



# An Analysis of Internet Gambling and its Policy Implications

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## Introduction

In 2005, millions of U.S. residents went online to bet more than \$4 billion on casino games, sporting contests and poker. Despite the official hostility of the federal government and most state governments, Internet gambling among U.S. residents continues to grow at a rate of more than 20 percent a year. Most online gambling businesses now operate from obscure jurisdictions such as Antigua, the Kahnawake Mohawk Nation of Canada, or Alderney (an island in the English Channel), but new laws in the United Kingdom soon will draw the industry there and offer a respectable, reliable regulatory framework for online gambling companies.

Although federal and state governments insist that online gambling is illegal, in reality it is thriving. Among the consequences of this contradiction between policy and reality are:

- Millions of U.S. residents gamble online every day without the protection of reliable regulatory structures that ensure age and identity verification, the integrity and fairness of the games, or that responsible gaming features are included on a site.
- Neither federal nor state governments receive tax revenues from online gambling.
- Disrespect spreads for laws that are neither enforced nor evidently enforceable against an activity that enjoys wide and growing popularity.
- The online gambling industry creates no jobs in the United States and American businesses earn no returns from online gambling.
- Current inconsistencies in U.S. Internet gambling policy could lead to sanctions by the World Trade Organization (WTO).

To provide an overview of the current online gambling market, this paper will survey the types of games being offered, the types of entities offering online gambling and where they are located, the payment mechanisms available for online bettors, the regulatory systems in place for online gambling, and prevailing tax rates. The deficiencies of current U.S. policies, as well as proposed legislation and its possible impact, also will be explored.

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## Background

Some 2,500 sites on the Internet provide gambling services that range from casino games (blackjack, roulette, slots) to sports and pari-mutuel betting, to bingo and lottery sales, to the recent poker phenomenon. The size of the online gambling market is difficult to gauge because so much of it is conducted by privately-held entities operating from lightly-regulated jurisdictions. For 2004, estimates of online gambling revenues ranged from \$7 billion to \$10 billion, with U.S. bettors providing at least half of that amount —\$4 billion or more.<sup>1</sup> Despite the growing popularity of online gambling, the amounts currently wagered online by Americans are still well below revenues from legalized gambling:

<i>Commercial casino revenue</i>	\$30.5 billion <sup>2</sup>
<i>Tribal casino revenue</i>	\$19.4 billion <sup>2</sup>
<i>State-operated Lotteries</i>	\$21.4 billion <sup>2</sup>

Nevertheless, the worldwide online gambling market is expected to grow at annual rates of 20 percent and more. Annual online gambling revenues of at least \$20 billion are projected by 2009, with perhaps a slight decline in the share derived from the United States.<sup>3</sup>

Because most forms of online gambling are illegal in this country, almost all online bets by U.S. residents are placed with non-U.S. entities. There are a handful of exceptions, however, where certain limited forms of “remote” gambling are permitted in the U.S., including:

- As authorized by the federal Interstate Horseracing Act, 37 states currently allow bets on horse and dog racing to be placed online. One of those states, Oregon, currently hosts multiple hubs for such forms of online gambling among state residents,<sup>4</sup> generating more than \$200 million in revenue in 2005.<sup>5</sup> It is worth noting, however, that as recently as April 5, 2006, the Justice Department has asserted that the horseracing industry is violating federal law by allowing online bets.<sup>6</sup>
- In 2005, Nevada Gov. Kenny Guinn signed Assembly Bill 471, which authorizes gambling through wireless devices in the state, so long as the players are on the premises of a licensed casino facility while using the technology.<sup>7</sup> In March 2006, Nevada regulators adopted regulations for this activity.<sup>8</sup>
- Station Casinos in Nevada operates a virtual private network for sports betting by residents of the Las Vegas area. After opening an account in person, bettors can direct wagers through that account through cable, dial-up service, or by telephone.

## **Types of Online Gambling Now Available**

The basic market segments for online gambling are sports betting, casino games, the lottery and the fast-growing poker market.

- In the early years of online gambling, sports betting was its strongest component, accounting for more than half of Internet gambling revenues in 2001. Sports betting now constitutes about 35 percent of the revenues (roughly \$4 billion in 2005), though it still is growing briskly. Virtually all online sportsbooks cater to the American market by accepting bets on U.S. sporting events, such as the games of the NFL, NBA and MLB.<sup>9</sup> Despite the popularity of online sports betting, the majority of sports bets in this country are still placed through local illegal bookmakers. A recent study estimates that the amount wagered with such illegal sports books (the handle) is twice the amount bet with offshore Internet sites.<sup>10</sup>
- Casino games consistently have accounted for about one-fourth of the online gambling market.
- Online poker has grown dramatically over the last five years, rising from \$82 million in annual revenue in 2000 to over \$2 billion in 2005. In the summer of 2005, PartyGaming cashed in on this sizzling growth, and helped fuel it further, when its initial stock offering on the London Stock Exchange established a market value for the company of close to \$10 billion (more than British Airways and EMI combined). An earnings warning in late 2005 deflated the stock somewhat, but it is still performing strongly.<sup>11</sup> PartyGaming has acknowledged that 88 percent of its revenues in 2005, which totaled close to \$1 billion, were generated by poker play and that 84 percent of its revenues come from U.S. players.<sup>12</sup>
- National and provincial lotteries earned more than \$1.5 billion in 2005. Among the nations selling their lottery products online are Austria, France, the United Kingdom and Sweden. These national lotteries direct their products to residents of their own countries. In North America, online lottery sales are offered by Atlantic Lottery Corporation, which operates in Nova Scotia, Prince Edward Island, Newfoundland, Labrador and New Brunswick. British Columbia Lottery Corporation offers online sports betting, lottery products and keno.

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## Location of Online Gambling Entities

Eighty-five jurisdictions around the world currently regulate some form of online gambling, but most such businesses are clustered in a few places. A March 2005 report listed the following totals for online gambling businesses, by jurisdiction:<sup>13</sup>

Antigua	536
Costa Rica	474
Kahnawake Mohawk (Canada)	401
Curacao	343
Gibraltar	111
United Kingdom	70
Belize	60

All of these nations have legalized online gambling as an economic development strategy for attracting investment and jobs in a non-polluting, technology-oriented industry. Many anticipate that online gambling businesses will be drawn to the United Kingdom as it implements its Gaming Act 2005, which significantly liberalizes regulation of online gambling. Many anticipate that taxes on online gambling will be higher in the U.K. than in other jurisdictions, but doing business in the U.K. offers substantial advantages: (i) a stable political environment, (ii) vibrant capital markets, (iii) a reliable communications infrastructure, (iv) a large pool of skilled workers, and (v) regulations that should inspire confidence among customers and investors.

