gambling Enforcement" was added at the last minute as an unrelated rider.¹⁰⁸ The Unlawful Internet Gambling Enforcement Act of 2006 is focused on making it more difficult for U.S. residents to gamble on offshore Internet casinos by regulating financial institutions.¹⁰⁹ To justify passage of the Act, Congress relied on four main findings: First, internet gambling is funded primarily through credit cards and wire transfers; second, the National Gambling Impact Study Commission (NGIS) recommended passage of this type of legislation; third, internet gambling is increasing consumer debt problems; and fourth, traditional mechanisms of enforcing gambling laws are inadequate.¹¹⁰

The new law does not change significantly the current substantive law on Internet gambling.¹¹¹ Rather it focuses on eliminating the financial transactions associated with Internet gambling. Specifically, the law prohibits any person from accepting money from someone who has engaged in unlawful Internet gambling.¹¹² This provision is focused on financial institutions and is designed to prevent a gambler from retrieving any funds from an offshore casino.¹¹³ To aid in enforcing this scheme, the Act provides a 270-day period for the Secretary and Board of Governors of the Federal Reserve, in consultation with the Attorney General, to prescribe regulations to identify and block gambling-related transactions.¹¹⁴ The regulations will add details and specificity to the Act by providing financial institutions with specific policies and procedures to follow.¹¹⁵

¹⁰⁷ Pub. L. No. 109-347, 120 Stat. 1884; see Jonathan Weisman, *Internet Gambling, Port Deals Reached*, WASH. POST, Sept. 30, 2006, at A08.

¹⁰⁸ *Id.*

¹⁰⁹ 31 U.S.C.A. § 5363 (2006). When referencing the Act, this Comment refers only to the gambling portion of the Act. See *infra* Part IV.A.

¹¹⁰ § 5361(a).

¹¹¹ § 5361(b) ("No provision of this subchapter shall be construed as altering, limiting, or extending any Federal or State law or Tribal-State company prohibiting, permitting, or regulating gambling within the United States.").

¹¹² § 5363.

¹¹³ See *id.*

¹¹⁴ § 5364(a).

¹¹⁵ *Id.*

The Act has two interesting attributes from a federalism perspective. First, while the Act allows both the United States and the attorney general of a “State in which a restricted transaction” has occurred to bring a civil action under the statute, the Act provides for exclusive jurisdiction in federal court.¹¹⁶ Second, the Act may help states that have banned online gambling to enforce their laws. This point is dealt with in more detail in Part IV.

Using these four laws, the federal government has outlawed the operation of an online casino within the United States. However, none of the four laws explicitly prohibits an individual bettor from gambling on an offshore casino.

II. SOCIETAL COSTS OF GAMBLING IN THE INTERNET AGE

Since the dawn of civilization, gambling has existed in one form or another.¹¹⁷ Probably since that very time, government and community leaders have sought to eliminate gambling because of its social cost.¹¹⁸ The first section of this Part will discuss three main social costs attributed to gambling. The second section will apply these traditional costs to the Internet gambling context and conclude that states are in a better position to regulate and deal with these costs. The third section will argue that states should be able to offset any negative social costs by collecting tax revenue on Internet gambling.

A. *Traditional Costs of Gambling*

In 1996, Congress passed the National Gambling Impact Study Commission Act to assess the impact of gambling in America and to provide recommendations on the feasibility and sensibility of legalization.¹¹⁹ Based on this and other studies, the social costs attributed to gambling fall into three main categories: adverse effect on individuals, underage gambling, and social-welfare costs.

¹¹⁶ § 5365(a). The Act does not provide a provision for an individual to sue; only the United States or a state may institute a civil action. *See id.*

¹¹⁷ *See* Kristen M. Campion, Note, *Riverboats: Floating Our Way to a Brighter Fiscal Future?*, 19 SETON HALL LEGIS. J. 564, 565 (1995) (citing ALICE FLEMING, SOMETHING FOR NOTHING: A HISTORY OF GAMBLING 1–11 (1978)).

¹¹⁸ *See id.*

¹¹⁹ Pub. L. No. 104-169, 110 Stat. 1482 (1996); *see National Gambling Impact Study Commission Final Report: Hearing on the Final Report of the National Gambling Impact Study Commission Before the S. Comm. on Indian Affairs*, 106th Cong. 115 (1999); A. Gregory Gibbs, Note, *Anchorage: Gaming Capital of the Pacific Rim*, 17 ALASKA L. REV. 343, 346–47 (2000).

1. *Adverse Effect on Individuals*

The first large social cost generally associated with gambling is its adverse effect on individuals. This adverse effect can be broken into two parts: financial and psychological. From a financial perspective, gambling can pose a significant pressure on otherwise financially stable individuals or households. From a psychological perspective, gambling can pose a threat of addiction to certain individuals. In many ways, these two issues are interrelated and normally go hand in hand. However, as a conceptual matter it is important to discuss the two issues separately as there are different approaches to solving each problem.

According to the American Psychiatric Association, compulsive gambling is an “impulse-control disorder.”¹²⁰ The disorder is characterized by an inability to stop gambling even when it is causing serious problems for the individual.¹²¹ Although compulsive gambling, in the clinical sense, is experienced by a very small percentage of the population, many “problem gamblers” have similar symptoms and behavioral issues.¹²² In fact, compulsive gambling parallels alcohol and drug addiction in many ways. The difference between socially acceptable use (at least for alcohol) and problematic behavior is usually a matter of degree.¹²³

Compulsive gamblers crave the “action” and “rush” inherent in any game of chance to achieve a “euphoric state comparable to the ‘high’ sought by drug users.”¹²⁴ The “rush” is often “characterized by sweaty palms, rapid heart beat, and nausea.”¹²⁵ As an individual continues to gamble, he develops a tolerance and must increase the volume or size of bets to maintain the same level of excitement.¹²⁶

¹²⁰ Mayo Clinic, Compulsive Gambling, <http://www.mayoclinic.com/health/compulsive-gambling/DS00443> (last visited Oct. 13, 2006).

¹²¹ TEXAS A & M RESEARCH FOUND., EMPLOYEES’ GUIDE TO SECURITY RESPONSIBILITIES; COMPULSIVE GAMBLING, <http://rf-web.tamu.edu/security/secguide/Eap/Gamble.htm>.

¹²² MedlinePlus Medical Encyclopedia, Pathological Gambling, <http://www.nlm.nih.gov/medlineplus/ency/article/001520.htm> (last visited Dec. 5, 2006).

¹²³ TEXAS A & M RESEARCH FOUNDATION, *supra* note 121. One key difference between social gambling and compulsive gambling is the ability to maintain self-control. Normally, social gamblers keep predetermined spending limits, play with friends or colleagues, and are satisfied with the experience irrespective of the monetary outcome. *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Id.*

Although reports and data tend to differ on the exact scope of the compulsive gambling problem in the United States, many studies indicate that 1.5% to 7.3% of Americans will have a compulsive gambling problem sometime in their lifetime.¹²⁷ Other studies have shown that compulsive gamblers make up about 1% of the general population.¹²⁸ In Las Vegas, however, compulsive gamblers make up approximately 6% of the population.¹²⁹ That difference in percentage seems to indicate that people with gambling problems tend to locate where gambling is legal and easily available. However, it is unclear whether the discrepancy between the Las Vegas population and the general population in terms of percentage of compulsive gamblers is because the Las Vegas population is self-selecting or because the mere presence of legal gambling exacerbates the innate risks of gambling addiction.¹³⁰

Monetary loss is a by-product of excessive gambling. By definition, one cannot win over time in negative expectancy games.¹³¹ To recoup losses, many gamblers engage in “chasing.”¹³² Chasing is the phenomenon where gamblers increase their bet size and frequency to come out even.¹³³ Chasing seems logical to most gamblers because without betting, the earlier losses sustained become permanent as opposed to being part of a temporary downswing. Thus, chasing may lead a gambler to borrow money or use money that he cannot afford to lose.¹³⁴

¹²⁷ See NATIONAL GAMBLING IMPACT STUDY COMMISSION REPORT 4-4 to 4-5 (1999) [hereinafter NGISC REPORT]. The wide discrepancy in percentage may be due to the difficulty in measuring this problem. *Id.* One reason for the difficulty is that there is no clear classification or criteria for the disorder. KY. LEGISLATIVE RESEARCH COMM’N, COMPULSIVE GAMBLING IN KENTUCKY, RESEARCH REPORT NO. 316, at x (2003), <http://www.lrc.ky.gov/lrcpubs/RR316.pdf>.

