Industry Trends: Gaming Leaders Sharing Tips & Tidbits

Each issue we feature articles and opinions from gaming insiders, executives and managers who face critical issues every day. We believe this helps balance theory and study with current practices in the casino world.

Our special guest for this issue is David Schwartz. David is the Coordinator of the Gaming Studies Research Center at UNLV. In this article, he shares his thoughts about Internet Gaming.

A Virtual Pandora's Box: What Cyberspace Gambling Prohibition Means to Terrestrial Casino Operators

David G. Schwartz

Abstract

Recently, there has been increased pressure on the U. S. Congress to act against Internet gambling. While it may be tempting for terrestrial casinos to watch idly as the federal government moves to eliminate a potential competitor, those in the business of gaming must be leery of any federal efforts to halt gambling online. In the final analysis, the same arguments to restrict consumer choice in cyberspace can be easily used against gambling in real casinos—a compelling reason for terrestrial gaming operators to forcefully oppose any federal restrictions on Americans' rights to gamble.

Keywords: Internet gambling, funding prohibition, online wagering

Introduction

The Internet, something that most people never knew they needed, has become in less than a decade a seemingly essential part of everyday life and business. Without the unfettered access to information, entertainment, and instant communication that the Internet provides, life would be profoundly slower, and only the most terminally nostalgic of Luddites would propose dismantling the electronic information highway. Yet the Internet has also brought challenges to the status quo, and one of the most provocative has been the growth of online gambling. The question of whether online wagering should be permitted, though, reaches far beyond ISPs and payment providers, because it has serious implications for anyone connected to the gaming business. By

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enacting laws against Internet gambling, state and federal governments may come perilously close to circumscribing one of the freedoms that has historically driven the American economy and allowed for the unparalleled growth of the casino entertainment industry—consumer choice. If Congress has the right to ban Americans from choosing to wager on the Internet, it is certainly conceivable that the federal government can bar Americans from gambling anywhere. For the gaming industry, a federal ban on Internet gambling is a bad idea.

The growth of online wagering

Internet gambling has had a brief, explosive, though not entirely unprecedented, history. Throughout recorded history, one thing has remained constant—with technical or social innovations will come new kinds of gambling. This is clearly seen in the history of American gambling. The rise of riverboat travel in the 1830s, for example, facilitated the creation of that most mythical of American characters, the riverboat gambler. The advent of affordable auto and air travel, of course, made possible the creation of a national gambling vacation destination on the Las Vegas Strip. Similarly, it was not long before enterprising operators realized that the real-time communication offered by the Internet created the possibility for a virtual casino.

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Today, Internet gambling is booming, despite its ostensible criminal status in the United States. Since the appearance of the first online wagering site, Internet casinos have become an accepted dimension of cyberspace. By 2001, there were well over 1400 domain names for online gaming sites and about 300 providers—businesses and governments that actually run these wagering sites. More than 60 jurisdictions had, by that year, decided to license, regulate, or endorse Internet gaming (Schneider, 2002).

Pundits feel that in the near future the online gaming industry will see a degree of consolidation and maturation similar to that of other new industries after an initial wide-open pioneering phase. Should Internet gambling receive the imprimatur of a federally-sanctioned state regulatory body within the United States, industry observers expect to see an even more rapid consolidation, if American consumers opt to wager at licensed, regulated, reputable sites backed by major terrestrial casino operators. Instead of the 300+ operators currently offering online wagering, perhaps 50 or so groups will host cyber casinos. This is, not coincidentally, a process that has been seen in the terrestrial casino industry for about the past fifty years—as early as 1958, a *Newsweek* article declared that "the day of the small gambler is over," as large combines could better balance profit and risk. Today, large corporations dominate the commercial casino market, and it seems reasonable that the same process will happen in cyberspace.

The urge to ban Internet gambling

On the surface, a state-taxed, regulated business operated by respected, known companies seems desirable for all concerned. The chief obstacle to this rational, ordered state of affairs is a lingering resistance to the idea of American regulation of Internet gambling, and the belief that the federal government should in fact prosecute those who offer online gambling. This opposition comes from many quarters: shortsighted terrestrial operators, those opposed to any expansion of gambling or specifically Internet gambling, and well-meaning citizens who are simply uninformed.