A few online gambling companies are publicly traded on the London Stock Exchange, including PartyGaming, Ladbrokes (as part of Hilton Group Plc), and Sportingbet Plc. The online lottery sector is populated with public agencies. Nevertheless, the vast majority of online gambling companies remain privately owned.

At least two companies holding licenses in American jurisdictions have operated offshore Internet gambling businesses that refused to accept bets from the U.S. or any other country where online gambling is against the law.<sup>14</sup> Both MGM MIRAGE and Kerzner International operated those sites without objections from state regulators in the U.S., although both companies closed their online gambling sites due to business reasons.

## Prevailing Tax Rates

Tax rates on Internet gambling vary among jurisdictions, with most below 5 percent. Some examples of current tax rates include:

<b>Isle of Man</b>	<b>2.5% on first £10 million of “handle”; 0.5% between £10 million and £40 million; 0.1% above £40 million.</b>
<b>Antigua and Barbuda</b>	<b>3% of “hold” (the amount retained by the gaming entity after paying off winning bets); ceiling of \$50,000/month.</b>
<b>Alderney</b>	<b>£75,000/year fee (no tax).</b>

Several commentators anticipate that the U.K. government will impose higher tax rates on Internet gambling than most other jurisdictions. The U.K. is expected to announce its tax rate in 2007.

## Payment Mechanisms

U.S. enforcement agencies have attempted to eliminate the mechanisms by which U.S. gamblers transfer money to offshore Internet gaming businesses. In 1997, the Florida Attorney General successfully pressured Western Union to stop issuing money orders or wire transfers payable to offshore betting businesses.<sup>15</sup> In 2002, the New York Attorney General entered into an agreement with Citibank requiring that the bank block use of its Visa and MasterCard credit cards for payments to offshore gambling businesses.<sup>16</sup> Other New York-based banks have followed this agreement, refusing to process credit card charges with the code “7995” (for online gambling), but a few banks in other parts of the country do not follow this policy. At the same time, the New York Attorney General subpoenaed PayPal for records of transfers to offshore gambling businesses, an initiative that persuaded PayPal to exit that business.<sup>17</sup> PayPal ended up paying a \$10 million settlement with the Justice Department for violations of the USA PATRIOT Act. Similarly, Sen. Jon Kyl (R-Ariz.) and Rep. Jim Leach (R-IA) have repeatedly proposed legislation that seeks to cut off payment mechanisms for offshore gambling,<sup>18</sup> most recently in the 108th Congress.<sup>19</sup> These bills will be discussed in more detail later in this paper.

Despite these efforts, U.S. bettors still have no trouble gambling online. Many U.S. bettors make payments to offshore gambling sites through “e-wallets” such as NETeller, FirePay, or Citadel.<sup>20</sup> The gambler directs money to the e-wallet, which is based in the Channel Islands or some other offshore jurisdiction, and the e-wallet makes the payment to the online gambling business. This medium could be restricted if U.S. banks were barred from doing business with such e-wallets, even though the e-wallets may be used for transactions with non-gambling businesses. In response to such a drastic step, U.S.-based gamblers might well be able to use European banks for transactions with online gambling businesses.

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## Existing Regulatory Systems

The leading online gambling jurisdictions have created regulatory structures that bear a surface resemblance to traditional regulation for commercial casinos in the U.S. Though varied, these regulatory regimes have some common elements:

- All require that gambling licensees and key employees be “suitable,” or persons of “integrity,” or “fit and proper.”<sup>21</sup> The completeness of the background investigations for licensing may be subject to question; some, for example, accept licensure in another jurisdiction as prima facie evidence of suitability.<sup>22</sup>
- All require that players establish their identification and residence.<sup>23</sup> Again, the effectiveness of those requirements depends on how they are applied, which cannot be evaluated from the regulations themselves.
- All require that the games be conducted fairly, and many insist that the Web site’s gambling technology be approved by the regulatory body or a designated testing facility. These requirements range from quite specific<sup>24</sup> to fairly open-ended.<sup>25</sup>
- On underage gambling, most online jurisdictions establish a minimum gambling age of 18,<sup>26</sup> though Alderney (an island in the English Channel) accepts bets from anyone who has reached his own country’s “age of majority”.<sup>27</sup> Some online gambling sites may apply the assumption that any holder of a major credit card is 18 years old, whether or not such an assumption is valid.
- On responsible gambling issues, several jurisdictions require that online players be provided a mechanism to set their own loss or betting limits, or limits on the deposits they can make into their online gambling account.<sup>28</sup> Similarly, regulations ordinarily require that a player be permitted to exclude herself from gambling with the online business, though such self-exclusions may be reversed quite easily.<sup>29</sup> Some jurisdictions go beyond current U.S. gambling regulation by promising to exclude a gambler from its Web sites in response to a petition from a person other than the gambler who claims a “close personal interest in the welfare of the [gambler].”<sup>30</sup>
- Certain jurisdictions ban the extension of credit to players,<sup>31</sup> though others specifically authorize it.<sup>32</sup>
- All of the jurisdictions require some form of anti-money laundering monitoring, which may take the form of restricting customers to a single account with the online gambling business<sup>33</sup> or identifying and reporting suspicious transactions or changes in a player’s pattern of transactions.<sup>34</sup>

In pursuit of greater respectability and consumer acceptance, some online companies have formed a voluntary standard-setting organization — “E-Commerce and Online Gaming Regulation and Assurance,” or “eCOGRA.” The organization establishes minimum standards for consumer protection (including data security issues and responsible gambling), fair gaming (including game rules, certification of equipment and maintenance of transaction records), and responsible conduct (including anti-money laundering steps and advertising restrictions). eCOGRA claims about fifty members.

Although the U.K. is expected to assume a leadership role on online gambling regulation, its new Gambling Commission was recently constituted and has issued for comment only a summary draft of “License Conditions and Codes of Practice.”<sup>35</sup> Key points of the draft focus on protecting children and problem gamblers, guaranteeing fairness of the games, excluding criminal activity from the industry, and ensuring the financial integrity of the licensed entities in that country. U.K. regulations of online gambling are expected to be put in place when the Gaming Act goes into effect in 2007.