¹²⁸ *Talk of the Nation* (National Public Radio broadcast June 24, 1999) (reported by Wade Goodwyn).

¹²⁹ *Id.*

¹³⁰ See DEAN GERSTEIN ET AL., NAT’L OPINION RESEARCH CTR. ET AL., GAMBLING IMPACT AND BEHAVIOR STUDY: REPORT TO THE NATIONAL GAMBLING IMPACT STUDY COMMISSION 78 (1999), <http://www.norc.uchicago.edu/new/pdf/gamble.pdf> [hereinafter GAMBLING IMPACT]. The study concluded that problem and pathological gambling rates double within fifty miles of a casino. *Id.* at 28.

¹³¹ See Edward J. McCaffery, *Why People Play Lotteries and Why It Matters*, 1994 WIS. L. REV. 71, 77 (1994).

¹³² TEXAS A & M RESEARCH FOUNDATION, *supra* note 121.

¹³³ *Id.* Typically the social gambler says, “The money is lost,” whereas the chaser says, “I’ll get even tomorrow.” *Id.*

¹³⁴ *Id.*

The National Opinion Research Center (NORC) estimated that problem gamblers account for approximately \$5 to \$6 billion a year in social costs.¹³⁵ Specifically, the average annual “costs of job loss, unemployment benefits, welfare benefits, poor physical and mental health, and problem or pathological gambling treatment is approximately \$1,200 per pathological gambler per year and \$715 per problem gambler per year.”¹³⁶ However, since the NORC study did not estimate gambling-related incidences of crime (e.g., theft, embezzlement), the costs estimated are most likely lower than the actual costs to society.

States that have legalized gambling have seen a rise in personal bankruptcies.¹³⁷ In fact, in the 1990s, people who lived in a county with a casino filed for personal bankruptcy more than those who lived in a casino-free county.¹³⁸ Specifically, Connecticut, which is home to the Foxwoods and Mohegan Sun casinos, has seen a rise in gambling-related bankruptcies.¹³⁹ Between January 1998 and January 2005, approximately eight percent of consumer bankruptcy petitioners reported gambling losses the year before declaring bankruptcy.¹⁴⁰

2. Underage Gambling

The second major social cost associated with gambling is its adverse effects on underage individuals. There are not many studies on the breadth and scope of underage gambling; however, there is “overwhelming evidence” that some form of gambling behavior is common among underage individuals.¹⁴¹ Some research suggests that children may be more susceptible than older generations

¹³⁵ GAMBLING IMPACT, *supra* note 130, at 53; *see also*, Lee Davidson et al., *Gambling Spurs Social, Legal Woes*, DESERET MORNING NEWS, June 29, 2005, available at <http://deseretnews.com/dn/view/0,1249,600144921,00.html>.

¹³⁶ NGISC REPORT, *supra* note 127, at 4-14.

¹³⁷ Patricia Kathryn Carlton, *All Bets Are Off: An Examination of Alabama's Proposed Lottery and the Educational Inadequacies It Was Intended to Remedy*, 51 ALA. L. REV. 753, 780 (2000).

¹³⁸ Robynn Tysver, *Study Finds More Personal Bankruptcies in U.S. Counties with Casinos*, OMAHA WORLD-HERALD, Mar. 11, 2004, at 3B.

¹³⁹ Jeff Benedict, *A Losing Hand; Casino Gambling Can Bring Financial Problems*, HARTFORD COURANT, May 8, 2005, at C1.

¹⁴⁰ *Id.* Anecdotally, a bankruptcy attorney who has one of the largest consumer practices in Eastern Connecticut noted that before the casinos opened he never had any bankruptcies as a result of gambling debts. *Id.*

¹⁴¹ HARRAH'S ENTMT, UNDERAGE GAMBLING (2000), <http://www.harrahs.com/images/PDFs/IPUnderage.pdf> (citing GAMBLING IMPACT, *supra* note 130).

to the development of gambling problems because of the plethora of gambling-related advertisement in today's environment.¹⁴²

Most people, including casino operators, agree that underage gambling poses public health risks.¹⁴³ The National Gambling Impact Study Commission (NGIS) conducted an extensive legal and factual study on the social and economic implications of gambling in the United States.¹⁴⁴ The NGIS findings were consistent with common perceptions of underage gambling.¹⁴⁵ For example, the NGIS study found that adolescents generally bet much smaller amounts of money than adults.¹⁴⁶ The most common forms of gambling that young people participate in are private games of skill, poker and other card games, sports betting, and state-run lotteries.¹⁴⁷ The study also found that although adolescents gamble much less than adults, the rate of compulsive gambling is similar among adults and adolescents.¹⁴⁸ Focusing on the similarity in rates of compulsive gambling seems to overlook the issue that many adult compulsive gamblers started in their teens.¹⁴⁹ The consequences of excessive gambling are very different at a young age than when one is an adult. Adolescents usually have less disposable income, no dependants, a parental safety net, and other safeguards that prevent them from feeling the full ill-effects of excessive gambling. Unfortunately, if young adults never kick the excessive gambling habit, it will stay with them long after their safeguards disappear.¹⁵⁰

3. *Social-Welfare Costs*

The third social cost is general negative social-welfare costs attributed to gambling operations. This general social-welfare cost can be divided into three distinct categories. First, gambling tends to target specific groups of people. Specifically, gambling acts as a regressive tax on the poor and

¹⁴² Gibbs, *supra* note 118, at 376. Most advertisements today are in the form of state sponsored lotteries, poker for-fun, and destination cities like Las Vegas. See Randy Stinchfield & Ken C. Winters, *Gambling and Problem Gambling Among Youths*, 556 ANNALS AM. ACAD. POL. & SOC. SCI. 172, 173 (1998).

¹⁴³ HARRAH'S ENTERTAINMENT, *supra* note 141.

¹⁴⁴ NGISC REPORT, *supra* note 127, at introduction.

¹⁴⁵ HARRAH'S ENTERTAINMENT, *supra* note 141.

¹⁴⁶ NGISC REPORT, *supra* note 127, at 7-20 to 7-24.

¹⁴⁷ *Id.* at 7-23 (citing GAMBLING IMPACT, *supra* note 130, at 4).

¹⁴⁸ HARRAH'S ENTERTAINMENT, *supra* note 141.

¹⁴⁹ NGISC REPORT, *supra* note 127, at 4-12.