Terrestrial operators who oppose the regulation of Internet gambling, on the face of it, seem to be acting from rational self-preservation. After all, how is a casino with hundreds of millions of dollars sunk into its physical plant, to say nothing of a payroll of several thousand employees, supposed to compete with an online casino that has a fraction of those costs? If convenience were the ultimate indicator of gambling choice, terrestrial casinos, at best a car or plane trip away, would be necessarily put out of business by in-home Internet casinos. Some operators fear that disreputable online casinos will taint the integrity that the commercial casino industry has struggled to build, and that public anger against fly-by-night operators of online casinos might feed a more inchoate anti-gambling mood. Those who make their living from regulated, taxed terrestrial casinos, in this argument, have nothing to gain and much to lose from Internet competitors.

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Then there are those who oppose, on grounds of principle or expedience, any expansion of gambling. For these, the proliferation of Internet gambling has seen the gnashing of teeth as, powerless, they watch Americans choose to gamble in their own homes. Gambling opponents see Internet gambling as the final line in the sand for gambling operators to cross—if opposition to gambling fails here, there will be no place that Americans are "protected" from gambling.

Others favor gambling in casinos, but specifically oppose online wagering because of the new problems it raises. The authors of H.R. 556, the Leach-LaFalce Internet Gambling Enforcement Act, concluded that Internet gambling was a "major cause of debt collection problems" for banks and credit card companies, and that offshore Internet casinos presented "a significant money laundering vulnerability" (House of Representatives, 2002). While they felt that the terrestrial industry could control money laundering, they saw unregulated online casinos as impossible to control.

Most opponents of Internet gambling, though, don't fall into either of these categories. They are simply disinterested observers who have concluded that Internet gambling is a bad idea. In an article in the *Federal Communications Law Review*, Hammer (2001) summarized three elements of this position. First, the proliferation of Internet gambling will inevitably lead to a loss of tax revenue, as Americans choose to gamble at untaxed Internet casinos instead of taxed terrestrial ones. Second, credit card companies who allow online-gambling transactions run the risk of lawsuits by customers seeking to avoid payment of their gambling debts—the costs of any litigation, and of fees alleviated, are passed on to other customers in the form of higher interest rates and fees. Finally, there are a host of other miscellaneous costs that cannot be quantified but nonetheless present compelling reasons to stop online wagering: pathological gambling, increased bankruptcies, and a nebulous array of social problems long associated with gambling.

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These well-meaning arguments against Internet gambling are troubling for three reasons. First, they assume that Internet gambling will strip revenue from the commercial casino industry, which is taxed, and that states will thus lose a portion of their revenues. Second, this position assumes that online wagering will always be unregulated and untaxed in the United States. Should the regulatory and legal framework of Internet gambling in the United States be codified, most of the first two arguments against online wagering (loss of taxes and credit card liabilities) will be rendered moot. Third, and more importantly for terrestrial operators, the "costs to society" argument can be made just as persuasively against terrestrial casinos. For that matter, invoking "miscellaneous costs to society" as justification for legal prohibition can, logically, lead to the federal banning of smoking, drinking alcohol to excess, gorging on fast food, or driving while talking on a cellular phone. Followed through to their logical extremes, arguments to prohibit Internet gambling via federal statute are less than compelling.

Despite the specious nature of anti-Internet gambling arguments, federal legislators and law enforcement agencies have devoted a significant amount of time and taxpayer money attempting to throttle online wagering. Net gambling foes cite the 1961Wire Act as ample justification for federal action. This law, originally intended to squelch the transmission of racing and betting information over the telephone and telegraph, makes illegal the use of a "wire communication facility" to transmit bets or wagering information across state or national borders. Since most Internet Service Providers use telephone or cable lines, the official position of the United States government is that those who offer gambling over the Internet are breaking the law.

Internet prohibition: The wrong choice

If the intentions of the Wire Act's framers count for anything, it is worth noting that, they would likely approve of applying the Wire Act to Internet gambling. After all, the Internet is nothing but another "wire communication facility," albeit one with far more sophistication than a bookie sitting by a rotary-dial phone. In 1961, Congress did what it could to halt the spread of gambling. While not attacking gambling within the states (a violation of states' rights it dared not attempt), it clearly said that gambling, besides established exceptions for off-track betting, cannot cross state lines. Until specifically changed by statute, that remains the letter—and spirit—of the federal law.

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But the United States, specifically in regard to gambling, is hardly the same place it was in 1961, when only Nevada had legal casino gambling. New Hampshire's state lottery, which would open the door for the revival of state-sanctioned gambling, was still three years off. Today, forty-eight states have some form of legal gambling, and no less than eleven states actively regulate commercial casinos. It is hard to drive more than a few hours in any direction without finding some kind of gambling facility. Most Americans would be hard pressed to go about their daily routines without passing a chance to gamble since convenience stores sell lottery tickets in most states, and bingo halls dot the American landscape. Simply put, Americans have legalized—and legitimized—their long-standing predilection towards gambling. It is now states that prohibit gambling that are exceptional. Clearly, Americans no longer agree with the framers of the Wire Act, and feel that gambling is better served by regulation than prohibition.

