A MODEL FOR RESPECTING STATES' RIGHTS IN REGARD TO INTERNET GAMBLING – THE INTERSTATE HORSERACING ACT

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The federal legislation considered in the past two years to legalize and regulate interstate Internet Gambling in the United States – 2009 "Frank Bill",[1] the 2009 "Menendez Bill",[2] the 2010 "Reid Bill" (never introduced), the 2011 "Campbell Bill[3] and the 2011 "Barton Bill"[4] – all contemplate the establishment of a significant federal infrastructure. Among other things, they would establish a federal licensing regime (although subcontracted, in part, to state and tribal regulators) to license operators and their major vendors. (Other federal oversight would come, for example, from the "Office of Internet Poker Oversight," which would be created pursuant to the Barton Bill.) This would be inconsistent with earlier findings and actions of Congress in regard to Internet gambling, and ignores the fact that a successful interstate Internet gambling infrastructure has been in place in the United States since 2000 without such dependence on the Federal Government. Specifically, the Interstate Horseracing Act of 1978, as amended in 2000 (the "IHA"),[5] created an environment that respects the rights of states to regulate gambling occurring within their borders and in which states have actively cooperated with each other in order to establish consistent regulatory licensing requirements. Indeed, with the recent passage of legislation in Kentucky, there is the promise of even greater state cooperation in the future, in particular in regard to the operators that accept Internet wagers on horse races (i.e., "advance deposit wagering" or "ADW" operators). With this as background, it is disappointing that the Federal Government has not considered using the IHA as a conceptual model for federal legislation relating to interstate Internet gambling in the United States.

The IHA authorizes interstate Internet wagering on horse races in a manner that respects states' rights to regulate gambling while at the same time providing states necessary federal assistance. It offers a model that Congress should consider should it finally decide that Internet wagering (besides wagering on horse races) should be regulated and taxed, rather than prohibited. Pursuant to the IHA, a person in one state may place a wager on a horse race occurring in another state, and that wager may be transmitted via "electronic media" and accepted in the person's state (the "off-track state") or the state hosting the race (the "host state"). The interstate wager must be lawful in each state involved, and a number of consents must be obtained, most notably, the consent of the racetrack where the race occurs, the group representing the horse owners and trainers at the track, the host state's racing commission and the off-track state's racing commission.

In passing the IHA, Congress made and stated explicitly the following findings:

> (1) the States should have the primary responsibility for determining what forms of gambling may legally take place within their borders;
> (2) the Federal Government should prevent interference by one State with the gambling policies of another, and should act to protect identifiable national interests; and
> (3) in the limited area of interstate off-track wagering on horse races, there is a need for Federal action to ensure States will continue to cooperate with one another in the acceptance of legal interstate wagers."[6]

In 2000, the IHA was amended to make clear that an "interstate off-track wager…includes pari-mutuel wagers, where lawful in each state involved, placed or transmitted by an individual in one state by a telephone or other electronic media and accepted by an off-track betting system in the same or another state, as well as the combination of any pari-mutuel wagering pools."[7] Thus, the 2000 amendment made clear that wagers via the Internet were within the scope of the IHA. (The United States Department of Justice ("DoJ") maintains that the Wire Act[8] and certain other federal laws prohibit Internet wagering on horse races, even where legal in the states involved, notwithstanding the express provisions of the IHA. The DoJ's position has been that under the principles of

1: H.R. 2267 (111th Congress, 1st Session). 2: S. 1597 (111th Congress, 1st Session). 3: H.R. 1174 (112th Congress, 1st Session). 4: H.R. 2366 (112th Congress, 1st Session). 5: 15 U.S.C. §3001, et seq. 6: 15 U.S.C. §3001(a) (emphasis added). 7: 15 U.S.C. §3002(3). 8: 18 U.S.C. §1084. 9: See President Clinton's Signing Statement upon signing the amendment to the IHA in 2000, 2000 U.S.C.C.A.N 2455, and the April 5, 2006 Statement of Bruce G. Ohr, Chief of the DoJ's Organized Crime and Racketeering Section, Criminal Division, with respect to H.R. 4777 (the "Internet Gambling Prohibition Act") before the Subcommittee on Crime, Terrorism and Homeland Security of the House Committee on the Judiciary, 109th Congress (2006). 10: See 146 Cong. Rec. H 11230, 106th Cong. 2nd Sess. (2000), statement of Rep. Frank R. Wolf, in which Rep. Wolf "want[ed] members of [the House] to be aware that [the amendment to the IHA] . . . would legalize interstate pari-mutuel wagering over the Internet.") 11: 15 U.S.C. §3001 (a)(3). 12: See http://racinglicense.com/owner.html, last accessed July 18, 2011. 13: See http://racinglicense.com/mission.html, last accessed July 18, 2011. 14: See http://racinglicense.com/accepted.html, last accessed July 18, 2011. 15: KY S.B. 24, enacted March 16, 2011, Article III(B). 16: KY S.B. 24, enacted March 16, 2011, Article V(A) and (C). 17: Bloodhorse.com, at http://www.bloodhorse.com/horse-racing/articles/62809/kentucky-racing-compact-bill-signed-into-law, last accessed July 19, 2011 (emphasis added). 18: See, for example, U.S. v. MacEwan, 445 F.3d 237, 244 (3d Cir. 2006); cert. denied, 549 U.S. 882, 127 S.Ct. 208, 166 L.Ed.2d 144 (2006); United States v. Carroll, 105 F.3d 740, 742 (1st Cir. 1997) and United States v. Kamersell, 196 F.3d 1137, 1139 (10th Cir. 1999);

