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Internet Gambling and the Dormant Commerce Clause

As more and more states enact legislation related to the use of the Internet for gambling and there remains no unambiguous federal law that addresses Internet wagering, challenges based on the "dormant" Commerce Clause can be expected. This article seeks to put this prospect into context.

The 110th Congress saw, for the first time, attempts to regulate Internet gambling. Three bills were introduced that would authorize some form of Internet gambling and provide for regulation and licensure of operators of Internet gambling websites. In a first for Internet gambling, the bill introduced by Rep. Barney Frank was approved by and reported out of committee. In addition, the lame duck session of the 110th Congress saw Senate Majority Leader Harry Reid of Nevada attempting, but failing, to gain support for legislation that would provide for the regulation of pay-to-play Internet poker.

In a draft of the Reid bill disclosed by various news organizations, 17 states were listed as states from which persons would be able to play Internet poker for money, unless they passed legislation "opting out" of the federal system. Those states, including Pennsylvania, are ones that permit land-based entities to offer pay-to-play poker. The proposed automatic inclusion in the federal regulatory system of states that already permit licensed land-based entities to offer pay-to-play poker suggests that Senator Reid does not think playing poker online is a different activity than playing poker at a land-based casino or cardroom.

Several states have statutes that prohibit Internet gambling, while allowing gambling of some type at licensed land-based facilities. Other states, believing that the federal Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) permits states to authorize intrastate Internet gambling, are discussing or considering legislation that would authorize some form of Internet wagering.

In 2010, legislation was introduced in California and Florida that would authorize and regulate intrastate Internet poker, but the legislative sessions expired without their passage. However, in 2010, legislation was introduced in the New Jersey Legislature that would authorize and regulate intrastate Internet gambling, including poker, by licensed New Jersey casinos. In early January 2011, the New Jersey Legislature passed that legislation and it is awaiting action by the New Jersey governor.

To date, there has been little, if any, discussion of legislation addressing Internet wagering (or Internet poker) in Pennsylvania. However, gambling expansion in one state often triggers its consideration by neighboring states. Consequently, it is realistic to expect that New Jersey's efforts will have an impact in Pennsylvania and other nearby states.

State activity in connection with the Internet raises the specter of challenges based on the Dormant Commerce Clause of the U.S. Constitution. In fact, the Washington
state Supreme Court, in *Rousso v. State*, recently considered and rejected such a challenge in connection with a state statute criminalizing Internet gambling. Should states continue to enact legislation addressing Internet wagering, the *Rousso* case is likely to be only one among many Commerce Clause challenges.

The *Rousso* decision builds on U.S. Supreme Court precedent that has established the framework for Dormant Commerce Clause challenges. Under the U.S. Constitution's Commerce Clause, Congress has the power "to regulate Commerce with foreign nations, and among the several States, and with the Indian Tribes." While the clause, on its face, does no more than grant regulatory power to Congress, the U.S. Supreme Court has long recognized a dormant aspect to it. This Dormant Commerce Clause "denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce," according to its 1994 decision in *Oregon Waste Sys. v. Dep't of Envtl. Quality*. A two-tiered standard is used to determine whether a state law violates the Dormant Commerce Clause.

First, if the state law "clearly discriminates" against interstate commerce, it is invalid unless "the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism," according to *Wyoming v. Oklahoma*. In other words, the state must "justify [the discrimination] both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake," as stated in *Hunt v. Washington State Adver. Comm'n*.

Second, if a state law regulates "evenhandedly" and only "indirectly" burdens interstate commerce, it is invalid only if the burden is "clearly excessive in relation to the putative local benefits," according to *Pike v. Bruce Church Inc*. This second tier is often called the "Pike balancing test." Under it, "[i]f a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities."