## **U.S. Policy on Internet Gambling**

With a few exceptions, the federal and state governments have been hostile to Internet gambling, though large numbers of U.S. residents routinely gamble online. This clash between policy and reality prevents American businesses from providing increasingly popular Internet gambling services that would create jobs and tax revenues for Americans. Government hostility to Internet gambling has been expressed in the form of (1) criminal and civil enforcement actions, (2) regulatory actions, and (3) legislation.

Much of the legal activity surrounding Internet gambling has focused on the federal Wire Act, 18 U.S.C. § 1084, which was adopted in the early 1960s to address telephone bookmaking and strictly prohibited gambling over the “wires.” The Department of Justice (DOJ) in both the Clinton and Bush administrations has expressed the view that the Wire Act prohibits all forms of Internet gambling.

There is some disagreement on this issue, however. The U.S. Court of Appeals for the Fifth Circuit ruled in *In re Mastercard Int’l, Inc.*, 313 F.3d 257 (5th Cir. 2002), that the statute’s language reaches only sports betting. (The key statutory language refers to “bets or wagers or information assisting in the placing of bets or wagers on any sporting event or contest.”) At least one state court has disagreed with that limitation,<sup>36</sup> and proposed legislation would reverse the Mastercard ruling to apply the

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statute to all forms of Internet gambling. In addition, Internet gambling might be challenged through the federal Travel Act, or money laundering statutes.<sup>37</sup>

### **Criminal and Civil Enforcement**

Though DOJ has consistently stated that Internet gambling violates federal law, federal prosecutors have not been very active in pursuing Internet gambling offenses. For more than a century, and largely to avoid political backlash, DOJ has declined to prosecute individuals who place bets with illegal gambling businesses. Because any sensible Internet gambling business is domiciled offshore, that policy has left DOJ with few targets for prosecutions. Nevertheless, the federal government has acquired several Internet gambling convictions:

- The most notorious case involved Jay Cohen, who ran a sports book in Antigua.<sup>33</sup> Cohen's legal defense turned largely on the metaphysical proposition that an online bet with his business in Antigua could not violate the Wire Act because the bet supposedly occurred in Antigua, not in the United States. Although that theory was popular for a time among advocates for online gambling companies, the courts have made short shrift of it, insisting that the gambling transactions occur both where the bettor is located and where the entity is located when it receives the bet. Cohen was sentenced to 21 months in prison.
- A 2001 prosecution in the Western District of Wisconsin targeted another online sports book, Gold Medal Sports, which operated out of Curacao. Both the company and its two principals (Jeff D'Ambrosia and Duane Pede) pled guilty to violations of the federal Wire Act. The individuals were sentenced to five years in jail.<sup>39</sup> The same office later prosecuted a disbarred lawyer who helped set up the business, David Tedder, also for violating the Wire Act, plus three counts of money laundering. Tedder was convicted and sentenced to a minimum of 37 months in prison.<sup>40</sup>
- In statements to Congress as recently as April 2006, DOJ has repeatedly insisted that current federal statutes (such as the Wire Act and the Travel Act) bar Internet gambling.<sup>41</sup> In 2003, DOJ mounted a coordinated challenge to the advertising of Internet gambling sites. A DOJ official sent a letter to the National Association of Broadcasters stating that media businesses likely were "aiding and abetting" violations of federal law when they circulated such advertising.<sup>42</sup> At roughly the same time, the United States Attorney for the Eastern District of Missouri served

document subpoenas on numerous media entities, including broadcasters, cable television companies, newspapers, and Internet search engines. In a 2005 settlement, the parent company of *The Sporting News* agreed to pay a \$4.2 million fine and spend \$3 million on public service announcements that online gambling is illegal.<sup>43</sup> In 2004, DOJ also seized from Discovery Communications another \$3.2 million that ParadisePoker.com had prepaid for future advertising of its Internet gambling site.<sup>44</sup> A subpoena in this initiative was served on *Esquire Magazine* in April 2005 after the magazine ran advertising for a Costa Rican poker site, Bodog.com.<sup>45</sup>

- Several state prosecutors have pursued civil enforcement actions against Internet gambling entities. The Minnesota Attorney General sued an Internet gambling business for deceptive trade practices and consumer fraud.<sup>46</sup> The New York Attorney General sued to enjoin the operation of an Antigua-based Internet gambling business which maintained offices in New York City. A state court granted the injunction, ruling that the federal Wire Act barred offering casino games over the Internet.<sup>47</sup> The State of New Jersey has brought several lawsuits to block billboard advertisements of Internet gambling businesses.<sup>48</sup>

## **Regulatory Actions**

State gaming regulators have blocked their licensees from having any connection to online gambling entities that take bets from U.S. residents. Nevada brought disciplinary actions against licensees for owning an online sports betting operation in Australia, forcing divestiture of the Australian business.<sup>49</sup> When Nevada regulators questioned equipment-maker IGT's partial ownership of an Australian producer of Internet gambling software, IGT swiftly sold its interest.<sup>50</sup> In a settlement with the New Jersey Division of Gaming Enforcement, a Canadian software firm (Cryptologic) agreed that it would not sell to online gambling companies any software systems that could accept sports bets from New Jersey residents.<sup>51</sup>

A further factor in the Internet gambling debate is the April 2005 ruling of the Appellate Body of the World Trade Organization (WTO). That entity found that by allowing U.S. businesses to take online bets on horseracing, yet barring non-U.S. companies from doing so, the United States acted inconsistently with its fair-trade commitments under the General Agreement on Trade in Services ("GATS"). The WTO also concluded, however, that the United States could justify its stance against foreign Internet gambling companies as a protection of public morals. WTO rulings "are not binding on the United States, much less [the courts]

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... [I]f U.S. statutory provisions are inconsistent with GATT or an enabling agreement, it is strictly a matter for Congress.”<sup>52</sup> Because that deadline passed without Congressional action, Antigua can ask the WTO to apply sanctions against the United States. Although Congress seems unfazed by the prospect of trade sanctions from Antigua, a much larger conundrum could be posed should a major U.S. trading partner (such as Great Britain) bring a similar case against the United States.