Still, some in Congress have seized the anti-gambling banner. The first attempt to specifically target Internet gambling, Senator Jon Kyl's 1997 Internet Gambling Prohibition Act, would have criminalized the act of betting over the Internet by penalizing both online casinos and online bettors. Though this act passed the Senate, the House of Representatives never voted on a parallel bill. Senator Kyl amended the bill in 1999 to punish only those who offered online gambling with fines and prison sentences. Once again, the bill passed the Senate, but a similar bill failed in the House. Thus, the American people escaped the 20th century with no new laws against online gambling.

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But in October 2002, the House passed by voice vote the Leach-Lafalce Internet Gambling Enforcement Act, which would prohibit the use of "bank instruments" (credit cards, debit cards, and wire transfers) in Internet gambling. As of this article's writing, it had been referred to the Senate but had not yet been voted on. The White House, however, urged Senate Majority Leader Tom Daschle to act on the bill, noting that Internet gambling had caused "countless heartbreaking stories" of personal ruin, and that the unregulated industry served as a haven for money launderers and terrorists. Congressman Michael Oxley has gone even further, stating that the Internet Gambling Enforcement Act is "just as essential to

American families as homeland security and terrorism insurance" (Smith, 2002). Clearly, there are those who believe that online wagering is as inimical a threat as any that the United States faces. This rhetoric, while heated, has not carried over into definitive legislative action against online gambling, but there is no reason to believe that it will not.

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Should the opponents of Internet gambling regulation carry the day, Americans will be officially prohibited from wagering on the Internet. Companies that "permit" American citizens to do so will be subject to prosecution, and those who advertise or facilitate payment for Internet gambling sites licensed by other jurisdictions but "illegal" in the United States will also be liable to criminal penalties. It will be illegal for credit card companies to process online wagering transactions. Americans will, effectively, be denied any choice in the matter of gambling online, on paper. Of course, this will probably not prevent millions of Internet users from gambling, but Congress will have acted to the best of its ability.

Free speech justifications for unlimited liberty to do or say anything online often ring a bit hollow, and they present few good reasons for not banning gambling online. Obviously, federal and state law enforcement officers have the right to police the Internet for violations of the law. Child pornographers, for example, have no right to disseminate their materials in any fashion, be it in a store, through the mails, or over the Internet. Advertising one's services online as a hit man or money launderer would no doubt attract the quick attention of authorities. It is easy to imagine a whole host of things that people should not be permitted to do over the Internet, and it will not be hard to produce the statutory justifications to prosecute those who use this technology to break the law.

But there is little to suggest that Congress should have the power to ban activities that are legal in the majority of states. Most Americans can hardly avoid the opportunities for legal, state-sanctioned gambling, be they at casinos, racetracks, or in convenience stores, which sell lottery tickets. Given the variety of problems facing law enforcement at every level, it seems misguided to funnel human resources into policing online gambling when gambling is already readily available to most Americans.

Internet gambling prohibition has many implications that go beyond the right to bet online. Should the federal government implement a ban on online wagering, it will set a dangerous precedent for cyberspace for the U. S. Congress will have taken the right to say what are and are not appropriate uses of Internet commerce. Even if the American people voted with unanimity to ban Internet gambling, how could the United States force the Netherlands Antilles—or Australia—to prevent their regulated online gaming industries from accepting bets from American consumers?

The federal government perfunctorily demonstrated its resolve and ability to punish those who violate the Wire Act with *United States v. Cohen*. Federal prosecutors convicted Jay Cohen, an American citizen, of violating the Wire Act by operating the World Sports Exchange, an online wagering site based and licensed in Antigua. Cohen chose to return to the United States to stand trial and lost. Though this case garnered many headlines, it hardly represents a working formula for restricting online gambling. After all, the World Sports Exchange is still accepting bets, and there is little precedent in international law for the United States government to prohibit other nations from licensing gambling sites. Had Cohen not chosen to return to test the legal waters, there is nothing that the United States government could have done to bring him to justice. It is unlikely that sovereign nations will think so little of their efforts to regulate online gambling that they will choose to hand over Internet gambling operators who have abided by their own laws and paid license fees for the right to operate an online casino. Federal attempts to ban online gambling thus run aground on the shoals of jurisdiction and national sovereignty.