statutory construction in the United States, because the IHA (a civil statute) did not explicitly repeal or amend the Wire Act (a criminal statute), the IHA is therefore trumped by the Wire Act, which, among other things, prohibits gambling businesses from using a wire communication facility to accept interstate wagers on sporting events.[9] However, the plain language of the IHA amendment contradicts this position, as does its legislative history.[10] In addition, the IHA was enacted long after the Wire Act, and later enacted statutes usually supersede earlier ones where they are in conflict. Finally, the IHA amendment is specific to horse racing, whereas the Wire Act applies more generally, and specific statutes usually trump general ones. In any event, the DOJ has never prosecuted Internet gambling businesses accepting wagers in accordance with the IHA, nor has it prosecuted those assisting such businesses.)

The purpose of the IHA is to "ensure states will continue to cooperate with one another in the acceptance of legal interstate wagers,"[11] and such cooperation has indeed occurred. Several states have passed legislation authorizing their membership in or participation with a cooperative interstate organization known as the "National Racing Compact." The National Racing Compact "is an independent, interstate governmental entity authorized by participating states and the FBI to issue a national license for participants in horse racing with pari-mutuel wagering."[12] Its purpose is "[t]o establish uniform requirements for and issue licenses to participants in pari-mutuel racing to ensure that all participants who are licensed meet a uniform standard of honesty and integrity, and to reduce the regulatory burden on those participants in pari-mutuel racing who are indisputably welcome to race in every state and province by providing them with a single license recognized in all racing states and provinces."[13] The National Racing Compact currently is recognized in 24 jurisdictions – 15 member states and 9 participating states,[14] and a national racing license now exists for several participants in the pari-mutuel racing industry (e.g., owners, jockeys and trainers). Although the National Racing Compact currently does not establish uniform requirements or issue licenses to businesses that accept Internet wagers on horse races, a law enacted in Kentucky in March, 2011 contemplates the establishment – pursuant to an additional state compact – of a national racing and wagering commission – "an interstate governmental entity of the member states, to coordinate the decision-making and actions of each member state racing commission…"[15] The compact would "allow each member state, as and when it chooses, to achieve the purpose of this compact through joint and cooperative action," and the member states would have the power and duty, "by and through the compact commission: [t]o act jointly and cooperatively to create a more equitable and uniform pari-mutuel racing and wagering interstate regulatory framework,…[and] [t]o create more uniform, effective, or efficient practices and programs, with the consent of each member state that shall participate in them, relating to any part of live pari-mutuel horse or greyhound racing or pari-mutuel wagering activities, whether on-track or off-track, that occur in or affect a member state…"[16] The compact will become effective when five additional states adopt related legislation. As reported in the media:

> The law allows Kentucky to join other states that conduct pari-mutuel wagering and racing to adopt and implement uniform rules and regulations governing the sport…The compact is designed to allow each member state to maintain control over how racing and wagering is regulated in their individual state. Every proposed rule would go through a public comment period, and states must publish regulations in their respective administrative registers."[17]

In this manner, the states' rights to control gambling within their borders are respected, and yet a national infrastructure is possible.

It is clear that both Congress and the states have the power to regulate Internet gambling. Congress enjoys this power through its power to regulate interstate commerce under Article I, Section 8 of the United States Constitution (the "Commerce Clause"). Congress' power likely exists even over Internet wagering where the wagers are made and received in the same state, because several courts have deemed use of the Internet to be automatically an activity in interstate commerce.[18] On the other hand, states enjoy the power to regulate Internet gambling under the Tenth Amendment to the United States Constitution, which reserves to the states the powers not granted to the Federal Government nor prohibited to the states, and thus protects the rights of states to regulate gambling activities within their borders pursuant to their police powers.

