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Internet Gambling & The Law – Prohibition vs. Regulation

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The Internet gambling industry was thrown into a state of turmoil in July 2006 when the U.S. Department of Justice arrested the CEO of a leading off-shore Internet gambling company, BetOnSports, after his plane touched down on U.S. soil during a trip from Britain en route to his company's offices in Costa Rica. Federal prosecutors indicted BetOnSports, its CEO, David Carruthers, and other individuals and companies who work with BetOnSports, and charged them with criminal RICO and wire fraud for taking sports bets over the Internet and telephone from the United States. This is the latest salvo fired by the U.S. Government in its long-standing attempt to ban Internet gambling by companies that accept wagers from the United States. While the indictment of BetOnSports and arrest of its CEO certainly represent a coup for the government, the road to prohibition is fraught with disaster.

The last time the government tried this hard to outlaw one of America's favorite pastimes was the liquor prohibition laws in the 1920s. We all know how unsuccessful that effort was. A more successful solution would be for Congress to devote its energy and resources to adopting regulations to ensure that Internet gaming is subject to a regulatory framework similar to casino gaming laws in Nevada, New Jersey and the other 9 U.S. states that authorize commercial gaming. Finally, Congress should consider imposing a "pay-to-play" tax on Internet gambling similar to the Federal taxes imposed on the sales of cigarettes and liquor.

The government's indictment, issued by a federal grand jury in the Eastern District of Missouri, centers on BetOnSports and its founder, Gary Kaplan, and alleges that he failed to pay federal wagering excise taxes on more than $3.3 billion in bets taken from the U.S. The indictment claims that Kaplan is a fugitive, having fled New York in the early 1990's after he was arrested on gambling charges related to illegal bookmaking activities. He is charged with 20 felony violations of federal laws, including the Wire Act, RICO conspiracy, interstate transportation of gambling equipment and tax evasion. The government is seeking the forfeiture of $4.5 billion and various properties from Mr. Kaplan and his alleged co-conspirators. In all, the government has charged eleven individuals, along with BetOnSports and three other companies said to be linked to the company. U.S. authorities have already arrested five of the alleged co-conspirators and seek extradition of the six others. In conjunction with the indictment, the government filed a civil complaint in federal court and obtained a temporary restraining order requiring BetOnSports to stop accepting sports bets from the U.S and to return money held in wagering accounts to its U.S. account holders. As a result of the indictment, and the coordinated arrests and TRO, BetOnSports shut down 85% of its website and no longer accepts any wagers from the United States. Moreover, upon the request of BetOnSports PLC, the publicly traded parent company of BetOnSports, the London Stock Exchange has halted trading in its shares. Prior to the suspension of trading, BetOnSports PLC's shares plunged by as much as 24%.

Internet gambling is an immensely popular and profitable industry that continues to grow exponentially. There are more than 80 countries outside the United States that have legalized Internet gambling, and these jurisdictions license some 300 operators that operate about 2,100 sites, according to Christiansen Capital Advisors, a leading gaming consulting firm. Despite the international locales of Internet gaming firms, they derive most of their income from Americans. In 2006, Internet gambling revenues from the U.S. will reach about $7.2 billion, nearly half of the world-wide total of $15 billion. If the current growth continues, many experts predict Internet gaming revenues could reach more than $24 billion by 2010.

For several years leading up to the

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indictment of BetOnSports, there had been a period of relative inactivity in the U.S. government's crack-down on Internet gaming companies. Up to now, the most celebrated prosecution of Internet gambling under the Wire Act has been the case of *United States v. Jay Cohen*, 260 F.3d 68 (2d Cir. 2001), in which Cohen established an Internet-based sports book, World Sports Exchange ("WSEX"), in Antigua that took bets from America and elsewhere on professional and college sporting events. The U.S. government charged Cohen and 20 others with violating the Wire Act, 18 U.S.C. §1084(a), which makes it a crime to "engage[] in the business of betting or wagering" using a "wire communication facility" to transmit in interstate or foreign commerce bets or wagers or related information. Instead of staying abroad to avoid prosecution like his alleged co-conspirators or accepting a plea deal, Cohen voluntarily returned to the U.S. to fight the charges, arguing that U.S. federal laws did not apply to WSEX because it was properly licensed and regulated in Antigua. The jury disagreed, convicting Cohen of violating the Wire Act and sentencing him to 21 months in prison. The *Jay Cohen* case is noteworthy for a couple of reasons: first, Cohen is the only person to stand trial in the U.S. for running an Internet gambling site, and, second, the court determined that the wagers occurred in both the U.S. and Antigua.

Despite the *Jay Cohen* case, the applicability of the Wire Act to Internet gambling is still unsettled. Some legal experts say the law, created in 1961 to combat illegal bookmaking by the Mafia, is outdated and does not readily apply to (a) the Internet, which did not exist as a form of communication in the 1960's, or (b) traditional casino-style games, such as blackjack and poker that are played online. Nevertheless, its seems clear that the Wire Act prohibits Internet sports books, especially if wagers are taken by telephone in addition to the Internet. It is much less certain, however, whether the Wire Act prohibits traditional casino-style games on the Internet.