## **Legislation**

### *Federal Legislative Responses to Internet Gambling*

Congress has been working to curb Internet gambling for over a decade, beginning in 1995 when Sen. Jon Kyl offered the first legislative measure aimed at curbing Internet gambling. Several iterations of Internet gambling prohibition legislation have been introduced since then. Two bills currently pending would take differing approaches. One would reinforce criminal prohibitions against Internet gambling while allowing individual states and tribal lands to legalize online gambling transactions that are conducted entirely within their own jurisdictions. Alternatively, a separate measure would prohibit the use of various payment systems to support online gambling. A third potential approach, which has been discussed in past Congresses, would appoint a national study commission to examine the phenomenon of Internet gambling and recommend appropriate policy responses. Each of the three approaches is outlined below. A more detailed account of the history of legislative proposals to restrict online gambling is included in the appendix.

### *Current Federal Legislative Activities*

On November 18, 2005, Rep. Jim Leach introduced H.R. 4411, the Unlawful Internet Gambling Enforcement Act. Like previous legislation introduced by Rep. Leach, this bill aims to choke off the use of the various payment systems that support Internet gambling. Until now, the Internet gambling industry has managed to stay one step ahead of enforcement authorities by migrating its payment schemes to new platforms as existing platforms become unavailable. Indeed, virtually all financial transactions in support of Internet gambling are now conducted by offshore entities. To address this issue, Rep. Leach’s bill not only covers credit card transactions, electronic funds transfers and money transmitting businesses, but also would authorize the Secretary of the Treasury to designate other payment systems to be subject to the statute in the future.

The statute’s prohibitions would not apply, however, to “intrastate transactions,” which are defined as bets made over the Internet exclusively within a single state, or within a tribal jurisdiction, when such Internet bets

are authorized and licensed by the state (and, where relevant, the tribe) and are subject to age and location verification systems. Similarly, the legislation would exempt betting authorized by the Interstate Horseracing Act, and would allow only those sports bets already legal under the Professional and Amateur Sports Protection Act (PASPA).<sup>53</sup>

On February 16, 2006, Rep. Bob Goodlatte (R-VA) introduced H.R. 4777, the Internet Gambling Prohibition Act. This legislation takes a different approach from the Leach bill, principally updating the scope of the federal Wire Act of 1961 to specifically include the Internet.

H.R. 4777 applies the Wire Act to all online gambling activity in addition to sports betting, thus reversing the holding of the U.S. Court of Appeals for the Fifth Circuit in *In re MasterCard*, and prohibits all financial transactions that use interstate or foreign communications facilities in support of illegal Internet gambling activities. However, the legislation specifically exempts several forms of gambling over the Internet, including: pari-mutuel betting on horseracing that already is authorized under the Interstate Horseracing Act; bets placed entirely within a state (that is, by an in-state gambler with an in-state business) so long as the state (i) specifically authorized the use of the Internet for that purpose, (ii) has licensed the gambling business, and (iii) has established “a secure and effective customer verification and age verification system;” a parallel provision would permit online bets placed within tribal lands, so long as the state and the tribe have authorized and licensed the activity under a tribal-state gaming compact, and have established age and residence verification systems.

The bill also would permit the transmission of “information assisting in the placing of bets or wagers” between a state or tribal jurisdiction that has authorized and regulated Internet gambling and any other state or foreign nation that also has legalized Internet gambling. This appears to fall short of authorizing the actual placement of bets between jurisdictions, though its potential reach is not entirely clear.

The legislation would not permit sports betting over the Internet, and thus preserves the current limitations on betting on sports contests of PASPA. Because exemptions in the legislation would limit only the Wire Act, and not other federal criminal statutes (such as the money laundering statutes, Travel Act, or other federal gambling statutes), it is not clear whether the Justice Department would continue to take its position that the exempted activity is illegal under other laws. Nevertheless, if a state were to adopt legislation authorizing the Internet gambling permitted by these exemptions, the basis for applying those other federal statutes may be removed, making it very difficult for the Justice Department to maintain its current opposition.

### *Alternative Legislative Approach*

Legislation taking a more comprehensive and deliberate approach to the policy issues raised by Internet gambling was introduced in 2002 by Reps. John Conyers (D-MI) and Chris Cannon (R-UT). The legislation called for a five-member study commission that would have one year to analyze and report on existing online gambling activity, its impact on problem and underage gambling, and the options for federal or state licensing and regulation.<sup>54</sup> Within six months after submitting that report, the study commission would be required to identify changes to federal laws and regulations that would:

1. Preserve the prerogatives of states to regulate gambling within their borders;
2. Minimize adverse impacts, such as underage gambling, money laundering, and problem gambling;
3. Preserve tribal sovereignty;
4. Clarify and harmonize federal laws that apply to Internet gambling;
5. Provide for appropriate taxation and licensing of Internet gambling; and
6. Deter Americans from placing bets with unlicensed offshore gambling Web sites.<sup>55</sup>

In April 2006, the board of directors of the American Gaming Association (AGA) modified its legislative position on Internet gambling to support the creation of a Congressional study commission such as the one described in the Cannon/Conyers bill. In addition to the study issues identified in that legislation, the AGA's position statement suggested that the commission consider recent WTO rulings suggesting that the United States' position on Internet gambling may violate its international trade obligations. A study commission approach could develop an effective, comprehensive legislative approach that would address the complex and often conflicting policies now in place, as well as the general confusion about the legal issues surrounding Internet gambling.

### *State Initiatives*

At least eight state legislatures have adopted laws that specifically prohibit Internet gambling, or financial transactions related to Internet gambling. These include Illinois,<sup>56</sup> Indiana,<sup>57</sup> Louisiana,<sup>58</sup> Massachusetts,<sup>59</sup> Nevada,<sup>60</sup> Oregon,<sup>61</sup> South Dakota,<sup>62</sup> and Utah.<sup>63</sup> A New Jersey court recently held that Internet gambling violates that state's law.<sup>64</sup> In addition, the Attorneys General of Texas, Florida, Oklahoma, Minnesota, and Kansas have issued opinions that Internet gambling is illegal in their

states.<sup>65</sup> Indeed, most states have a constitutional or statutory bar against any gambling business that is not licensed by that state,<sup>66</sup> which would apply to all Internet gambling sites that are licensed only in foreign jurisdictions.