¹⁵⁰ *Id.*

minority groups.¹⁵¹ Gambling's attraction to those who can least afford it contributes to general social costs.¹⁵² People who are poor and lack education are least likely to appreciate the odds against winning and thus gamble with the "hope of changing their lives."¹⁵³

Second, the legalization of gambling tends to have a negative impact on preexisting businesses.¹⁵⁴ Nongambling businesses, especially in the entertainment market, are at a competitive disadvantage vis-à-vis gambling businesses for consumer dollars.¹⁵⁵ Although legalized gambling may promote more tourism in the short term, the long-term socioeconomic effects may provide an incentive for many businesses to locate in a gambling-free state.¹⁵⁶ Also, nongambling businesses will be further discouraged by the favorable tax breaks gambling businesses receive.¹⁵⁷ Thus, while some markets and business segments might benefit from the legalization of gambling in a specific geographic area, for the most part, the costs to nongambling-related businesses create an overall negative impact on local economies.¹⁵⁸

Third, and somewhat related to the second concept, is that the legalization of gambling tends to create a "race to the bottom."¹⁵⁹ Each area that legalizes gambling tends to compete with neighboring regions to attract more gamblers. This competition forces operators to provide the widest variety of games to attract the largest segment of the population.¹⁶⁰ The more gamblers that are attracted from outside a given geographical region, the easier it is for local economies to generate revenues that exceed the inherent social costs of

¹⁵¹ John Warren Kindt, *Legalized Gambling Activities as Subsidized by Taxpayers*, 48 ARK. L. REV. 889, 896-97 (1995) (citing Thomas W. Calmus, *Measuring the Regressivity of Gambling Taxes*, 34 NAT'L TAX J. 267 (1981)).

¹⁵² *Id.*

¹⁵³ *Id.* (citing Earl Grinols, Commentary, *Gambling Is Bad Business for Local Economy, Society*, NEWS-GAZETTE (Champaign, Ill.), Sept. 29, 1991, at B3).

¹⁵⁴ *Id.* at 899.

¹⁵⁵ *Id.*

¹⁵⁶ See John W. Kindt, *The Negative Impacts of Legalized Gambling on Businesses*, 4 U. MIAMI BUS. L.J. 93, 113-24 (1994).

¹⁵⁷ Kindt, *supra* note 156, at 902.

¹⁵⁸ Ricardo Gazel, *The Economic Impacts of Casino Gambling at the State and Local Levels*, 556 ANNALS AM. ACAD. POL. & SOC. SCI. 66, 83 (Mar. 1998). Dr. Gazel argues that although more research and data are needed, state and local economies have experienced a net monetary loss due to legalized gambling in their jurisdiction. *Id.*

¹⁵⁹ Kindt, *supra* note 156, at 905-06. "Race to the bottom" describes the phenomenon where state regulatory standards decline to the lowest common denominator. See, e.g., John Tierney, *The Environmental Procrastination Agency*, N.Y. TIMES, July 8, 2006, at A13.

¹⁶⁰ See Kindt, *supra* note 156, at 906.

gambling.¹⁶¹ Thus, communities tend to compete against each other by racing to provide more thrilling and “harder” forms of gambling.¹⁶²

B. Costs of Internet Gambling

In some ways, the costs inherent in legalizing gambling are similar regardless of the medium used to gamble. This section will compare and contrast the social costs discussed above and apply them to the Internet context.

1. Adverse Effect on Individuals

The adverse effect gambling has on an individual is similar whether that person plays at a brick-and-mortar casino or on an online casino. The two components of the adverse impact on individuals are the financial and psychological.¹⁶³ From a financial perspective, Internet gambling is just as costly as traditional gambling. For a compulsive gambler, each medium provides access to games of chance for the same cost.¹⁶⁴ One main difference between the two is the ease of access to Internet sites.¹⁶⁵ Instead of driving or flying to a gaming establishment, an individual only needs to turn on their computer to gamble.¹⁶⁶

The psychological impact on individuals can be very different with respect to Internet and traditional gaming establishments. One of the key differences is the solitary nature of Internet gambling. For most gambling addicts, the act of gambling is a solitary activity.¹⁶⁷ Internet gambling is almost exclusively, by definition, a solitary form of gambling; thus, this characteristic tends to

¹⁶¹ *See id.*

¹⁶² *Id.*

¹⁶³ *See supra* Part II.A.1.

¹⁶⁴ Although there are no travel costs associated with Internet gambling, the monetary savings are probably negligible when compared to the amount of money gambled by compulsive or problem gamblers. Accessing the Internet has costs associated with it, but these costs are also negligible and usually a sunk cost for most households.

¹⁶⁵ In 2003, approximately 62 million, or 55%, of all United States households had Internet access. U.S. CENSUS BUREAU, COMPUTER AND INTERNET USE IN THE UNITED STATES: 2003, at 3 (2005), <http://www.census.gov/prod/2005pubs/p23-208.pdf>.

¹⁶⁶ According to the NORC study, “The availability of a casino within 50 miles (versus 50–250 miles) is associated with a higher prevalence (about double) of problem and pathological gambling.” *See* GAMBLING IMPACT, *supra* note 130, at 28. Presumably, the amount of money gambled is greater when an individual has easy access to a gambling site.

¹⁶⁷ Mark Fox, Larry Phillips & Ganesh Vaidyanathan, *Managing Internet Gambling in the Workplace*, FIRST MONDAY, Apr. 2003, http://www.firstmonday.org/issues/issue8_4/fox.

make it a more hazardous gambling environment. Also, it is very difficult for others (i.e., friends, family, support groups) to identify whether someone has a problem when they gamble on the Internet.¹⁶⁸ It is much easier to monitor an individual who takes numerous trips to a casino than it is to determine how often someone logs on to a particular web site.¹⁶⁹

On the other hand, Internet gambling may not have the same psychological appeal as more traditional forms of gambling. Casino owners have found that there is a link between the appeal of winning money and the environment at a particular casino.¹⁷⁰ In fact, many brick-and-mortar casinos rely on this to differentiate themselves in the marketplace.¹⁷¹ Traditional casinos may employ tactics and strategies not available to Internet casinos to keep an individual gambling.¹⁷² For example, casinos generally offer free or heavily-subsidized alcoholic beverages.¹⁷³ The layout and environment are crafted with an eye toward keeping the gambler on the casino floor.¹⁷⁴ Casinos use these and other tricks and strategies to keep an individual gambling for as long as possible.¹⁷⁵

Additionally, Internet sites may be able to identify and help compulsive gamblers in a way that traditional casinos cannot hope to accomplish as easily. Online casinos could maintain and update a database of compulsive gamblers.¹⁷⁶ Although traditional casinos may attempt to keep track of the amount of money that every player gambled, the best they can hope for is a rough approximation.¹⁷⁷ By contrast, an online site must keep track of every

¹⁶⁸ Unless, of course, they live with the person and monitor their Internet usage.

¹⁶⁹ At least it is harder to do so anecdotally as opposed to using software that may monitor such usage.

¹⁷⁰ See Kevin Kitchen, *A New Approach to Traditional Gambling*, U.S. BUS. REV., July 1, 2005, available at http://www.usbusiness-review.com/content_archives/Jul05/index.html.

¹⁷¹ *Id.*

¹⁷² *Cf. id.*

¹⁷³ See John Warren Kindt, "*The Insiders*" for *Gambling Lawsuits: Are the Games "Fair" and Will Casinos and Gambling Facilities Be Easy Targets for Blueprints for RICO and Other Causes of Action?*, 55 MERCER L. REV. 529, 553 (2004).

¹⁷⁴ James Popkin, *Tricks of the Trade: The Many Ways Casinos Try to Part Bettors from Their Cash*, U.S. NEWS & WORLD REP., Mar. 14, 1994, at 48.