In *In re MasterCard International Inc. Internet Gambling Litigation, et al.*, 132 F.Supp.2d 468 (E.D. La. 2001), *aff'd* 313 F.3d 257 (5th Cir. 2002), the plaintiffs were individuals who allegedly used their credit cards to gamble on-line from the U.S. at Internet casinos. There was no allegation that the plaintiffs bet on sporting events. The court held, and the appeals court affirmed, that the Wire Act only prohibits wagers on sporting events or contests, and not gambling in an Internet casino. The court stated that, "a plain reading of the statutory language [of the Wire Act] clearly requires that the object of the gambling be a sporting event or contest." *Id.* at 480.

Despite the *MasterCard* decision, the Department of Justice continues to proclaim that Federal law prohibits gambling over the Internet, including casino-style games as well as sports betting. In the view of the Department of Justice, the fact that Internet gaming operators are not breaking laws in the nations where they run their casinos is of no consequence because the wager occurs in the U.S. where it is illegal, as well as in the foreign jurisdiction. The U.S. has never fully set forth its rationale, but has publicly cited two other statutes that, it claims, support its position that Federal law bans traditional casino-style games, namely, the Travel Act, 18 U.S.C. §1952 (outlaws distribution of proceeds from an unlawful activity across state lines or international borders) and the Illegal Gambling Business Act, 18 U.S.C. §1955 (makes it a crime if 5 people engage in gambling during a 30-day period or generate more than $2,000 in a single day).

The big question at board meetings around the world is, "Am I next?" Everyone is trying to determine whether the BetOnSports indictment really signals a new aggressiveness in U.S. policy towards offshore Internet gambling operations or if there might be another motive for the indictment. Some analysts believe that the indictment is really aimed at Kaplan, BetOnSports' founder, and not at the industry as a whole, while others see it as a reflection upon CEO David Carruthers, who has been extremely vocal against U.S. Internet gambling policy. There are also those who claim that the government is just trying to create support and positive press for legislation, the Unlawful Internet Gambling Prohibition and Enforcement Act, H.R. 4411, that the House of Representatives passed on July 11, 2006. This legislation (if adopted in its present form) would ban the use of credit cards and other forms of electronic payment to settle Internet wagers, amend the Wire Act to specifically include the Internet and prohibit traditional casino-style games, and require Internet service providers to block access to Internet gambling websites.

Internet gambling companies criticize the glaring inconsistencies in the House bill, which provides exemptions for buying lottery tickets and placing "authorized" bets on horse races over the Internet. They steadfastly maintain that U.S. laws don't apply to them because they are located in places where online gambling is legal, such as Antigua, Costa Rica, Isle of Man and Gibralter. They also are comforted by the fact that the U.S. Government has not had much success extraditing executives who remain outside the U.S, although a recent extradition case in Britain, known as the NatWest Three, has caused a great deal of concern there. One thing is certain – no offshore Internet gaming executive or director will travel to America anytime soon. This fear of prosecution is evidenced by the last-minute postponement of a major International gaming conference that was due to be held in Las Vegas in July, 2006. As Calvin Ayre, CEO of Bodog.com, the conference's sponsor and a leading Internet gaming company, stated in announcing the cancellation, "the U.S. government has made it clear that anybody that's involved in Internet online gambling is not welcome in the U.S." Similarly, U.S. Attorney Catherine L. Hanaway of the Eastern District of Missouri, states that "[i]llegal commercial gambling across state and international borders is a crime. Misuse of the Internet to violate the law can ultimately only serve to harm legitimate businesses. [The BetOnSports] indictment is but one step in a series of actions designed to punish and seize the profits of individuals who disregard federal and state laws."

Like the prohibition of alcohol, which did not work, the prohibition of Internet gambling is destined to fail. Despite the prosecutors' best intentions, it is unlikely that they will be able to effectively stop Internet gambling in the U.S., even if the law were clear, which it is not. The Internet has spawned a $12 billion industry – Internet gambling – which cannot be stopped by a couple of strategic prosecutions and legislation that cannot be readily enforced. Instead of fighting to ban Internet gambling, the government should regulate Internet gaming and adopt a regulatory structure that ensures that Internet gambling is conducted honestly, fairly and competitively, safeguards the rights of players, casinos and others and enforces age and identity verification. Finally, Congress should consider imposing a "pay-to-play" tax on Internet gambling that would not only reduce the deficit but also create a successful regulatory framework. The government needs only to look to Nevada or New Jersey for examples of how a strictly regulated gaming industry protects against undesirable elements and financial improprieties, provides needed consumer protections to those who gamble and, as a consequence, generates substantial tax revenue.