In 2001, the Nevada legislature adopted a law permitting the Nevada Gaming Commission to license Internet gambling businesses to operate wholly within that state.<sup>67</sup> That initiative was derailed by a 2002 letter from the Justice Department stating that such businesses would violate federal law.<sup>68</sup> In October 2005, North Dakota legislators met with Antigua officials to discuss a similar approach to online gambling in that state,<sup>69</sup> but the effort was stopped by a similar letter from DOJ.<sup>70</sup> In both Georgia and Illinois, one house of the state legislature has approved the sale of state lottery tickets over the Internet. Both bills await action by the other branch of the legislature.<sup>71</sup>

## Public Policy Issues Raised by Internet Gambling

Traditionally, the Tenth Amendment of the Constitution has left it up to individual states to decide whether or not to legalize and regulate gambling activity for their citizens. In that spirit, 11 states have legalized commercial casinos, 43 have pari-mutuel facilities, 11 have authorized slot machine gambling at racing facilities, and state lotteries operate in forty-one states and the District of Columbia. One emerging policy question now surrounding Internet gambling is why each state also should not be free to decide whether to legalize and regulate online gambling for its own citizens.

As previously noted, the Goodlatte bill, H.R. 4777, would allow states to legalize intrastate Internet gambling, and tribes to conduct Internet gambling entirely on tribal lands. (For convenience, this paper will refer to both intrastate and tribal Internet gambling authorized by the Goodlatte bill as “in-state legalization.”) The potential benefits from such an approach are straightforward.

1. The state could protect its citizens by requiring that online gambling businesses operate honestly according to that state’s rules. State regulation would include social protections, such as enforcing standards against underage gambling, requiring mechanisms such as loss limits that gamblers could use to control their gambling, and mandating the delivery of responsible gaming information to online players.
2. The state could tax online gambling revenues, creating an additional source of funding for public services. Although revenue projections are always speculative, a small state with only one

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percent of the nation's population might expect to raise close to \$20 million in taxes directly from in-state online gambling, without considering additional revenues that would flow from an increase in overall economic activity in the state.<sup>72</sup>

3. In-state legalization would end the widespread disrespect for the law fostered by the current mismatch between policy and reality, as millions of ordinary Americans gamble online on a daily basis despite the official prohibitions against such gambling.
4. A state could nurture a new industry within its borders and stanch the flow of its citizens' dollars to overseas businesses. By requiring that online gambling businesses locate their operations in-state, the state could create employment opportunities for its citizens.

Conversely, a range of policy arguments might be offered against legalization and regulation of Internet gambling by individual states, including:

- That Internet gambling should not be available in people's homes because it is too convenient and will generate more gambling than is good for society.
- That Internet gambling will exacerbate problem gambling, increasing access to gambling while removing problem gamblers from public view.
- That Internet gambling will increase underage gambling, because it is easier for youths to pose as adults online than to do so in a casino environment.
- That Internet gambling is a form of regulatory "Wild West," where companies are free to cheat their customers.
- That Internet gambling is particularly susceptible to money laundering by dangerous criminals and even terrorists.
- That the authorization of Internet gambling by even one state would undermine the policies of other states against it.

As a practical matter, all of these concerns flow from a reasonable assumption: that in-state authorization of Internet gambling should be expected to increase gambling activity somewhat. That increase, however, may not be as significant as some might expect. Of greater concern may be the fact that the current policy of prohibition already permits a high volume of Internet gambling while imposing no regulatory policies to protect gamblers. By driving all Internet gambling business to foreign entities, the current regime also ensures that no jobs are created for American workers, no returns are earned by American companies, and no tax revenues are paid to American governments.

## **Gambling Availability**

In-state legalization of online gambling could well increase the number of state residents willing to gamble online. Although no data are available on this point, a state reasonably might expect that some residents now decline to gamble online because it is illegal, but would be willing to gamble online if the state regulated the activity. The resulting increase in online gambling activity seems likely to be modest. Avid online gamblers are surely not deterred by current policies; indeed, public opinion research has found that a majority of online gamblers believe it is either legal to wager online or are unsure about its legal status.<sup>73</sup> Moreover, in-state legalization would not materially increase the online gambling options for U.S. residents, who currently have more than 2,000 offshore gambling Web sites to choose from (all of which would continue to be available to residents in U.S. states that chose to authorize and license in-state gaming operators on the Internet). Indeed, if a U.S. resident were to decide today to gamble on a different Web site every day, it would take him more than five years to visit every Web site currently in business, without considering the additional sites that start up every week. Moreover, there are policy tools for limiting access to online gambling even if it is legalized in an individual state, such as requiring that online gamblers register in person at a licensed location in order to access state-sanctioned sites.

## **Responsible Gaming**

Though compulsive gambling behaviors are experienced by only about 1 percent of the population, and problem gamblers today enjoy access to a wide range of online gambling options, this legitimate concern warrants consideration. Indeed, in-state legalization and regulation of online gambling could lead to thoughtful regulations that give online gamblers important tools for controlling their gambling through such techniques as self-imposed bet limits or time-of-play limits. With an effective system for identification of online players, self-exclusions of online gamblers could be enforced. Additionally, responsible gaming messages and links to resources for problem gamblers could be displayed directly on the player's computer screen.

## **Underage Gamblers**

The ready availability of online gambling today means that in-state legalization and regulation may not significantly increase online gambling activity of minors, either. Most offshore jurisdictions require a minimum age for online gamblers of only 18, not 21 as in U.S. casinos. Accordingly, in-state legalization and regulation would be less accessible to youthful gamblers than are current online options. The Goodlatte

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Finally, many of the current online gambling sites, which mostly are regulated by small and relatively unsophisticated jurisdictions, likely are more vulnerable to money laundering schemes than U.S.-regulated sites would be.

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legislation would require an effective system for identification of online players, which likely would include use of commercial databases to confirm identity, plus password-protected gambling accounts. A further level of control could be achieved by requiring that every online gambler open his or her online account in person at a state-licensed location, where a potential online gambler would have to prove identity and age in a face-to-face meeting before receiving authorization to access state-sanctioned online gambling sites.

### **Fairness of the Games**

Many state governments have extensive experience in regulating gaming businesses, and have achieved high levels of probity and integrity in the industry. Those states likely could extend those exacting standards to the regulation of online gambling businesses, ensuring that the games are conducted honestly and in accord with state rules.