¹⁷⁵ Some common strategies casinos use are lack of clocks and visual and auditory cues such as the sound from slot machines.

¹⁷⁶ *Cf.* Jenna F. Karadbil, *Casinos of the Next Millennium: A Look into the Proposed Ban on Internet Gambling*, 17 ARIZ. J. INT'L & COMP. L. 413, 442-43 (2000) (arguing that casinos need to be able to store user information and data).

¹⁷⁷ See Kindt, *supra* note 173, at 557.

penny that is gambled on its site.¹⁷⁸ Regulation of these sites could allow the sharing of user information to identify compulsive or problem gamblers proactively. The ability to track user information may implicate some data privacy issues,¹⁷⁹ but surrendering privacy rights could be a cost individuals must accept to gamble legally.

2. Underage Gambling

An underage gambler will have an easier time accessing an Internet gambling site than gambling at a casino because it is more difficult for a gambling site to detect if someone is underage than for traditional casinos. Operators cannot examine a particular user to check their age or view their photo identification.¹⁸⁰ Also, many underage individuals are extremely tech-savvy and can defeat some age-verification procedures.¹⁸¹ Another factor contributing to the ease of underage gambling is that online casinos have no real incentive to curb underage gambling. Since operating an Internet gambling site is technically illegal in the United States,¹⁸² web sites that fail to comply with U.S. age restrictions are in the same or better¹⁸³ position than if they did comply. According to one study, thirty out of thirty-seven randomly selected gambling sites allowed an underage gambler to register, play, and collect money.¹⁸⁴

The United Kingdom's decision to regulate online gambling instead of creating a *per se* ban has helped to deter underage gambling.¹⁸⁵ U.K. companies use third-party checking services and databases to determine a user's age.¹⁸⁶ These services can use voter rolls, bank records, and other sources to verify an individual's age.¹⁸⁷ Some vendors have created real-time

¹⁷⁸ By definition, this proposition must be true because of the very nature of online gambling and transaction-based software. Every transaction and every bet must be tracked or else an online casino would fail to function properly.

¹⁷⁹ Data privacy issues are beyond the scope of this Comment.

¹⁸⁰ Press Release, Sen. Charles E. Schumer, New Schumer Finding—Thousands of New York Kids Fall Prey to Scourge of Internet Gambling Each Month, (Mar. 20, 2005), http://www.senate.gov/~schumer/SchumerWebsite/pressroom/press_releases/2005/PR41537.Online%20Gambling.032005.html.

¹⁸¹ *Id.*

¹⁸² *See supra* Part I.B.

¹⁸³ Internet gambling sites would be in a better position because they are catering to a larger segment of the gambling population, namely underage individuals.

¹⁸⁴ Press Release, Sen. Charles E. Schumer, *supra* note 180.

¹⁸⁵ *See U.S. Said to Be Isolating Itself on Internet Gambling*, WASH. INTERNET DAILY, Jan. 12, 2005.

¹⁸⁶ *Id.*

¹⁸⁷ *Id.* Nothing can really stop a child from stealing his parents' information or credit card except parental oversight.

software verification tools as a possible solution to underage gambling.¹⁸⁸ Thus, although it may be easier for underage users to gamble online than in a traditional casino, Internet gambling is not unsafe inherently. As stated above,¹⁸⁹ online gambling web sites must have the proper incentive such as regulatory oversight to adopt measures to prevent underage gambling.

3. *Social-Welfare Costs*

The negative social costs attributed to brick-and-mortar gambling operations are greater than or equal to the costs associated with Internet gambling. The Internet medium does not diminish the regressive nature of gambling. Poor and minority groups will probably still be disproportionately impacted.¹⁹⁰ People who lack education and are least likely to appreciate the odds against winning probably are not concerned with whether the “hope of changing their lives” comes from a traditional brick-and-mortar casino or an online casino.¹⁹¹

There is no evidence to suggest that Internet gambling would add to the negative impact that traditional legalized gambling has on preexisting businesses. Specifically, there is no evidence that shows that Internet gambling increases general social problems at a higher rate than traditional gambling opportunities.¹⁹² Furthermore, the existing law prevents states from collecting any money from their residents’ Internet gambling usage.¹⁹³ Thus, effective state regulation could offset or at least alleviate a negative impact on the local economy.¹⁹⁴

The race-to-the-bottom analysis is similar in both the Internet and traditional gambling contexts. Communities will tend to compete against each other to attract more gamblers.¹⁹⁵ However, the scope and impact of the problem is not critical. In the traditional gambling context, many states tax casinos at a different rate.¹⁹⁶ For example, Mississippi taxes casinos at eight

¹⁸⁸ Stevie Watson et al., *The Legalization of Internet Gambling: A Consumer Protection Perspective*, 23 J. PUB. POL’Y & MARKETING 209, 211 (2004).

¹⁸⁹ See *supra* note 176 and accompanying text.

¹⁹⁰ Cf. Kindt, *supra* note 151, at 896–97.

¹⁹¹ Cf. *id.*

¹⁹² Christine Hurt, *Regulating Public Morals and Private Markets: Online Securities Trading, Internet Gambling, and the Speculation Paradox*, 86 B.U. L. REV. 371, 426 (2006).

¹⁹³ JOHN LYMAN MASON & MICHAEL NELSON, *GOVERNING GAMBLING* (2001).

¹⁹⁴ See discussion *infra* Part II.C.

¹⁹⁵ See Gazel, *supra* note 158 and accompanying text.

¹⁹⁶ See MASON & NELSON, *supra* note 193, at 51.

percent of gross revenue and allows local governments to levy an additional four percent tax.¹⁹⁷ In Iowa, casinos are taxed at twenty percent.¹⁹⁸ Under a traditional race-to-the-bottom analysis, one would expect states to compete and thus decrease taxation to attract more business.¹⁹⁹ This competition has not occurred in the traditional casino context and is unlikely to occur if states are given the opportunity to regulate online casinos.²⁰⁰

There is no evidence to suggest that as a general matter, the social costs of Internet gambling are significantly different from brick-and-mortar operations. States should be choosing how to regulate Internet gambling in the best interest of their residents as they are in a much better position to understand and deal with any resulting social costs.

C. Offsetting Costs of Gambling Through Taxation

Federal law preemption of U.S.-based online casinos prevents states from generating any revenue to offset the extra social costs.²⁰¹ The offshore Internet casinos do not pay any state or federal taxes.²⁰² Nor do they create jobs, invest capital, or directly help the local economy.²⁰³ Furthermore, the ability to collect taxes is dependent upon the gamblers' own volition in reporting any winnings as taxable income.²⁰⁴ Predictably, the number of people who voluntarily report taxable income is significantly smaller than "those whose winnings are reported directly to governments by commercial and tribal casinos, lottery agencies, and racetracks."²⁰⁵ As discussed previously,²⁰⁶ states end up dealing with the social and economic problems caused by online gambling.

States that have legalized gambling tend to generate different amounts of revenue to use to combat potential social problems. For example, Nevada

¹⁹⁷ *Id.*

¹⁹⁸ *Id.* at 51–52.

¹⁹⁹ See Shawn Turner, Comment, *U.S. Anti-Money Laundering Regulations: An Economic Approach to Cyberlaundering*, 54 CASE W. RES. L. REV. 1389, 1395–99 (2004).

²⁰⁰ Furthermore, the federal government could always prevent a race to the bottom while allowing states to retain control over online casino regulation. The easiest way is to prevent residents of one state from playing on an online casino regulated by another state.

