

# BUSINESS LAW TODAY

The ABA Business Law Section's Online Resource

## States Prepare to Bet the House on Online Gaming

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In recent years, cash-strapped states have begun to seek alternative means of generating revenue and boosting state coffers—including exploring expanded gaming. For some states, this meant the legalization of casinos, once considered the exclusive territory of Nevada, Atlantic City, and the tribal authorities. However, the frontier of expanded gaming stretches well beyond casinos and slot machines. In particular, the online gaming, or iGaming, industry is booming. According to the American Gaming Association's (AGA) white paper: *Online Gambling Five Years After UIGEA*, global online gambling revenue in 2010 was nearly \$30 billion, with roughly \$4 billion originating in the United States.

Recently, the United States Department of Justice issued a legal opinion indicating it may be reversing its long-standing opposition to online gaming under the Wire Act, causing several states to move to seize new gaming territory—and the considerable tax revenue that it could generate.

### Regulation of Online Gaming

Most iGaming operators are licensed and regulated in their home jurisdictions and operate legally in many countries around the world. According to the AGA's white paper, roughly 85 countries, including Canada, have legalized—and regulated—online gaming. A 2010 survey conducted by Spectrum Gaming for the AGA found 2,679 Internet gambling sites worldwide,

owned by 665 companies. While iGaming is legal and regulated in the UK and several European countries, the largest online gaming operators are predominately licensed in off-shore island nations such as Gibraltar, Malta, the Isle of Man, and Alderney. These jurisdictions tend to offer low taxes, ease of formation, and sometimes, less regulatory oversight. Until recently, many of these jurisdictions have essentially taken the position that U.S. law only bans online wagering on sports betting, and have therefore allowed licensees to accept bets from U.S. residents on non-sports wagers, such as poker. However, while the gaming companies' overseas operations have made it difficult for federal authorities to monitor or prosecute their activities within U.S. borders, the U.S. Department of Justice nonetheless has a history of using federal and state laws to target iGaming operators.

Congress has not enacted legislation that expressly prohibits wagering online, but certain federal statutes provide ammunition for the Justice Department's attacks on iGaming. As an example, the Illegal Gambling Business Act, 18 U.S.C. § 1955, prohibits illegal gambling businesses, which are defined by the act as businesses that: (1) violate state law; (2) are operated by five or more persons; and (3) receive at least \$2,000 a day in revenue. The 2006 Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA), 31 U.S.C. § 5361 *et seq.*, provides criminal and civil liability

for financial transactions related to unlawful Internet gambling, rather than expressly targeting online wagering activity. The UIGEA defines "unlawful Internet gambling" as "plac[ing], receiv[ing], or otherwise knowingly transmit[ing] a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made." Thus, the UIGEA and the Illegal Gambling Business Act, rather than expressly prohibiting certain types of wagering, allow other state or federal laws to define what is legal or illegal Internet gambling.

Only a limited number have states have enacted legislation that expressly prohibits Internet gaming, but these laws can be effective in the prosecution of iGaming operators when used in combination with federal statutes. In February 2012, online sports wagering company Bodog Entertainment Group and its founder, Calvin Ayre, were indicted by the U.S. district court in Maryland for violations of the Illegal Gambling Business Act, based on violations of Maryland's prohibition of online sports wagering. With respect to federal gambling laws, the federal Wire Act, 18 U.S.C. § 1084, prohibits at least some forms of interstate online gaming. However, because the Wire Act was passed in 1961, and has not been amended since the advent of the Internet, the act has

been open to interpretation with respect to its application to iGaming—namely, whether it prohibits all forms of online interstate wagering, or only online interstate sports wagering.

The exception to the general, if ambiguous, federal prohibition on interstate Internet wagering is telephone and Internet wagering on horse racing, which was expressly authorized by a 2000 amendment to the Interstate Horseracing Act of 1978 (IHA), 15 U.S.C. § 3001 *et seq.* Nevertheless, in line with the department's long-held position that the Wire Act prohibits interstate Internet wagering, the department of Justice has taken the position that the 2000 amendment to the IHA did not supersede the prior existing federal criminal gambling statutes, and that pari-mutuel wagering on horse racing over the Internet is, therefore, illegal under federal law.