### **Money Laundering Risks**

Money laundering risks are somewhat diminished with online gambling since all electronic funds transfers (via e-wallet, credit card or debit card) can be electronically recorded, providing a detailed and automatic transaction trail not currently available in bricks-and-mortar casinos. Additionally, many offshore jurisdictions have imposed suspicious activity reporting requirements for online gambling businesses, which also could be applied by U.S. jurisdictions. All of these characteristics would mean that the risk of money laundering with state-regulated online gambling businesses would be no greater than with banks or land-based casinos. Finally, many of the current online gambling sites, which mostly are regulated by small and relatively unsophisticated jurisdictions, likely are more vulnerable to money laundering schemes than U.S.-regulated sites would be.

### **Undermining Anti-gambling Policies of Other States**

The anti-gambling policies of individual states already are undermined by the current availability to U.S. residents of more than 2,500 offshore gambling Web sites. If a state were to authorize online gambling only for its residents, however, it could require that licensed Web sites use an integrated security system to screen out non-residents. Indeed, the Goodlatte legislation requires an effective customer verification system to exclude customers from outside any jurisdiction that may legalize online gambling within its borders. The components of such a security system might include (a) customer disclosure of his address, (b) confirmation of customer identification and address through a commercial database such as Experian, and (c) further confirmation of customer

location through software that tracks the IP address for the customer's messages to the online gambling business. These geolocation techniques have been proven effective when used by national lotteries that are open only to residents of that country<sup>74</sup> and by a very few offshore Web sites that have elected to exclude U.S. gamblers.<sup>75</sup>

## Conclusion

Recent legislative proposals to curb online gambling would take an important step in protecting U.S. customers from the potential hazards of the current illegal, offshore, unregulated online gambling market. These measures alone, however, are not going to solve the problem. In fact, these proposals could have the unintended consequence of forcing Internet gambling further underground, making it more difficult for law enforcement to track. The Conyers/Cannon study commission model offers a viable approach to this complex issue. This comprehensive approach could lead to effective, integrated Internet gambling legislation that takes into account policy issues ranging from how best to protect children and problem gamblers to whether Internet gambling can be effectively legalized and regulated in the United States.

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*The data and comments presented in this white paper are solely those of the author and do not represent the positions of the American Gaming Association. The AGA assumes no responsibility for errors or omissions in these materials.*

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## Appendix

### Detailed History of Internet Gambling Legislation

Sen. Jon Kyl (R-Ariz.) introduced the first bill to prohibit Internet gambling as part of a larger crime prevention measure during the 104th Congress. This measure failed to make it out of committee. Sen. Kyl introduced a similar bill in the 105th Congress. The bill as introduced would have amended the Wire Act of 1961 to impose penalties for the bettor/gambler as well as for any person engaged in an Internet gambling business. Under the Kyl language, Internet service providers (ISPs) would have been forced to regulate Internet gambling under the watchful eye of federal and state authorities. A provision also was included to encourage the Executive branch to negotiate agreements with foreign countries that would help deter Internet gambling. There was no action on a companion measure introduced by Rep. Bill McCullum (R-FL) in the House of Representatives, thus ending prospects for a final bill.

Undeterred, Sen. Kyl came back with a new proposal in the 106th Congress. This iteration did not impose penalties on the bettor, toned down the ISP language, and included exemptions sought by specific sectors of the gaming industry. This bill passed the Senate by unanimous consent. In the House of Representatives three separate bills were introduced taking varying approaches. Rep. Bob Goodlatte (R-VA) sponsored a bill, H.R. 3215, that was very similar to the Kyl measure, although the ISP language was much stronger. Legislation introduced by Reps. Jim Leach (R-IA) and John LaFalce (R-NY) would have prohibited the use of credit cards or other forms of payment from being used in Internet gambling transactions. Finally, a bill introduced by Reps. John Conyers (D-MI) and Chris Cannon (R-UT) would have eliminated exemptions to the ban being sought by various interests. Rep. Goodlatte attempted to pass his measure under suspension of the rules, a procedural maneuver that allows a measure to come to the floor without amendments or lengthy floor debate but requires a two-thirds vote for passage. Rep. Goodlatte fell 25 votes short of the 270 needed, thus ending prospects of enacting Internet gambling legislation during the 106th Congress.

During the 107th Congress two competing bills, H.R. 3215, sponsored by Rep. Goodlatte (R-VA), and H.R. 556, sponsored by Rep. Leach (R-IA), again took differing approaches to Internet gambling. These two pieces of legislation were merged into H.R. 556, which passed in the House by voice vote in the final weeks of the 107th Congress. The final version of H.R. 556 would have effectively prevented the use of credit cards and other financial instruments for unlawful Internet gambling. The Senate did not pass H.R. 556 prior to adjournment.

Rep. Leach reintroduced the Unlawful Internet Gambling Funding Prohibition Act, renumbered H.R. 21, in the 108th Congress. The House

Financial Services Committee marked up this legislation on March 13, 2003. No amendments were offered, and the measure was reported favorably out of committee.

The bill subsequently was referred to the House Judiciary Committee where it was not warmly received. On May 14, 2003, Rep. Chris Cannon offered an amendment to strike the provision in the bill that aimed to protect the traditional rights of individual states to regulate gaming. The Cannon amendment was agreed to by a vote of 16-15, H.R. 21 was reported out of the Judiciary Committee by the same narrow margin.

The contentious mark-up in the House Judiciary Committee, and inclusion of the Cannon amendment, sparked Financial Services Chairman Oxley to redraft H.R. 21. The new version removed the enforcement titles, taking away Judiciary Committee jurisdiction over the legislation. The new version, H.R. 2143, was marked up in the House Financial Services Committee on May 20, 2003 and was reported out by voice vote with no debate. This legislation passed the full House by an overwhelming vote of 319-104 on June 10, 2003. The House voted 237-186 to reject an effort by Rep. Jim Sensenbrenner (R-WI) to remove the states' rights provision from the final version of the legislation.

Companion legislation again was introduced in the Senate by Sen. Kyl. Tracking closely the language of H.R. 21, S. 627 attacked Internet gambling in the same way — by attempting to cut off the funding mechanisms. The Senate Banking Committee marked up S. 627 on July 31, 2003, reporting out the bill with significant changes from the original version. The states-rights provision in the bill was removed in favor of language that gave pari-mutuel wagering operations and Native American casinos the ability to conduct wagering on-line. Due to a myriad of objections to the amended version of the bill, the Senate did not pass S. 627 prior to adjournment.