²⁰¹ See *supra* Part I.B.

²⁰² MASON & NELSON, *supra* note 193, at 84.

²⁰³ *Id.*

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ See *supra* Part II.A.3.

generates approximately fifty percent of its revenues from gambling taxes and New Jersey generates between three and four percent.²⁰⁷ Similarly, tax policies differ from state to state.²⁰⁸ As stated above, Iowa taxes its highest grossing casinos at a rate of twenty percent; Mississippi, by comparison, levies a tax of twelve percent.²⁰⁹

Many states use tax policy, regulation, and the revenue generated from land-based casinos to offset the negative social costs associated with gambling.²¹⁰ Proponents of the Indian Gaming Regulation Act (IGRA) point to the fact that the IGRA requires states and tribes to negotiate a compact so that a state may “offset the social costs of gambling with gambling profits.”²¹¹ Specifically, some states require casino companies to fund treatment for gambling disorders.²¹² Any tax revenues may be used to combat social ills.²¹³

Some commentators argue that a tax on gambling cannot offset the negative economic consequences that flow from legalized gambling.²¹⁴ Therefore, one may argue that the prudent choice is to implement a per se ban on all forms of Internet gambling.²¹⁵ This argument, however, fails to grasp three key issues. First, the status quo provides absolutely no revenue to the individual states and yet each state must cope with gambling-related social problems. Second, this Comment’s proposal is limited in scope, arguing that each state should be able to choose for itself whether to legalize and regulate Internet gambling, rather than being subjected to one federal standard. Third, as discussed above, the harms associated with traditional gambling may be more attenuated in an online world. At the very least, a state would have

²⁰⁷ Colin S. Campbell & Garry J. Smith, *Gambling: Socioeconomic Impacts and Public Policy: Canadian Gambling: Trends and Public Policy Issues*, 556 ANNALS AM. ACAD. POL. & SOC. SCI. 22, 29 (1998).

²⁰⁸ MASON & NELSON, *supra* note 193, at 51.

²⁰⁹ *Id.* at 51–52; *see id.* at 84. The more revenue a state generates through taxation, the more it can spend on social programs. *See, e.g.*, TENN. CONST. art. 11, § 5 (2005) (providing funds for education).

²¹⁰ *See* Joseph L. Lester, *B-I-N-G-NO! The Legal Abuse of an Innocent Game*, 18 ST. THOMAS L. REV. 21, 29–30 (2005).

²¹¹ *Id.*

²¹² *See id.*

²¹³ How states spend revenue generated from lottery sales provides an instructive example.

²¹⁴ *See* John Warren Kindt, *U.S. National Security and the Strategic Economic Base: The Business/Economic Impacts of the Legalization of Gambling Activities*, 39 ST. LOUIS U. L.J. 567, 579 (1995) (arguing that gambling activities constitute a regressive tax that “make poor people poorer and intensify many pre-existing social-welfare problems”).

²¹⁵ *Cf.* WILLIAM N. THOMPSON, LEGALIZED GAMBLING 15 (1994) (explaining that anti-gambling advocates have caused “prohibition efforts [that] have at times entered the realm of the ridiculous”); Kurt Eggert, *Truth in Gaming: Toward Consumer Protection in the Gambling Industry*, 63 MD. L. REV. 217, 246–47 (2004) (explaining why a per se ban will not end gambling and in most cases is counterproductive).

access to better information regarding the amount of money each individual gambler wins or loses. Therefore, a tax on Internet-based casinos may be enough to offset any social costs associated with legalization.

III. ONLINE PORNOGRAPHY SHOWS THAT TOP-DOWN FEDERAL REGULATION FAILS

The federal government's failure to regulate Internet pornography provides a useful analogy and illustrates the dangers of a heavy-handed approach to federal Internet regulation. The United States has a long history of regulating pornography and traditional casino gambling.²¹⁶ The Internet has driven the federal government to regulate online pornography because it is viewed as a symbol of societal ills.²¹⁷ Similarly, many policymakers focus on the moral issues prevalent in the Internet gambling context.²¹⁸ In fact, online gambling rivals pornography as the most controversial content on the Internet.²¹⁹ Thus, online gambling and online pornography share many of the same attributes. Congress's regulation of online pornography illustrates the potential pitfalls of a top-down regulatory approach.

Congress has tried to regulate Internet pornography many times and its attempts have run into many practical and constitutional roadblocks.²²⁰ The history of federal regulation of Internet pornography provides two instructive lessons. The first is that few politicians are willing to reject a politically expedient bill because it is inherently defective, even to the point of being unconstitutional.²²¹ The second is that a top-down approach to regulating Internet pornography is ineffective. The concept of a national community standard is a myth, particularly in First Amendment cases, but also in any legislation that serves to create a "one-size-fits-all" societal standard.²²²

²¹⁶ See Campion, *supra* note 117, at 566.

²¹⁷ See Mark C. Alexander, *The First Amendment and Problems of Political Viability: The Case of Internet Pornography*, 25 HARV. J.L. & PUB. POL'Y 977, 977 (2002).

²¹⁸ Hurt, *supra* note 192, at 376.

²¹⁹ Thomas James Friedrich, *Internet Casino Gambling: The Nightmare of Lawmaking, Jurisdiction, Enforcement & the Dangers of Prohibition*, 11 COMMLAW CONSPECTUS 369, 369 (2003) (citing Mike Epifanio, *Bytes & Bets: Finding Casino Related Information and Betting on the Internet*, CASINO PLAYER, Aug. 1996, at 38).

²²⁰ Alexander, *supra* note 217, at 983.

²²¹ *Id.* at 994.

²²² *Id.* at 1001.

The Communications Decency Act (CDA) passed in 1996 was Congress's first serious attempt to curb Internet pornography.²²³ From the moment Congress passed the CDA, it was clear that the law had serious constitutional issues. Despite the belief held by many Members of Congress and the President that the law was unconstitutional, political pragmatism won over the Constitution.²²⁴ Eventually, the premonitions of the President and Members of Congress were proved correct as the Supreme Court struck down the CDA in *ACLU v. Reno*.²²⁵

After the Supreme Court struck down the CDA, Congress passed the Child Online Protection Act (COPA) in 1998.²²⁶ Although COPA represented an improvement over CDA, it did not sufficiently address the fundamental flaws the Supreme Court articulated in *ACLU v. Reno*—too many vague terms and no definition of community standards.²²⁷ Currently, federal courts have blocked the implementation of COPA because of First Amendment concerns.²²⁸

The First Amendment²²⁹ issues with Internet pornography are complex, yet a basic understanding will suffice for the Internet gambling analogy. Although the First Amendment protects freedom of speech and expression, it is not limitless.²³⁰ The Supreme Court has interpreted the First Amendment to exclude from protection speech that is obscene.²³¹ The key question is what standard should be used to define obscenity.

²²³ Pub. L. No. 104-104, tit. V, 110 Stat. 56, 133-44 (1996); see also Reid Goldsborough, *New Cyberstalking Law Raises Criticism*, PHILA. INQUIRER, Jan. 29, 2006, available at <http://www.philly.com/mld/inquirer/business/13736440.htm>.

²²⁴ Alexander, *supra* note 217, at 984-85. According to Alexander, not only did many people realize the CDA could not pass Constitutional muster but the Clinton administration began looking for other ways of protecting children from online pornography even as the President signed the bill. *Id.* at 984.

²²⁵ 521 U.S. 844 (1997).