The *Rousso* court, in applying the first tier, found no discrimination against interstate commerce on the face of the Washington statute or in its practical effect, because "[t]he statute prohibits Internet gambling evenhandedly, regardless of whether the company running the web site is located in or outside the state of Washington." The court rejected the argument that the statute discriminated "because the Internet gambling ban excludes Internet gambling web sites, all of which are out-of-state businesses, from the Washington market while leaving untouched an alternative service — in-state, 'brick and mortar' gambling businesses."

The court concluded that Internet gambling operators and land-based gambling operators are not similarly situated and, therefore, cannot be compared to one another for Dormant Commerce Clause purposes: "Internet gambling and brick and mortar gambling are two different activities, presenting risks and concerns of a different nature, and creating different regulatory challenges; a state can regulate different activities differently."

The *Rousso* court, in applying the second tier, determined that the statute did not impose an unreasonable burden on interstate commerce. It pointed out that the statute serves the legitimate state interest of combating "organized crime, money laundering, gambling addiction, underage gambling, and other societal ills" and commented that "[c]oncerns over ties to organized crime and money laundering are exacerbated where on-line gambling operations are not physically present in-state to be inspected for regulatory compliance."

It explained that while the statute imposes a burden on interstate commerce by removing Washington from the Internet gambling market, this burden is not "clearly excessive" in relation to the legitimate state interest because "it is not clear regulation […] could avoid concerns over Internet gambling as well as a complete ban" or that "the burden on interstate commerce would be decreased through that regulation." The court also rejected the notion that authorizing Internet gambling without regulating it at all would serve Washington's legitimate state interest as well as a complete ban.

The plaintiff sought reconsideration of this decision, which was denied on Dec. 15, 2010. The plaintiff
now has 90 days to file a petition for certiorari with the U.S. Supreme Court; something that, following the issuance of the decision in September, news stories indicated he intended to do.

The Rousso decision prompted at least two foreign operators to stop accepting wagers from players located in Washington.

On Sept. 30, 2010, PokerStars.com — an Internet poker site — released a statement explaining: "PokerStars has operated in Washington on the basis of legal opinions where the central advice was that the state could not constitutionally regulate Internet poker, or at least could not discriminate in favor of local cardrooms and against online sites. …

However, the Washington Supreme Court for the first time rejected that position and upheld the state’s Internet gaming prohibition. In light of this decision, following extensive consultation with our legal advisers, we believe that the right course of action is to now block real money play by Washington residents on the PokerStars.com site."

The PokerStars' statement that it had received legal advice that a state "could not discriminate in favor of local cardrooms and against online sites" illustrates what is likely to be the part of the Rousso decision that is generating debate — that gambling on the Internet is different from gambling at a land-based casino or card room and, accordingly, can be regulated differently. If other courts find, as the Rousso court did, that Internet gambling is a different activity than land-based gambling, the odds of prevailing on a Dormant Commerce Clause challenge to a state statute that prohibits Internet gambling will likely favor the statute.

Setting the odds of winning a Dormant Commerce Clause challenge to a state statute (like the one awaiting gubernatorial action in New Jersey) that permits intrastate Internet gambling to be offered only by land-based casinos in New Jersey presents other considerations. Several factors come into play, including whether Congress, by excepting authorized intrastate Internet wagering from the definition of unlawful Internet gambling in UIGEA, intended to permit the states to discriminate against out-of-state providers of Internet gambling. To date, no court has considered that question.

While beyond the scope of this article, a state statute authorizing intra-state Internet wagering activities may be subject to other challenges. These include that the statute does not comport with UIGEA’s intra-state wagering exception or that, even if it does, UIGEA does not provide an exemption to the Wire Act, 18 U.S.C. 1084(a), the federal anti-wagering statute. With regard to the Wire Act, the U.S. Department of Justice has taken the position that it is implicated by all Internet wagering transmissions, regardless of the type of wagering and even if the transmission begins and ends in a state authorizing the activity.

Unless Congress acts to clarify the situation, these issues are ones that will need to be considered in connection with state legislative action concerning Internet gambling.
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