

1998

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Jack Goldsmith

Recommended Citation

Jack Goldsmith, *What Internet Gambling Legislation Teaches about Internet Regulation*, 32 INT'L L. 1115 (1998)

<https://scholar.smu.edu/til/vol32/iss4/8>

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What Internet Gambling Legislation Teaches About Internet Regulation

Congress is considering the enactment of the Internet Gambling Prohibition Act (IGPA).¹ In accordance with the widely held view that the Internet defies national regulation,² many commentators claim that the IGPA will not stop or even diminish Internet gambling.³ In this essay, I use the IGPA to show why

*Jack Goldsmith is an Associate Professor of Law at the University of Chicago. Thanks to Larry Lessig, Doug Lichtman, and George Triantis for comments and conversation, Kyle Gehrmann and Greg Jacob for excellent research assistance, and the Arnold and Frieda Shure Research Fund for support.

1. The Internet Gambling Prohibition Act was approved by the Senate on July 23, 1998. It was passed as Amendment 3266 to Senate Bill 2260 (The Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 1999). 144 CONG. REC. 58792-01, 58,801 (daily ed. July 23, 1998) [hereinafter Amend. 3266]. On August 10, 1998, the House passed its version of the Commerce appropriations measure, House Bill-4276, without including a ban on Internet gambling. It does not appear that an Internet gambling prohibition will be enacted this year. Final Internet gambling legislation will likely await a report due in 1999 by the National Gambling Impact Study Commission. See Letter from L. Anthony Sutin, Acting Assistant Attorney General, U.S. Department of Justice, Office of Legislative Affairs, to Sen. Patrick Leahy, U.S. Senate (May 26, 1998) (found at <<http://www.rgtonline.com/gamepage/artlisting.cfm/2380>>). Although I use the Senate bill as a springboard for analyzing Internet regulation, nothing in my analysis turns on the enactment of this legislation, or on the final form that Internet gambling legislation might take.

2. See James Boyle, *Foucault in Cyberspace: Surveillance, Sovereignty, and Hardwired Censors*, 66 U. CIN. L. REV. 177, 178 (1997) ("For a long time, the Internet's enthusiasts have believed that it would be largely immune from state regulation."); see generally David R. Johnson & David Post, *Law and Borders—The Rise of Law in Cyberspace*, 48 STAN. L. REV. 1367, 1370-72 (1996) (most prominent and comprehensive argument in support of this claim).

3. See Harley J. Goldstein, *On-line Gambling: Down to the Wire?*, 8 MARQ. SPORTS L. J. 1 (1997); Seth Gorman & Anthony Loo, *Blackjack or Bust*, 16 LOY. ARTS & ENT. L. J. 667 (1996); Scott M. Montpas, Comment, *Gambling On-line: For a Hundred Dollars, I Bet You Government Regulation Will Not Stop the Newest Form of Gambling*, 22 DAYTON L. REV. 163 (1996); Nicholas Robbins, Comment, *Baby Needs a New Pair of Cybershoes: The Legality of Casino Gambling on the Internet*, 2 B.U. J. SCI. & TECH. L. 7 (1996); Andrew Beyer, *Internet Gambling Bill: All Bets Are Off*, WASH. POST, July 25, 1998, at E1. Compare John T. Fojut, Legislative Update, *Ace in the Hole: Regulation of Internet Service Providers Saves the Internet Gambling Prohibition Act of 1997*, 8 DEPAUL-LCA J. ART & ENT. L. 155 (1997). See also *infra* note 12 for additional sources.

skepticism about the feasibility of Internet regulation rests on an impoverished conception of regulation.⁴

I. Internet Gambling

To gamble on the Internet, one simply visits one of dozens of gambling sites and inputs the financial and related information needed to establish a credit account. One can then engage in all forms of virtual gambling, including sports wagering, casino wagering, horse and dog wagering, and lotteries. The interactive gambling sites available on one's computer screen originate on computer servers that are almost always located and operated from abroad.