²²⁶ Pub. L. No. 105-277, tit. XIV, 112 Stat. 2681-736 to 2681-739 (1998) (codified at 47 U.S.C. § 231 (2000)); see Steven Levy, *Searching for Searches: The Government Is Demanding Millions of Your Queries. AOL, Yahoo, and Microsoft Have Coughed Up. Google is Resisting*, NEWSWEEK, Jan. 30, 2006, at 34.

²²⁷ Alexander, *supra* note 217, at 990.

²²⁸ Levy, *supra* note 226, at 34.

²²⁹ "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances." U.S. CONST. amend. I.

²³⁰ See generally A.S. Klein, *The Supreme Court and the Right of Free Speech and Press*, 21 L. ED. 2d 976 (2006).

²³¹ *Roth v. United States*, 354 U.S. 476, 485 (1957) (holding that obscene materials do not receive First Amendment protection).

In the last half of the twentieth century, the Court focused on the concept of allowing the community to define obscene.²³² The open question was whether the community should be defined nationally or locally. Although the Court seemed to be headed in the direction of defining a national standard,²³³ the issue was finally settled in favor of local community standard.

In *Miller v. California*, the defendant was convicted of mass mailing sexually explicit materials in violation of California law.²³⁴ Chief Justice Burger, writing for the majority, upheld the conviction against a First Amendment challenge.²³⁵ The Chief Justice declared that the local community standard should apply when determining what constitutes decency:²³⁶

Under a National Constitution, fundamental First Amendment limitations on the powers of the States do not vary from community to community, but this does not mean that there are, or should or can be, fixed, uniform national standards of precisely what appeals to the “prurient interest” or is “patently offensive.” These are essentially questions of fact, and our Nation is simply too big and too diverse for this Court to reasonably expect that such standards could be articulated for all 50 States in a single formulation, even assuming the prerequisite consensus exists. . . . To require a State to structure obscenity proceedings around evidence of a national “community standard” would be an exercise in futility.²³⁷

In a nod towards practicality and perhaps sound public policy, Chief Justice Burger reasoned that “[i]t is neither realistic nor constitutionally sound to read the First Amendment as requiring that the people of Maine or Mississippi accept public depiction of conduct found tolerable in Las Vegas, or New York City.”²³⁸ *Miller* has been well-settled First Amendment doctrine since it was decided.²³⁹ Thus, the concept that some types of societal harms are realistically and pragmatically better suited for state regulation fits comfortably into constitutional theory.

Miller was decided in an era where the Internet was still a Department of Defense project. Some commentators have argued that a national community

²³² For a more complete history, see Alexander, *supra* note 217, at 1001–04.

²³³ See *Jacobellis v. Ohio*, 378 U.S. 184, 192 (1964) (Brennan, J., plurality opinion).

²³⁴ 413 U.S. 15 (1973).

²³⁵ *Id.* at 36–37.

²³⁶ *Id.* at 32–34.

²³⁷ *Id.* at 30.

²³⁸ *Id.* at 32.

²³⁹ Alexander, *supra* note 217, at 1006.

standard should be used with respect to Internet content.²⁴⁰ The primary objection to a national standard is that the least tolerant community's standards would prevail, thus severely limiting the diversity of available content.²⁴¹ Specifically, it is argued that adults in more tolerant communities would be deprived of access to materials that would not violate their own local community standards because Internet service providers²⁴² would be unable to control the geographic distribution of material and thus eliminate all but the least offensive content.²⁴³

The argument that state regulation of Internet gambling could lead to a similar "least tolerant community standard" problem is not as powerful as it is in the online pornography context. A simple example should help explain the distinction. First, assume that no federal law applies and each state is able to decide how to regulate online gambling. Second, if State A criminalizes online gambling, this does not affect the power of State B to legalize online gambling.²⁴⁴ The issue reduces to what liabilities State A could impose on (1) a resident that uses the online site created pursuant to State B's power and (2) the content provider that allowed the State A resident access to the gambling site. The resident is the easy case as he would be subject to the laws of State A and could be prosecuted for online gambling.²⁴⁵

The content provider is a different case altogether. In the online pornography context, content providers would have difficulty implementing safeguards to prevent a resident from State A from accessing content that is illegal in their state. Pornography, by its nature, can exist on numerous web sites and thus would be difficult to control or censor.²⁴⁶ Also, one of the strongest arguments for online pornography regulation is that most pornographic web sites serve as "bait" or "teasers" and provide everyone (including children) free access to "almost all of the available adult content on the Internet."²⁴⁷ Internet gambling sites, however, are different for three

²⁴⁰ See Mark Cenite, *Federalizing or Eliminating Online Obscenity Law as an Alternative to Contemporary Community Standards*, 9 COMM. L. & POL'Y 25 (2004); Matthew Towns, Note, *The Community Standards of Utah and the Amish Country Rule the World Wide Web*, 68 MO. L. REV. 735, 752 (2003).

²⁴¹ Cenite, *supra* note 240, at 56–57.

²⁴² E.g., AOL and BellSouth.

²⁴³ Cenite, *supra* note 240, at 57.

²⁴⁴ The traditional notion is that each state is a sovereign government and only the federal government, not another state, can affect its policies.

²⁴⁵ This assumes, of course, that State A criminalizes *players* for gambling online rather than solely operating an online casino.

²⁴⁶ See Alexander, *supra* note 217, at 1021.

²⁴⁷ *Id.* at 982.

reasons. First, the sites would be centrally controlled and presumably licensed by state authorities. This level of control would allow states to shift the burden of ensuring that players are residents of states that allow legalized online gaming to gambling sites. Second, free bait or teasers do not exist in the gambling world. Either you are gambling or you are not.²⁴⁸ Third, and perhaps most importantly, the regulation of Internet gambling does not give rise to First Amendment issues. Thus, issues that may be difficult to legislate around in the online pornography area are easily resolved by regulation at the state level.

IV. STATE AND FEDERAL ENFORCEMENT ISSUES

Before the passage of the Unlawful Internet Gambling Enforcement Act, the enforcement of an online gambling prohibition in the United States was extremely weak. Given the incentives of offshore Internet gambling firms to exploit the loopholes in state and federal gambling laws,²⁴⁹ many governments have decided to focus prohibition efforts on other parties involved in the various transactions associated with Internet gaming.²⁵⁰ State and federal governments currently take three basic measures to enforce their prohibitions on online gambling. First, the governments focus on the credit card companies that allow customers to deposit money into online casinos. Second, they focus on the online payment providers²⁵¹ that were developed to facilitate e-commerce transactions.²⁵² Third, they develop tactics that prohibit the transfer of gambling data across the Internet. Many of these efforts are hampered by outdated laws,²⁵³ but many of the inherent enforcement issues are technological in nature.

²⁴⁸ Although many online casinos have “free” sites, access to a free site does not automatically give access to the gambling site. A player must deposit money and go through various other procedures to play for “real” money.

²⁴⁹ This motivation includes the concept that many Internet gambling sites are offshore and outside the reach of U.S. jurisdiction.

²⁵⁰ See Adrian Parke & Mark Griffiths, *Why Internet Gambling Prohibition Will Ultimately Fail*, 8 GAMING L. REV. 295, 295–96 (2004) (discussing U.S. efforts to prohibit Internet gambling).

²⁵¹ Online payment providers are also known as Internet Banks.

²⁵² See Schwarz, *supra* note 64, at 1061, 1067.

²⁵³ See *supra* Part I. Time will tell if the Unlawful Internet Gambling Enforcement Act will have a meaningful impact on the online gambling industry.