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The implications for terrestrial operators

Thus, federal efforts to prohibit Internet gambling are simply not workable. There is no reason to believe that communications technology will stand still while the federal government devises a system to stop Americans from gambling online. While American jurisdictions are powerless against online casinos, they exercise very real authorities over land-based commercial casinos, and these operators might be haunted by efforts to ban online gambling.

Should the federal government be somehow granted the right and power to deny Americans the ability to wager online, there is little logical reason to stop there. After all, if gambling is a socially undesirable activity, why should gambling businesses be allowed to advertise over the Internet? Isn't a website that displays a banner ad for a Las Vegas casino encouraging its visitors to gamble, or facilitating a gambling transaction? How about casino web sites? Even though they may not allow visitors to bet online, they do provide prospective patrons with information about their casinos, which is no doubt facilitating future gambling transactions. What about sites that allow travelers to make reservations at casino hotels? Though they are not gambling, they are arranging to stay at an establishment with gambling, and they are also directly supporting a "gambling business."

Terrestrial casino operators, then, should not be drawn in by chimerical hopes of using federal Internet gambling prohibition to stifle a potential rival industry. When put it its most basic form, the question of Internet gambling becomes one of consumer choice—should citizens have the right to decide how they want to spend their money, or should the federal government choose how they can do so?

If terrestrial casino operators truly want to shore up their defenses against losses to online casinos, they must offer a more appealing product. The world's gambling capital, Las Vegas, rose to prominence precisely because it offered visitors a mix of casino action, entertainment, and vacation pleasures. Casinos throughout the nation may have to re-invent themselves as all-inclusive entertainment destinations that have more than just nickel slot machines. Or they might need to get back to increasing the appreciation of the gambling experience itself. One of the attractions of a night of gambling is the public, theatrical element; it is hard to believe that people will give up the shared excitement of a hot blackjack table for the cold reality of a solitary point-and-click wagering experience.

Should they wish to be more aggressive casino operators might openly criticize online casinos as disreputable and insecure (saying for instance, that you don't know who you are playing with, or who else can "see" your transactions). Attack ads are often distasteful but apparently effective, as their proliferation in the political arena has shown. Casinos with an eye towards industrial espionage might even consider hiring hackers to launch denial of service attacks on online casinos, if they truly feel threatened. This is legally and ethically indefensible, but is more sensible than letting the federal government attempt to legislate against consumers' right to choose to gamble online.

Federal efforts to stop gambling by banning online wagering could boomerang and devastate the commercial casino industry.

Although industry supporters have convincingly argued for the past generation that "gaming is a business just like any other," the commercial casino industry is in many critical ways crucially different from other forms of entertainment. For years, gambling in the United States existed in a kind of purgatory. Universally popular, usually illegal, it defied attempts to stamp it out. Yet it also held a stigma of corruption and cheating—something not entirely undeserved—because many professional gamblers cheated, and illegal operators found a *modus vivendi* could best be reached by paying off politicians and police. Beginning with Nevada's legalization of gambling in 1931, however, the past seventy years have seen an almost unchecked spread of legal, state-regulated gambling, and gambling now provides the economic underpinning for more than one regional economy. Still, gambling cannot escape its roots, and the commercial casino industry remains one of the most heavily regulated businesses in America.

With its many regulatory safeguards, and a proven track record of assisting in both revenue enhancement and job creation, leaders of the traditional casino industry have good grounds to feel secure. Their business has expanded in an unprecedented way over the past two decades, and Americans seem to be clamoring for more and larger casinos at every turn. Even though several states, it would seem, are pledged to the indefinite continuation of casino gambling, there is nothing to say that the federal government could not take decisive action against gambling. A ruinous federal tax on those who provide gambling or a prohibitive income tax on gambling winnings are only two of the ways that the federal government could legislatively limit the choice to gamble in a legal casino. In this way, federal efforts to stop gambling by banning online wagering could boomerang and devastate the commercial casino industry.

Conclusion

While there may be some good reasons for terrestrial casino operators to contest online wagering, it is in their own self-interest to oppose any laws that seek to restrict the right of citizens to choose how they wish to spend their money. Arguments against Internet gambling, while understandable, can, with the turn of a phrase, be directed against all forms of gambling. For people who make their living from casinos and for communities that live by a casino economy, a federal ban on Internet gambling may prove costly. Whether and how Americans gamble or not is best left as a choice freely available to individual consumers.

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