Although it received little attention at the time, H.R. 1223, the Internet Gambling Licensing and Regulation Commission Act, was introduced in the House of Representatives by Reps. Cannon and Conyers. This bill would have created a commission to study Internet gambling and report back to Congress in one year their recommendations on the best way to deal with the issue. The commission would have been instructed to evaluate whether legalization, regulation, and taxation would be a more viable option than an

## Endnotes

<sup>1</sup>Deutsche Bank AG/London, Online Gaming Industry, Surreal or Real Returns? (July 19, 2005) (Deutsche Bank *AG Report*).

<sup>2</sup>The 2004 Gross Annual Wager of the United States, *Insight* (Christiansen Capital Advisers) Aug. 19, 2005, at 1.

<sup>3</sup>The estimate is derived from the Deutsche Bank AG Report, *supra* note 1, at 1, and from The Internet and Horseracing's Future, *Insight* (Christiansen Capital Advisers), July 31, 2005, at 1 ("July CCA Report").

<sup>4</sup>Residents of the following states may not place such bets: Alaska, Georgia, Hawaii, Michigan, Mississippi, New Jersey, Nevada, North Carolina, New Mexico, Oklahoma, South Carolina, Texas, and Utah.

<sup>5</sup>Oregon Racing Commission, *Quarterly Hub Handles*, available at [http://egov.oregon.gov/RACING/docs/quarterly\\_hub\\_handles.pdf](http://egov.oregon.gov/RACING/docs/quarterly_hub_handles.pdf).

<sup>6</sup>The Internet Gambling Prohibition Act, H.R. 4777, Subcommittee on Crime, Terrorism, and Homeland Security, Committee on the Judiciary, 109th Cong., 2006, (Statement of Bruce G. Ohr).

<sup>7</sup>*Nev. Rev. Stat.* § 463.

<sup>8</sup>Nevada Gaming Control Board, Adoption of New Regulation 5.220: Operation of a Mobile Gaming System (January 11, 2006).

<sup>9</sup>The summary statistics in this discussion for overall revenues are drawn from the July CCA Report, *supra* note 3, at 8.

<sup>10</sup>Betting on College Sports, Nevada vs. the Others, *Insight* (Christiansen Capital Advisers), May 2003.

<sup>11</sup>James Rutherford, Stakes are rising, and fast, for PartyGaming, *International Gaming & Wagering Business*, Oct. 2005, at 22.

<sup>12</sup>PartyGaming Plc, *Annual Report 2005*, at 48.

<sup>13</sup>Dresdner Kleiner Research Report on Internet Poker (June 2005).

<sup>14</sup>MGM Mirage (then holding licenses in Nevada, Mississippi, and Illinois), and Kerzner International (then holding a New Jersey license).

<sup>15</sup>News Release, Florida Attorney General, *Western Union Cuts Off Sports Betting Accounts* (Dec. 23, 1997).

<sup>16</sup>*In re Citibank* (South Dakota), N.A., Internet Bureau, Attorney General of the State of New York (June 21, 2002).

<sup>17</sup>*In re PayPal, Inc.*, Internet Bureau, Attorney General of the State of New York (Aug. 16, 2002).

<sup>18</sup>Unlawful Internet Gambling Enforcement Act of 2005.

<sup>19</sup>H.R. 4411.

<sup>20</sup>Tom Weir, Online Sports Betting Spins Out of Control, *USA Today*, Aug. 22, 2003.

<sup>21</sup>Isle of Man Online Gambling Regulation Act 2001 § 4; The Directorate of Offshore Gaming Antigua and Barbuda, Regulations Concerning Interactive Gaming and Interactive Wagering § 14; Kahnawake Gaming Commission, Regulations Concerning Interactive Gaming § 29; Alderney Gambling Control Commission, Electronic Betting Centre License General Condition 10(b).

<sup>22</sup>Kahnawake Regulations § 32.

<sup>23</sup>Kahnawake Regulations § 145; Isle of Man Anti-Money Laundering (Online Gambling) Code 2002 ¶ 4; Alderney Gaming Control Commission, Control System Guidelines for an Electronic Betting Centre, Appendix E, § 2.

<sup>24</sup>Alderney Gaming Control Commission, Control System Guidelines for an Electronic Betting Centre § 6.1; Antigua and Barbuda Regulations, Part VII, §§ 106-112.

<sup>25</sup>Isle of Man, The Online Gambling (Systems Verification) Regulations 2001; Kahnawake Regulations § 128; Gibraltar Gambling Bill 2005 § 24.

<sup>26</sup>Kahnawake Regulations § 145(a)(iii); Antigua Regulations § 115; Gibraltar Gambling Bill 2005 § 28.

<sup>27</sup>Alderney Control System Guidelines, Appendix E, ¶ 4.

<sup>28</sup>*Id.* at Appendix J, ¶ 7; Isle of Man, The Online Gambling (Registration and Accounts) Regulations 2001 § 5(3); Kahnawake Regulations § 156.

<sup>29</sup>Kahnawake Regulations § 157; Alderney Control System Guidelines, Appendix J, § 3.

<sup>30</sup>E.g., Alderney Control System Guidelines, Appendix J, § 4(i).

<sup>31</sup>Antigua and Barbuda Regulations § 130.

<sup>32</sup>Alderney Control System Guidelines § 4.9.

<sup>33</sup>Antigua and Barbuda Regulations § 127; Alderney Control System Guidelines, Appendix E, § 7(iv).

<sup>34</sup>Isle of Man Anti-Money Laundering (Online Gambling) Code 2002 § 6; Antigua and Barbuda Regulations § 186; Kahnawake Regulations § 111; Gibraltar Gambling Bill 2005 §§ 34, 38.

<sup>35</sup>U.K. Gambling Commission, License Conditions and Codes of Practice: Remote Gambling, (March 2006)

<sup>36</sup>See *In re Mastercard Int'l, Inc.*, 313 F.3d 257 (5th Cir. 2002); but see *People v. World Interactive Gaming Corp.*, 714 N.Y.S.2d 844, 852 (N.Y.S. Ct. 1999) (online casino offering “virtual slots, blackjack, and roulette” was in violation of the Act) .