Internet gambling is a booming business. In 1997, Internet gambling in the United States generated \$600 million in revenues on sports betting alone, and it is estimated that it will generate up to \$10 billion by the year 2000.⁵ The industry's success is due in large part to the fact that it is easier to gamble on the Internet than in real-space. Instead of traveling to a casino or dog track or lottery outlet, one can play roulette or bet on the greyhounds or buy a lottery ticket from a computer in one's home or office. Not only does a gambler avoid the inconvenience and other costs of traveling to a gambling venue, but she also avoids reputational sanctions that might accompany gambling in a public place. In addition, Internet gambling facilitates gambling by those who cannot legally gamble in real-space, such as minors and people living in non-gambling states.

All gambling produces benefits and costs. On the benefit side of the ledger are revenues for the state, local employment, and personal recreation. On the cost side of the ledger are fraud, addiction, decreased productivity among gamblers, child gambling, and family and other social tensions produced by gambling losses.

Internet gambling changes the calculus of these costs and benefits. To the extent that Internet gambling makes it easier to gamble, it enhances the personal enjoyment of gambling, but it also facilitates gambling by children, and (because of the Internet's virtual environment) it might increase the incidence of fraud, addiction, and social displacement. Perhaps more significantly, Internet gambling diminishes the revenue-generating benefits of real-space gambling, at least from the perspective of local regulators. It does this because the very large majority of gambling sites are located abroad. This means that revenues from Internet gambling are earned and taxed by persons and governments abroad rather than at home. In addition, as more people substitute Internet gambling for real-space gambling, local employment and local recreation expenditures drop. These and

4. For a more comprehensive analysis of the feasibility (and legitimacy) of Internet regulation from the perspective of jurisdiction and choice of law, see Jack L. Goldsmith, *Against Cyberanarchy*, 65 U. CHI. L. REV. 1199 (1998).

5. See Edwin Chen, *Internet Gaming Ban Clears Senate With Ease*, L.A. TIMES, July 24, 1998, at A24 (quoting recent estimates of Sen. Jon Kyl and the Justice Department).

other real-world, local harms explain why state and federal governments have begun to regulate Internet gambling.

II. Internet Gambling Legislation

Gambling from one's home or office via offshore bookies is not new. Such gambling has long taken place by telephone, and is proscribed by a variety of state and federal statutes, most notably the 1961 Interstate Wire Act (Wire Act).⁶ The Wire Act penalizes bookies who use a "wire communications facility" to receive bets or wagers on sporting events or contests.⁷ The Wire Act has rarely been enforced, because enforcement is costly and the social harms added by telephone gambling have been relatively low.⁸

As explained above, the harms of Internet gambling—and in particular the various revenues lost to offshore gambling sites—significantly undercut the justifications for legalized gambling, at least from the perspective of domestic regulators. This is the main reason why Congress is considering amendments to the Wire Act. The proposals in the IGPA would alter the Wire Act in three important respects. First, the IGPA would make clear that the Wire Act applies to Internet gambling.⁹ Second, it would extend the Wire Act's prohibitions and penalties to individual bettors.¹⁰ Third, it would authorize federal and state officials to require Internet service and access providers to block access to illegal Internet gambling sites.¹¹

The conventional wisdom seems to be that the IGPA will not work.¹² Offshore owners and operators of Internet gambling sites are beyond the enforcement

6. 18 U.S.C. §§ 1081-1084 (1994).

7. *Id.* at §§ 1081, 1084. The Wire Act defines "wire communications facility" as: any and all instrumentalities, personnel, and service (among other things, the receipt, forwarding, or delivery of communications) used or useful in the transmission of writings, signs, pictures, and sounds of all kinds by aid of wire, cable, or other like connection between the points of origin and reception of such transmission.

See *id.* at § 1081.

8. See I. NELSON ROSE, *GAMBLING AND THE LAW* (1986); Britta Gordon, *Gaming on the Internet: The Odds Are on The House, But How Long Will it Last?*, at 5-8, (last modified Nov. 18, 1996) <<http://www.law.ttu.edu/cyberspc/jour9.htm>>.

9. IGPA amends the Wire Act's definition of bets or wagers to apply to all forms of gambling, and inserts a new section that explicitly prohibits Internet gambling. See Amend. 3266, *supra* note 1.