### The Wire Act

The Wire Act, which was passed in 1961 in response to organized crime and book-making, essentially prohibits the placing of certain interstate wagers by wire transmission. More specifically, the relevant provision of the Wire Act, 18 U.S.C. § 1084(a), contains two broad clauses. First, the Wire Act prohibits anyone who engages in the business of betting or wagering from knowingly using a wire communication facility to transmit interstate bets or wagers, or information assisting in the placing of bets or wagers, on any sporting event or contest. Second, the act prohibits using a wire communication facility to transmit communications that entitle the recipient to receive money or credit either as a result of bets or wagers, or for information assisting in the placing of bets or wagers. These two clauses have resulted in considerable ambiguity with respect to whether the Wire Act, as a whole, applies only to betting on sporting events or contests, or whether it prohibits all interstate wagering wire transmissions—including online gaming, such as Internet poker. The Department of Justice has traditionally taken the position that the act prohibits all Internet wagering—including, and perhaps especially, poker.

A 2002 case addressing the applicability of the Wire Act to iGaming was *In re*

*Mastercard International Inc. Internet Gambling Litigation*, 313 F.3d 257 (5th Cir. 2002), in which the plaintiff debtors, who had been gambling at Internet casinos, alleged that credit card companies violated the Wire Act and other statutes, and that, therefore, their gambling debts were unenforceable under state law. The Fifth Circuit agreed with the district court's conclusion that the Wire Act concerns gambling on sporting events or contests, and that the plaintiffs failed to allege that the defendants had engaged in Internet sports gambling. The district court found that a plain reading of the Wire Act clearly required that the object of gambling be a sporting event or contest. Other courts have disagreed, however, lending uncertainty to the application of the Wire Act.

Perhaps because of this uncertainty, the recent indictment of several Internet poker companies in, *United States v. Sheinberg, et al.*, filed in the Southern District of New York, was based not on the Wire Act, but on the UIGEA, the Illegal Gambling Business Act, state gambling laws, and federal money laundering and wire fraud statutes. On April 15, 2011, the federal government announced that a New York grand jury had indicted the founders of the three largest Internet poker operations that were accepting bets from U.S. residents—PokerStars, Full Tilt Poker, and Absolute Poker/Ultimate Bet. The indictment focused on the processing of payments to and from the companies' customers, alleging that those transactions involved bank fraud, money laundering, and the maintenance of illegal gambling businesses. The Justice Department filed a parallel civil complaint demanding forfeiture of the Internet domains used by those operators. Five weeks later, a second wave of indictments against online poker and sports betting companies was handed down; these charges also involved the Illegal Gambling Business Act and money laundering statutes, rather than the Wire Act. While the indicted companies took measures to stop wagering by U.S. residents, the AGA's white paper indicates that approximately 300 off-shore gambling operators continue to operate in

the U.S. market through more than 1,000 online gaming websites. However, these off-shore operators may soon face domestic competition in light of the recent legal opinion from the Justice Department.

### The 2011 Department of Justice Wire Act Opinion

The underlying ambiguity of the Wire Act in its application to iGaming has clearly resulted in uncertainty as to the legality of any Internet gaming—including intrastate, non-sports wagering. This uncertainty led policy makers from New York and Illinois to formally request opinions from the Justice Department's Office of Legal Counsel as to the legality of the sale of lottery tickets over the Internet. In late December, 2011, the Justice Department released a memorandum opinion (Opinion), written by Deputy Attorney General Virginia Seitz for the Office of Legal Counsel, which not only confirmed the legality of intrastate online lotteries under the federal Wire Act, but, in the view of some regulators, also opened the door to other forms of intrastate online gaming, including poker, by stating that the Wire Act applies only to sport betting. Ironically, this does not put to rest the tension between the Department of Justice and horse racing.