<sup>37</sup>18 U.S.C. Sec. 1952 (Travel Act) “prohibits traveling in interstate or foreign commerce, or using the mails, or using a facility in interstate or foreign commerce with intent to distribute the proceeds of an unlawful activity or otherwise promoting, managing, establishing, carrying on, or facilitating the promotion, management, establishment, or carrying on, or any unlawful activity and thereafter performing or attempting to perform such act. The term “unlawful activity” is defined in Section 1952 (b) to mean ‘any business enterprise involving gambling ... in violation of the laws of the State in which they are committed or of the United States.; 18 U.S.C. Secs. 1956 & 1957 (money laundering statutes).

<sup>38</sup>See *United States v. Cohen*, 260 F.3d 68 (2d Cir. 2001).

<sup>39</sup>*United States v. D'Ambrosia*, 313 F.3d 987 (7th Cir. 2002).

<sup>40</sup>*United States v. Tedder*, 403 F.3d 836 (7th Cir. 2005).

<sup>41</sup>Statement of Bruce G. Ohr at 2.

<sup>42</sup>Letter from John G. Malcolm, Deputy Assistant Attorney General, to National Association of Broadcasters (June 11, 2003).

<sup>43</sup>*In the Matter of Vulcan Sports Media*, Settlement Agreement and Release of Claim to Property (January 2006). Earlier, several Missouri radio stations paid \$158,000 to settle a similar claim. *In re Missouri Sports Radio, L.L.C.*, Settlement Agreement and Release of Claim to Property, with Federal Bureau of Investigation.

<sup>44</sup>U.S. Steps Up Push Against Online Casinos by Seizing Cash, *The New York Times*, May 31, 2004, at C1.

<sup>45</sup>Liz Benston, Regulators eye charity event sponsored by online casino, *Las Vegas Sun*, July 22, 2006.

<sup>46</sup>*State by Humphrey v. Granite Gate Resorts*, 568 N.W.2d 715 (Minn. App. 1997), *aff'd*, 576 N.W.2d 747 (Minn. Sup. Ct.)

<sup>47</sup>*People v. World Interactive Gaming Corp.*, 714 N.Y.S.2d 844 (N.Y. Sup. Ct. 1999).

<sup>48</sup>Mark Balestra & Anthony Cabot, *Internet Gambling Report* (7th ed., 2004), at 258.

<sup>49</sup>*State Gaming Control Bd. v. American Wagering, Inc.*, (Dec. 16, 1999).

<sup>50</sup>*Online Ventures in Australia Run Afoul of Nevada Regulators*, MSNBC.com, Dec. 24, 2001.

<sup>51</sup>*State of New Jersey v. www.intercasino.com*, No. MER-C-161-01 (Mercer County Civ. Ct.) (Oct. 16, 2001).

<sup>52</sup>*Corus Staal BV v. Dep't of Commerce*, 395 F.3d 1343, 1348 (Fed. Cir. 2005).

<sup>53</sup>28 U.S.C. Sec. 3701-3704 (Professional and Amateur Sports Protection Act)

<sup>54</sup>One commissioner would be appointed by each of the Speaker and Minority Leader of the House of Representatives, and by the Majority and Minority Leaders of the

Senate, with a fifth commissioner (the Chairman) then selected by the four commissioners.

<sup>55</sup>H.R. 5760, 107th Cong., 2d Sess., §4.

<sup>56</sup>720 Ill. Comp. Stat. 5/28-1.

<sup>57</sup>Ind. Code § 35-45-5-2(c).

<sup>58</sup>La. Rev. Stat. Ann. § 14:90.3.

<sup>59</sup>Mass. Ann. Laws ch. 271, § 17A.

<sup>60</sup>Nev. Rev. Stat. § 465.092.

<sup>61</sup>Or. Rev. Stat. § 167.109.

<sup>62</sup>S.D. Codified Laws § 22-24A-1 to -15.

<sup>63</sup>Utah Code Ann. § 76-10-1102.

<sup>64</sup>Peggy Wright, Morris judge pulls plug on Web sites for Gambling, *Morris County Daily Record*, Oct. 5, 2005.

<sup>65</sup>Tex. Atty. Gen. Op. No. DM-344; Fla. Atty. Gen. Op. No. 95-70 (Oct. 18, 1995); Oklahoma Atty. Gen. Op. No. 02-025 (June 26, 2002); Minn. Attorney General's Memorandum (Nov. 20, 1995); Kan. Atty. Gen. Op. No. 96-31 (March 25, 1996).

<sup>66</sup>Mich. Comp. Laws Ann. § 432.218.

<sup>67</sup>Nev. Rev. Stat. § 463.750 et seq.

<sup>68</sup>Letter from Michael Chertoff, Assistant Attorney General, to Dennis Neilander, Chairman of the Nevada Gaming Control Board (August 23, 2002).

<sup>69</sup>Press Release, Government of Antigua and Barbuda, North Dakota Legislators to discuss Internet Gaming in Antigua and Barbuda next week (Oct. 1, 2005).

<sup>70</sup>Letter from Laura H. Parsky, Deputy Assistant Attorney General, to Wayne Stenehjem, Attorney General of North Dakota (March 7, 2005).

<sup>71</sup>Ill. Sen. Bill No. 0198 (passed by Senate on April 14, 2005; currently pending in House Rules Committee); Ga. H.R. Bill No. 346 (passed by House on March 10, 2005; currently pending before full Senate).

<sup>72</sup>This calculation assumes that gaming at sites regulated by a hypothetical U.S. state accounted for 1% of the nation's online gaming activity in 2006. Projections by Christiansen Capital Advisers suggest that the "handle" of online gaming in the U.S. will be \$188 billion in 2006. One percent of that amount would be \$1.9 billion; taxed at a 1 percent rate — half of the tax rate projected by the U.K. for its online gaming industry — that would yield \$19 million.

<sup>73</sup>2006 *State of the States: The AGA Survey of Casino Entertainment*, (American Gaming Association) May 2006, at 26.

<sup>74</sup>Stop signs on the web, *Economist.com*, Jan. 11, 2001; I know where you've been gaming, Internet.com via COMTEX, Apr. 2, 2002 (describing geolocation services that facilitate compliance with territory-specific laws on the Internet).

<sup>75</sup>United Kingdom Department for Culture, Media and Sport, The Future Regulation of Remote Gambling: A DCMS Position Paper ¶¶ 53-59, 61-67 (April 2003); Click Cash Prizes, News Report, *BBC World*, Nov. 28, 2002 (describing geo-verification process used by MGM Mirage Web site).

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