

K&LNGAlert

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Internet Gaming Gambling and the Internet in the United States

As revenues from the United States associated with Internet gambling continue to grow, investors in Internet-gambling companies are anxious to see whether the United States Congress will pass nationwide legislation that definitively prohibits gambling over the Internet. Unless and until the United States Congress acts, the legality of gambling on the Internet hinges on a patchwork of inconsistent state laws and conflicting interpretations of federal gambling statutes that predate the Internet. Divining the future of Internet gaming in the United States in general, and gambling in particular, was further complicated recently by a decision from the World Trade Organization (“WTO”) suggesting that the United States’ continued intransigence on the issue of Internet gambling effectively interfered with international trade agreements. This Alert will explore the existing legal landscape of Internet gambling in the United States and attempt to summarize the issues that investors in Internet-gambling companies and the developers of Internet games should consider as they determine whether the potential rewards will be worth the risks associated with such activities.

CURRENT LAW

The States

Under its inherent police power, each of the fifty states has the power to decide the legality of gambling within that particular state. Because each state possesses such power, there is little uniformity among the law in the states. For instance, Nevada has legalized most gambling, while other states – i.e., California, Illinois, Maryland, Michigan, Missouri,

Rhode Island and South Carolina – ban most forms of gambling. At least six states, including Illinois, Indiana and Oregon, specifically outlaw “online” or Internet gambling, while most others remain silent on the issue. Furthermore, not every state defines “gambling” in the same manner. Some forms of Internet gaming may constitute “gambling” in one state but not in another, while some states may not even have a definition of gambling.

It is not surprising that the states have been slow to legislate on Internet gambling. Realistically, many states possess neither the desire nor the resources to regulate or even investigate Internet gambling, which has become an extremely popular pastime, with published reports indicating over \$21 billion in online U.S. bets from 2000 through 2004. Moreover, given the lack of standardized laws, states are reticent about prosecuting their own citizens for participating in Internet gambling. The Internet’s ability to put state residents in touch with gambling websites anywhere in the world (most of which are outside the United States) add another level of challenge for state officials, making it both legally complicated and very expensive for a state to pursue purveyors of Internet-gambling sites.

Federal Law

As with state law, there are a number of federal laws that address gambling, although their application and interpretation in the context of Internet gambling is as yet unclear. Under current federal law, three federal antigambling statutes – the Wire Wager Act (better known as the “Wire Act”), the Travel Act and the Illegal

Gambling Business Act – are frequently posited as laws that, in some form, restrict or prohibit Internet gambling. The Wire Act, which prohibits any betting or wagering using wire communications in interstate or foreign commerce, is most frequently referenced. The United States Department of Justice interprets the Wire Act to prohibit all forms of Internet gambling. But the courts are not necessarily in agreement.

The Fifth Circuit Court of Appeals, in direct contrast to the Department of Justice’s position, declined to extend the Wire Act to Internet casino games, choosing instead to limit the reach of the Act to prohibit only sports betting conducted over the Internet. These contradictory positions illustrate the problems associated with attempting to apply legislation enacted in 1961 to issues arising from technology developed almost thirty years later. Unless the United States Supreme Court weighs in with an interpretation or Congress passes new legislation addressing Internet gaming, confusion will remain as to legality, under federal law, of gambling on the Internet, including the legality of specific types of Internet games.

ATTEMPTS AT THE CONGRESSIONAL LEVEL TO ADDRESS INTERNET GAMBLING

Since the mid-1990s, the United States Congress has been considering, but not enacting, legislation that would effectively prohibit Internet gambling. In 1995, Senator John Kyl (R-Arizona), a longtime opponent of Internet gambling, introduced his first bill to prohibit Internet gambling. The 1995 bill never made it out of committee and died at the end of the Congressional session. Senator Kyl tried again in 1997 when he introduced a bill titled “The Internet Gambling Prohibition Act of 1997.” This bill would have amended the Wire Act by expanding its scope to include any bet or wager placed over the Internet. The 1997 Kyl bill also died at the end of the session without ever having been voted on by the full Senate.

In 1999, Senator Kyl was back with a bill to prohibit Internet gambling. Unlike prior bills, the 1999 bill did not attempt to amend the Wire Act. Instead, the 1999 bill proposed to add a new section to the United

States Code that would have prohibited persons from engaging in an illegal gambling business, including a business engaged in Internet gambling activities. The 1999 bill passed the Senate on November 19, 1999 but was not passed by the House of Representatives before the end of session.

Undeterred, Senator Kyl continued to introduce bills that would prohibit or otherwise thwart Internet gambling activities. Most recently, Senator Kyl attempted to attach language restricting Internet gambling to an appropriations bill. Senator Kyl’s amendment would have prohibited any “person engaged in the business of betting or wagering” from knowingly accepting in connection with another person’s participation in Internet gambling: (1) credit; (2) electronic fund transfers or funds transmitted through money-transmitting businesses; (3) any instrument drawn by or on behalf of another and payable through financial institutions; or (4) the proceeds of any other form of financial transaction involving a financial institution as payer or financial intermediary on behalf of another person. Under Senator Kyl’s amendment, “bet or wager” was defined very broadly to mean “the staking or risking by any person of something of value upon the outcome of a contest of others, a sporting event, or a game subject to chance, upon an agreement or understanding that the person will receive something of value in the event of a certain outcome.”