A. *Financial Institutions*

For U.S. residents to gamble over the Internet, the online casino must have the ability to receive and process payments from within the United States.²⁵⁴ Some type of third party, whether it is a credit card company or online payment provider, must transfer funds from the gambler's account to the online casino.²⁵⁵ There are two main ways U.S. residents fund their gambling account: credit cards and online payment providers.

1. *Credit Card Companies*

Internet gambling activities are "primarily financed through credit card transactions."²⁵⁶ As a result, some states have focused on holding the credit card operators liable for "facilitating . . . illegal transactions."²⁵⁷ In June 2002, Citibank, the country's largest credit card issuer, settled a suit with New York Attorney General Elliot Spitzer.²⁵⁸ Spitzer accused Citibank of "knowingly profiting from illegal activities" by allowing its credit cards to be used for Internet gambling charges.²⁵⁹ Under the settlement agreement, Citibank will not process gambling-related transactions.²⁶⁰ Many credit card issuers such as Bank of America, Fleet, Direct Merchants Bank, Chase Manhattan Bank, American Express, and Discover now have a policy that prohibits their cards from being used for Internet gambling transactions.²⁶¹

The ability to enforce these "no online gambling transaction" provisions is technologically difficult even for companies that take their bans seriously.²⁶² One serious issue is the structure of the credit card payment system. Credit card issuers are able to identify Internet gambling activity by the use of transaction codes.²⁶³ Internet gambling providers must use a transaction code that includes both a gaming merchant category code and an electronic commerce indicator code.²⁶⁴ Theoretically, these two codes should allow

²⁵⁴ See Schwarz, *supra* note 64, at 1061.

²⁵⁵ *Id.*

²⁵⁶ See Parke & Griffiths, *supra* note 250, at 296.

²⁵⁷ Carol Power, *Citibank Pulls Plug on Online Betting*, IRISH TIMES, July 12, 2002, at 55.

²⁵⁸ *Id.*

²⁵⁹ Rebecca Porter, *Prosecutors, Plaintiffs Aim to Curb Internet Gambling*, TRIAL, Aug. 2004, at 16.

²⁶⁰ Power, *supra* note 257.

²⁶¹ *Id.*

²⁶² See Parke & Griffiths, *supra* note 250, at 296–97.

²⁶³ See *id.* at 297.

²⁶⁴ *Id.*

credit card issuers to identify gambling activity and deny the transactions.²⁶⁵ However, according to the United States General Accounting Office (GAO), this structure is ineffective in preventing Internet gambling-related credit card transactions.²⁶⁶ The GAO reported that Internet gambling providers would deliberately disguise the transaction codes to avoid denial of a transaction.²⁶⁷ Using a procedure called “factoring,” an online casino could submit credit card transactions through a nongambling-related merchant, thereby avoiding a transaction denial.²⁶⁸

The recent Unlawful Internet Gambling Enforcement Act is focused on solving these problems. The Act itself does not provide a solution, but does authorize the Board of Governors of the Federal Reserve System to promulgate regulations that can solve these enforcement problems.²⁶⁹ At the time of publication of this Comment, the new regulations have not been promulgated. Thus, it is unclear whether the Federal Reserve can create regulations that provide effective solutions to correctly identify and block unlawful gambling transactions. If the regulations are overbroad, they may impede legitimate transactions. If the regulations do not go far enough, this Act may be unable to stop gambling-related transactions.

In a world where the individual states regulated online casinos, the credit card transaction problems would cease to be an issue.²⁷⁰ Currently, a large problem is that all the online casinos exist outside the effective control of any state or federal government.²⁷¹ If a state licensed an online casino, the state regulatory board would be able to ensure that the casino did not disguise its transaction codes. Furthermore, the state could put the burden of ensuring the legality of the transaction on the online casino instead of the credit card companies.²⁷² An online casino could easily identify the location of the

²⁶⁵ *Cf. id.* (arguing that the current transaction structure does not allow credit card companies to differentiate between legal and illegal gambling activity).

²⁶⁶ See U.S. GEN. ACCOUNTING OFFICE, INTERNET GAMBLING: AN OVERVIEW OF THE ISSUES 21 (2002) (report to congressional requesters).

²⁶⁷ *Id.* at 26.

²⁶⁸ *Id.* at 26–27.

²⁶⁹ 31 U.S.C.A. § 5364(a) (2006).

²⁷⁰ The credit card transaction problem in its current form would not be a problem.

²⁷¹ See *supra* Part I.B.

²⁷² Under principles of lowest-cost avoider, the online casino would be in a better position to ascertain the identity and location of a potential customer. Thus, the burden should fall on the online casino to validate the transaction. For a general description of lowest-cost avoider theory, see R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 1–8 (1960); see also Richard A. Posner & Andrew M. Rosenfield, *Impossibility and*

customer and determine whether the state sanctioned online gaming. In fact, the direct shipping of wine provides a useful analogy for this type of regulatory structure.²⁷³ In the wine industry, the individual shippers must know the law of each state and whether the state allows direct shipment of wines.²⁷⁴ A regulatory framework for Internet gambling could take a similar approach.

2. *Online Payment Providers*

Gamblers use online payment providers such as PayPal²⁷⁵ and Neteller²⁷⁶ to circumvent the system when credit card companies deny their gambling-related transactions.²⁷⁷ Fundamentally, online payment providers and credit card companies are similar. From the standpoint of a consumer, the biggest difference between the two is that an online payment provider operates analogously to a debit card.²⁷⁸ The online account must be funded before it can be used to gamble online.²⁷⁹ However, many online payment providers (including PayPal and Neteller) allow a consumer to fund an account via credit card transactions. Determining whether money is deposited for gambling or legitimate purposes is impossible because consumers use online payment providers for a variety of e-commerce activities.²⁸⁰ The government could try to regulate the online payment providers directly. As a result, the government would treat these providers much like credit card companies.

Experience has shown that pressuring companies to crack down on online gambling transactions appears to be ineffective or at least “highlights that identification of illegal Internet gambling transactions is a difficult if not impossible objective.”²⁸¹ In 2002, eBay²⁸² acquired PayPal and pledged to

Related Doctrines in Contract Law: An Economic Analysis, 6 J. LEGAL STUD. 83, 89–97, 113 (1977) (discussing the lowest-cost avoider as part of the superior risk-bearer in contractual relationships).

²⁷³ See generally Gerald B. McNamara, *Free the Grapes: The Commerce Clause Versus the Twenty-First Amendment with Regard to Interstate Shipment of Wine in America*, 43 DUQ. L. REV. 113 (2004) (discussing the regulatory conditions of direct shipments of wine in the United States); L. Paige Woodard, Note, *Shipping Directly to Consumers . . . Wine Not?*, 32 W. ST. U. L. REV. 63 (2004) (discussing the direct ban on shipping some states have instituted).

²⁷⁴ See McNamara, *supra* note 273, at 114–15.

²⁷⁵ Paypal, <http://www.paypal.com> (last visited Oct. 30, 2006).

²⁷⁶ Neteller, <http://www.neteller.com> (last visited Oct. 30, 2006).

²⁷⁷ See Parke & Griffiths, *supra* note 250, at 297.

²⁷⁸ See Schwarz, *supra* note 64, at 1067.

²⁷⁹ *Id.*

²⁸⁰ See Parke & Griffiths, *supra* note 250, at 297.