The question before the Justice Department was the same as the question before the court in *In re Mastercard* and its ilk: whether both of the relevant clauses of 18 U.S.C. § 1084(a) apply only to betting on sporting events or contests, or whether the second provision effects a broad prohibition of all gambling transactions by wire. Reversing its previous interpretation, the Justice Department in the December Opinion found that, even though the phrase "on any sporting event or contest" does not appear in the second clause, "the references to 'bets or wagers' in the second clause are best read as shorthand references to the 'bets or wagers on any sporting event or contest' described in the first clause." Thus, the Wire Act only prohibits certain interstate wagers on sporting events or contests—and wagers that are outside of this category fall beyond the scope of the Wire Act's prohibitions. Therefore, because the New York and Illinois online

lottery sales are intrastate and do not relate to a “sporting event or contest,” the Wire Act does not prohibit them.

The Justice Department relied heavily on legislative history and the congressional testimony contemporary with the passage of the Wire Act in 1961. The primary focus of the act was to stop the use of wire communications for sports gambling. “This focus on sports-related betting makes sense,” Seitz wrote, because “the record before Congress indicated that sports bookmaking was the principal gambling activity for which crime syndicates were using wire communications at the time.”

### Implications

The Justice Department did not address other forms of Internet wagering, but states that are eyeing expanded gaming as a way to boost revenue are looking to seize the moment and pass legislation that will allow them to regulate—and thus tax—online gaming companies that wish to operate within their borders. Nevada recently enacted regulations legalizing limited intrastate Internet gambling, and California, Iowa, Mississippi, and New Jersey also took steps to legalize intrastate online gaming. The D.C. City Council legalized online gaming in 2010 and repealed it in 2012, but Councilman Michael Brown plans to reintroduce a bill to legalize Internet poker and slots. According to the *New York Times*, Steven Grossman, Massachusetts state treasurer and chairman of the New York Lottery Commission, believes the Justice Department’s Opinion is a “turbocharged opportunity to engage new markets,” and that it “will put additional pressure on Congress and others to allow online poker and other Internet gambling.” Coupled with significant improvements in online gaming technology, both for play and for integrity, and increased acceptance of gaming, states are realizing that it is practicable to tax and regulate online gaming both for revenue reasons and to protect consumers.

However, the Justice Department’s Opinion, in deciding such a narrow issue, does not indicate that iGaming companies are now free to accept wagers from U.S. customers without reservation. In fact,

gaming industry groups, such as the American Gaming Association, are lobbying for federal legislation to regulate Internet gaming, in order to establish consistent regulatory standards and to prevent fraud and money laundering. In the February 2012 issue of *Global Gaming Business*, Frank Fahrenkopf, CEO of the AGA, wrote that “the [Justice Department’s] opinion further illustrates the urgent need for federal legislation to prevent a patchwork quilt of rules and regulations governing domestic online gambling and the continued proliferation of unlicensed and unregulated foreign gambling websites targeting the millions of Americans playing online[.]”

Federal legislation could provide a mechanism for regulating and taxing foreign operators in order to protect players; it would also clear up lingering ambiguities as to the application of the Wire Act and other federal laws to online gaming. Even casino companies like Caesars Entertainment Corp., wary of possible competition with Internet casinos, are lobbying for federal regulation of Internet gaming. Another possible avenue for regulation is by interstate compacts similar to those currently used in horse racing. These compacts permit larger pools—and larger payoffs—for customers. Interstate compacts are not a complete bypass of federal regulation, however, as Congress may take the position that it has to approve any proposed compact.

Ultimately, the Justice Department’s Opinion clarified two points of law: that the Wire Act only applies to interstate wire transmissions related to bets or wagers on sporting events or contests; and that the Wire Act does not prohibit intrastate online lotteries. Despite the rush by several states to bet the house on iGaming tax revenue, regulators are well-advised to acknowledge potential conflicts with other federal laws and to stay well within the narrow bounds of the 2011 Opinion.

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