10. See Amend. 3266, *supra* note 1, at 58,802.

11. See *id.* The Wire Act already allows federal and state officials to require common carriers such as telephone companies to discontinue service. 18 U.S.C. § 1084(d). The IGPA allows state or federal agents to enjoin Internet service and access providers to take similar action. Amend. 3266, *supra* note 1, at (d)(2) and (d)(3).

12. In addition to the sources cited in note 3, *supra*, see Scott L. Jones, Commentary, *Internet Betting Ban Won't Work*, DENVER POST, Aug. 13, 1998, at B11 ("IGPA does not even come close to addressing the problem it is supposed to solve"); Justin Matlick, *A Bad Bet for the Internet: Government Regulation of Online Gambling Would Contribute to Dampening the Entrepreneurial Character of Web Commerce*, ORANGE COUNTY REGISTER, May 31, 1998, at G3 ("[p]rohibition would not stop on-line gambling"); Beyer, *supra* note 3 ("trying to control what happens on the Internet is an exercise in futility"); Mark Tran, *One of the Web's Most Profitable Sectors is Under Attack*, THE GUARDIAN, June 26, 1997, at 6. ("Net experts think efforts to outlaw online gambling are useless").

jurisdiction of the United States. They cannot be shut down by the U.S. government. In addition, the United States cannot (at an acceptable cost) stop at the border the information protocol packets that make Internet communications possible. Finally, enforcement of an Internet gambling prohibition against individual bettors in the United States is futile. Not only is it difficult and costly for the government to monitor personal Internet use or trace Internet communications, but the government could also not possibly apply its prohibitions against all domestic Internet gambling bettors.

III. What Internet Gambling Legislation Teaches About Internet Regulation

The claim that the IGPA and similar Internet regulations will not work rests on an impoverished understanding of the way governments can regulate the Internet. Governments have many more options for regulating Internet transactions than the Internet regulation literature suggests. The fact that the United States cannot directly regulate Internet gambling site operators and equipment located abroad does not mean that it cannot regulate the transnational communications that these site operators facilitate. Such communications take place only in virtue of persons and equipment that are located in the United States. The United States can achieve a great deal of regulatory control over these transjurisdictional communications by regulating these local persons and property.

Most obviously, the United States can exercise control over both residents of the United States involved in foreign gambling operations and any local assets of persons involved in such operations whether or not they are residents of the United States. For example, the United States has recently invoked the unamended Wire Act to initiate a prosecution against the owners and managers of six Internet sports gambling companies headquartered in the Caribbean and Central America.¹³ Many of the individual defendants lived in the United States and were arrested; the local assets of other defendants were seized. Internet gambling firms can, of course, avoid such enforcement by not maintaining any presence in, or connection with, the United States, including not holding accounts with financial institutions that have a U.S. presence. Nonetheless, local enforcement against Internet gambling firms' local presence raises the marginal cost of the operation. To this extent, however small, the regulation is effective.

The United States has many other options for imposing regulatory control over Internet gambling. For example, the IGPA's prohibitions apply to bettors within the United States. It is admittedly costly to identify and prosecute local Internet bettors. But the government need not prosecute each individual violator. Through

13. See Patricia Hurtado, *Sports-Bet Bust: Feds Charge 14 in Foreign Taking of U.S. Wagers*, *NEWSDAY*, Mar. 5, 1998, at A3; Dean Starkman, *US Indicts 14 Over Gambling on the Internet*, *WALL ST. J.*, Mar. 5, 1998, at A8; *More Charged in Internet Betting*, *SAN DIEGO UNION-TRIBUNE*, Mar. 27, 1998, at D3.

selective but notorious prosecution of violators, it can deter individuals it otherwise would have no intention of prosecuting. The effectiveness of this approach will depend on the rate and publicity of individual prosecutions and the size of the penalty. The Senate version of the IGPA imposes a penalty of three months in jail and fines of up to three times the amount wagered or received for each individual violation.¹⁴ For many bettors this potential penalty will not be a deterrent in the absence of unexpectedly aggressive enforcement. But for many others it will. And of course there is nothing sacrosanct about the penalties currently prescribed by the IGPA. The United States could achieve greater control by imposing a twenty-year penalty for each individual violation. The point is that by raising the penalty on local bettors the government can also raise the cost of Internet gambling and to this extent achieve regulatory control.