²⁸¹ *Id.* As of January 18, 2007, Neteller has decided to stop processing gambling-related transactions. Ryan Nakashima, *Neteller Exits, Online Gambling Won't*, YAHOO NEWS, Jan. 18, 2007,

prohibit PayPal from performing transactions with online gambling providers. In the same year, PayPal was fined \$10 million for aiding and abetting online gambling.²⁸³ Although the fine removed PayPal from the online gambling arena, the federal action cleared the path for “overseas-registered companies to take over the highest growth U.S. banking opportunity of recent years.”²⁸⁴ Thus, instead of decreasing the number of U.S. players accessing gambling sites, the government action simply transferred business to overseas firms catering to U.S. needs.²⁸⁵ In fact, some online casinos developed their own online payment system.²⁸⁶

The solution to the enforcement problem for online payment providers is similar to that of credit card companies. State regulation would shift the burden away from the payment providers onto the regulated online casino. This shift would allow U.S. banks to compete for U.S. residents’ business and provide a strong mechanism to filter out those customers that lived in a jurisdiction that prohibited online gambling. By placing the burden on the entity that ultimately receives the consumers’ money, the incentive to bypass or “game” the system decreases dramatically.

The Unlawful Internet Gambling Enforcement Act is both a step forward and backward from the perspective of state’s rights with respect to online payment providers and credit card companies. States that decide to prohibit Internet gambling need a law similar to the Act to enforce their own prohibition. By passing this legislation, Congress has given a state attorney general an up-to-date tool to crack down on gambling-related transactions within the state.²⁸⁷ However, the law is also a step backward for states that want to regulate and legalize online gambling. The definition of unlawful internet gambling includes transmitting a bet that “is unlawful under any applicable Federal law.”²⁸⁸ As discussed earlier, although federal law does not criminalize an individual bettor from making a wager, it prohibits any state

http://news.yahoo.com/s/ap/20070119/ap_on_hi_te/online_gambling. However, other companies are moving in to fill the void. *Id.*

²⁸² eBay, <http://www.ebay.com> (last visited Oct. 30, 2006).

²⁸³ Nick Louth, *The Problem with Capital Punishment*, INVESTOR’S CHRON., Aug. 5, 2005, at 70.

²⁸⁴ *Id.*

²⁸⁵ *See id.*

²⁸⁶ *See, e.g.,* Spencer E. Ante, *Looks Like a Sure Thing, but . . . as It Readies Its IPO, PartyGaming Is Beset by Big Risks—of Running Afoul of U.S. Law*, BUS. WK., July 4, 2005, at 41. Similar to PayPal, the system developed by PartyGaming provides “an online wallet to customers into which they can transfer funds from their bank accounts.” *Id.*

²⁸⁷ 31 U.S.C.A. § 5365(b)(2)(A) (2006).

²⁸⁸ § 5362(10)(A).

from allowing an online casino to operate within that state.²⁸⁹ Thus, the law represents another hurdle for those states that want to tax and regulate an online casino.²⁹⁰

B. Prohibit Transfer of Internet Gambling Data

Forcing Internet service providers (ISPs) to use content-filtering technology is one way of prohibiting access to Internet gambling sites.²⁹¹ Content filtering is a technology most notable for preventing children from accessing sensitive web sites. However, as a theoretical matter, content filtering can be used in other areas.

The two simplest ways of implementing a filtering system are “IP Address Blocking” and “DNS Blocking.”²⁹² Both IP Address Blocking and DNS Blocking only affect users who access the Internet through the ISPs that adopt these measures.²⁹³ IP filtering can be implemented easily and quickly by ISPs.²⁹⁴ In fact, many ISPs already have existing internal procedures to implement these filtering systems.²⁹⁵ DNS filtering, on the other hand, is not a standard process and would require many significant changes on the part of ISPs.²⁹⁶ Regardless of the implementation, however, both of these approaches have significant flaws that online operators can exploit.

An online casino operator can potentially bypass an IP- or DNS-based filtering system using one of three methods. First, a potential gambler can use an “anonymizer” service. This service prevents the ISP from ascertaining the user’s ultimate destination.²⁹⁷ Thus, the ISP never knows what web site the user is ultimately viewing, thereby bypassing its filtering mechanism. Second, online casinos can always change their IP address. Changing a DNS name is a bit harder because it is generally the brand name that gamblers remember.

²⁸⁹ See *supra* Part I.

²⁹⁰ A simple safe harbor provision could allow a state to regulate an online casino. The safe harbor could simply exempt any state that chooses to regulate an online casino from the provisions of the Act and any other applicable federal law.

²⁹¹ Schwarz, *supra* note 64, at 1050.

²⁹² Tim Gerlach, Note, *Using Internet Content Filters to Create E-Borders to Aid in International Choice of Law and Jurisdiction*, 26 WHITTIER L. REV. 899, 916 (2005).

²⁹³ *Ctr. for Democracy & Tech. v. Pappert*, 337 F. Supp. 2d 606, 628 (E.D. Pa. 2004).

²⁹⁴ *Id.* at 629.

²⁹⁵ *Id.*

²⁹⁶ *Id.* at 629–30.

²⁹⁷ Anonymizer—Internet Privacy & Security Solutions, <http://www.anonymizer.com> (last visited Oct. 29, 2006).

Therefore, by changing the DNS name, an online casino may have to redo its marketing campaign, a costly option. However, many casinos make you download a software client.²⁹⁸ Continually updating the client to point to a new IP address could potentially circumvent the IP filtering issues. Third, an online gambler can access the Internet through an ISP located outside the United States.²⁹⁹ The ISPs outside the United States would not use the same filtering technology because the regulatory environment would be different.³⁰⁰

Focusing on financial institutions and technology solutions will not be sufficient to restrict access to Internet gambling sites. Without removing the incentive to circumvent existing laws, Internet casinos will continue to attract more gamblers from jurisdictions that ban Internet gaming. Allowing states to regulate online casinos directly creates an incentive for the online gaming corporations to adhere to the law.

CONCLUSION

Internet gambling is here to stay. Revenue generated by Internet gambling has increased over the past few years and shows no sign of decreasing. Despite the current federal regulatory regime that prohibits any online casino from operating in the United States, the industry is growing. Times have changed. The need for federal laws that were originally designed to deter organized crime has passed.

The federal government needs to act in the interest of the states and allow them to choose for themselves whether to allow online gambling. Some states may choose to ban online gambling altogether; some may decide to regulate it. Similar to land-based casinos, the ultimate decision should remain with the states and their residents. In other areas such as online pornography regulation, the federal government has shown how a heavy-handed, one-size-fits-all approach does not work. The federal government should not make the same mistake in the online gambling context.

²⁹⁸ See PartyPoker, <http://www.partypoker.com> (last visited Oct. 29, 2006); PokerStars, <http://www.pokerstars.com> (last visited Oct. 29, 2006).

²⁹⁹ Schwarz, *supra* note 64, at 1052.

³⁰⁰ *Id.* This argument, however, is not strong. Even if a few individuals wanted to access the Internet through an offshore ISP, the cost of accessing the Internet through a long-distance toll call would "probably serve as an adequate deterrent to most local bettors." *Id.* Also, most users would probably not want to sacrifice their broadband speed for an overseas modem connection.

A federal regime that empowers states to make their own decisions about online gambling is advantageous over the status quo. States would also be able to regulate and monitor online casinos in an effort to help problem gamblers, prevent underage gambling, and minimize any adverse social costs. Furthermore, states would be able to raise additional revenue through taxation to offset the negative costs associated with gambling. Enforcement would also become easier because states could force online casinos to comply with their rules. Rather than using a technology-based solution, states could ensure that their online casinos do not take customers from states where online gambling is not permitted.

Ultimately, the federal government should allow each state to make its own decision as to whether to ban or regulate online gaming.

KIRAN S. RAJ*

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