To enforce this prohibition, the amendment would have empowered the U.S. Secretary of the Treasury to “prescribe regulations requiring each designated payment system, and all participants therein” – i.e., credit card companies and financial institutions – “to identify and prevent restricted transactions through the establishment of policies and procedures reasonably designed to” prevent owners and operators of Internet-gambling sites from receiving payments. In essence, this proposed amendment would halt Internet gambling in the United States by requiring banks and credit card companies to block payments to Internet gambling sites, putting into positive law a requirement that banks and credit card companies enforce what are, in many cases, their own, already

established, private rules and regulations designed to block funding of Internet gambling sites from residents of the United States. By restricting such payments, the reach of this legislation would be broad, not only affecting domestic gambling but also the international gaming community as a whole.

Senator Kyl's latest attempt to prohibit Internet gambling in the United States failed after another Senator's objection to the amendment as an inappropriate rider to an appropriations bill was sustained by vote of the Senate. According to media reports, however, Senator Kyl intends to continue to introduce similar legislation until the United States Congress passes legislation that effectively bars Internet gambling in the United States or until Senator Kyl is not reelected.

THE IMPACT OF FEDERAL LEGISLATION

On one hand, Senator Kyl's resolve to enact legislation that outlaws Internet gambling is likely to hamper the long-term profitability of the Internet-gaming industry. Revenues from Internet gambling are expected to top \$10 billion worldwide in 2005. Revenues from sources within the United States make up between 60% and 65% of that \$10 billion. If Senator Kyl succeeds, the loss of the revenue stream from the United States would severely affect and negatively impact the profits that Internet-gaming companies currently enjoy. Senator Kyl's efforts to prohibit Internet gambling by essentially blocking the only viable methods of payment would, in essence, cut off the world from "willing and able" American bettors. The result could be catastrophic to the on-line gaming industry.

On the other hand, a potential benefit of Senator Kyl's continued machinations may be the passage of definitive U.S. federal legislation that would squarely address Internet gambling. Currently, as explained above, the individual states have enacted laws, each subject to varying interpretation, governing the legality of gambling. As it stands now, Internet-gaming companies are required to review and analyze the laws of all states to determine the legality of any particular gaming opportunity. With one statute, the analysis would become easier. However, if the

legislation is passed according to Kyl's predilections, all Internet gambling transactions would either be illegal or regulated in such a way that it would be a practical impossibility for U.S. consumers to take part in any kind of meaningful way.

Although no bills to enact federal legislation are currently pending, there is a possibility that broad-based discussions of Internet gambling will take place among members of the United States Congress and that such discussions might lead to some form of nationally regulated Internet gambling. It is also possible that lobbying efforts on behalf of the Internet-gaming industry advocating responsible regulation may counter Senator Kyl's activities and lead to federal legislation that regulates rather than prohibits Internet gambling.

IMPACT OF THE U.S. DEPARTMENT OF JUSTICE'S ACTIVITIES

The U.S. Department of Justice continues to insist that the Wire Act bans Internet gambling. Other countries are impacted by the Department's activities to use the Wire Act to stop Internet gambling in the United States. For example, in 1999, Antigua's gambling and betting services industry, operating primarily over the Internet, employed over 3,000 people and generated over \$7.4 million in licensing fees for the Antiguan government. By 2003, however, there was a noticeable economic downturn in Antigua's gambling and betting services industry. According to Antigua, gaming-related employment and fees paid to the government have declined significantly. This downturn caused Antigua to request formal consultations with the United States and the WTO to address the United States' attempts to ban cross-border gambling.

Much to the surprise of the United States, the WTO ruled on April 7, 2005, in effect, that federal efforts to restrict or otherwise ban Internet gambling might violate the United States' WTO obligations. Although the meaning and impact of the WTO's decision is the subject of great debate, the decision has been touted in certain media outlets as potentially limiting the right of the United States to enact legislation

prohibiting Internet gambling and remain a member in good standing of the WTO. The actual impact of the WTO's decision, however, is yet to be determined. The Department of Justice could proceed to attempt to enforce its interpretation of the Wire Act. The United States Congress could pass legislation that effectively acts as a ban on Internet gambling or legislation that regulates Internet gambling. At some point, the WTO might have to attempt to enforce its decision, but the question is how it would do so.

CONCLUSION

The fog has yet to disperse with respect to the legality of Internet gambling in the United States. But perhaps the WTO decision and Senator Kyl's failure to succeed in his quest to outlaw Internet gambling offer some indication of the landscape that will be revealed when the fog lifts. Governments (whether national, state or local) are always on the lookout for ways to increase revenue to fund operations. Regulation of Internet gambling on a national level in the United States might provide reassurance to investors in and

providers of Internet gaming, as well as participants. But investors in the Internet-gaming industry and the developers of Internet games need to be vigilant. K&LNG will continue to monitor and report on legislation proposed to the United States Congress by bill or by amendment to bills already under consideration. If, and when, any such legislation is passed, K&LNG will analyze its potential impact on the Internet-gaming industry.

If you would have questions or would like further information please contact

IN THE USA, THE AUTHORS:

Robert A. Lawton
rlawton@kIng.com
717.231.4549

Deborah J. Peckham
dpeckham@kIng.com
617.261.3126

Linda J. Shorey
lshorey@kIng.com
717.231.4510

IN THE UK:

Warren Phelops
wphelops@kIng.com
+44.(0)20.7360.8129



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