The most effective form of enforcement under the IGPA is the ability to order local Internet service providers to block access to illegal gambling sites.¹⁵ Almost every Internet user in the United States accesses the Internet via a provider with a local presence. In contrast to their ability to filter out particular sites on the basis of content criteria, Internet access providers have a relatively easy time blocking access to particular website addresses. This form of regulation can thus literally shut down access to Internet gambling sites within the United States.¹⁶ A U.S. resident could still access these Internet gambling sites by making an international phone call to an offshore Internet access provider. But this method of circumvention is difficult and costly, and would deter the bulk of local bettors. And, of course, the Wire Act can be used to enjoin local telephone companies from permitting international calls to offshore access providers who give access to Internet gambling sites.

A different response to the injunction provisions of the IGPA is that a blocked gambling site can circumvent the injunction by changing its Internet address. Given the current architecture of the Internet, this form of circumvention works fairly well for persons abroad trying to send discrete content into the United States. But Internet gambling is different. It is a real-time activity that depends on continual access. It will be much less attractive to bettors if Internet wagering faces a constant threat of interruption, followed by the need for bettors to locate the blocked site's new address. In addition, the government will be able to identify the relocated site just as readily as individual bettors, and can continue to hound the gambling site as it changes addresses. These regulatory strategies can significantly raise the costs of Internet gambling—both to offshore Internet gambling firms and local individual bettors.

14. See Amend. 3266, *supra* note 1, at 58,802.

15. See Fojut, *supra* note 3, at 172.

16. Internet access providers could easily set up proxy servers and block any traffic based on Internet addresses. In principle, the very architecture of the Internet could be structured to block Internet addresses; for example, routers could be programmed not to forward information from particular addresses.

The IGPA's strategy to enjoin access providers reminds us that individuals must access the Internet through services and functions with a local presence, and that governments can achieve regulatory control over Internet transactions by regulating the local infrastructure that makes these transactions possible. Although the regulation of Internet access providers is the only infrastructure regulation employed in IGPA, it is not the only one at the government's disposal. The government could, for example, mandate the inclusion of filtering or identification technology in computer hardware or software that would facilitate monitoring or blocking of proscribed sites.¹⁷ The government could also regulate the local financial institutions that make Internet gambling possible. Internet gambling depends on bettors in the regulating jurisdiction being able to establish credit. Bettors establish credit through financial institutions (such as banks and credit card companies) that have a local presence. The government can significantly curtail Internet gambling by enjoining these local banks and credit card companies from engaging in transactions with banned Internet gambling firms.¹⁸

As with all regulation, the feasibility of Internet gambling regulation depends on the harms produced by the regulated activity, the desired level of regulatory control, and the costs of regulation. This calculus varies depending upon the type of Internet activity; the Internet is not an undifferentiated communications medium. Internet gambling imposes significant local harms, including the harm of the export of the usual benefits of local gambling. This exportation of benefits, in turn, has heightened the government's interest in regulating the activity, and might warrant increased public expenditures to achieve acceptable control. Regulation directed at local intermediaries like Internet access providers and financial institutions is likely to be especially cost effective.

Regulation of Internet transactions is challenging because the Internet is decentralized and site operators are often located abroad. The IGPA example shows that these factors do not undermine the feasibility of Internet gambling regulation. A government regulates an activity by raising the activity's costs in a manner that achieves desired ends. As we have seen, various forms of purely territorial regulation enable the government to raise the costs of Internet transactions significantly, and to this extent to achieve regulatory control.

17. See Boyle, *supra* note 2; Lawrence Lessig, *Tyranny in the Infrastructure*, WIRED, July 1997.

18. Compare Matt Beer, *The wagers of the Web; Lawsuit could unravel on-line gaming industry*, S.F. EXAMINER, Aug. 17, 1998, at B1 (Internet gambler argues that Internet gambling is illegal and seeks to bar the credit card companies and their issuing banks from collecting gambling debts).