It has been argued that a comprehensive federal regime overseeing Internet gambling is needed. A recent White Paper commissioned by the American Gaming Association states:

> Although each state should have the discretion to decide whether or not to permit online gambling within its borders, as is done under the Interstate Horseracing Act, individual states should not be able to create their own online gambling regimes. The result would be a legal patchwork that would make little economic sense, with online poker permitted in one state, a state lottery offering casino games in a second state, and a third state authorizing only Internet blackjack. The result would be confusion for consumers and an inefficient overlap in regulatory effort.[19]

Such inefficiency need not occur under federal legislation modeled upon the IHA. The states have shown that they can work together on gambling licensing and regulatory issues – such cooperation is evidenced not only by the National Racing Compact, but also by multi-state lottery games such as "Mega Millions" (involving the cooperation of 41 states, the District of Columbia and the U.S. Virgin Islands)[20] and "Powerball" (operated by the Multi-State Lottery Association, with membership including 31 states, the District of Columbia and the U.S. Virgin Islands).[21] States that accept some Internet gambling within their borders could agree on uniform licensing, security and operational standards, leaving them free – as indeed they should be – to determine which games will be permitted within their borders. Internet gambling operators today are able to determine the location of bettors, and they also have the capability to make available different games to bettors located in different jurisdictions. It might not make "economic sense" that different states permit different types of online games, but it would be no different and no less confusing than it is today, with different gambling states permitting different mixes of gambling products within their borders. Federal legislation should not adopt an approach where states are forced to choose between permitting no Internet gambling (other than pari-mutuel wagering on horse races) and permitting only those Internet games deemed appropriate by the Federal Government.

Accordingly, Congress should consider legislation modeled on the IHA, that encourages the states to cooperate on licensing, security and operational rules, but permits the states to determine the games to be offered within their borders and, through a state compact, to license, regulate and have jurisdiction over Internet gambling operators accepting bets from persons within their borders. Allowing states to make their own choices with respect to Internet gambling would be consistent with federalism principles and the Tenth Amendment to the United States Constitution, and would permit those states involved to make their own decisions regarding the taxation of Internet gaming revenues generated by persons within their borders.

This is not to suggest that the IHA is without flaws or should be slavishly copied as the model for federal Internet gaming regulation, except in regard to purpose – to "ensure states will continue to cooperate with one another in the acceptance of legal interstate wagers." The IHA has recently been criticized as establishing "a flawed business model"[22] in that it mandates an obsolete revenue sharing scheme that pays too much of the track takeout (portion of wagers de-

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cert. denied, 530 U.S. 1231, 120 S.Ct. 2664, 147 L.Ed.2d 277 (2000). 19: "Online Gambling Five Years After UIGEA," by David O. Stewart, Ropes & Gray, LLP, May, 2011, White Paper commissioned by the American Gaming Association and available at http://www.americangaming.org/industry-resources/research/white-papers. 20: http://www.megamillions.com/about/history.asp, last accessed July 20, 2011. 21: http://www.musl.com/musl_members.html, last accessed July 20, 2011. 22: "The Guardians of Racing's Slow Death," by Jim Squires, New York Times Horse Racing Blog, June 10, 2011, at http://therail.blogs.nytimes.com/2011/06/10/the-guardians-of-racings-slow-death/, last accessed June 19, 2011. 23: Testimony of Jess Stonestreet Jackson before the Commerce, Trade and Consumer Protection Subcommittee of the House Committee on Energy and Commerce, June 19, 2008, 110th Congress (2008). 24: In addition, many feel that under the existing IHA, the industry has been unable to rid the sport of performance enhancing drugs. This has resulted in the Interstate Horseracing Improvement Act – H.R. 1733 (112th Congress, 1st Session) – federal legislation introduced May 4, 2011 and designed to eliminate drugs from horse racing. 25: Thomas v. Bible, 694 F.Supp. 750, 760 (D. Nev. 1988), aff'd. 896 F.2d 555 (9th Cir. 1990) and Chun v. New York, 807 F.Supp. 288, 292 (S.D.N.Y. 1992). 26: Rousso v. State of Washington, 239 P.3d 1084 (Wash. 2010), quoting Johnson v. Collins Entertainment Co., 199 F.3d 710, 720 (4th Cir. 1999).

ducted from the pari-mutuel wagering pool and used to fund purses, operating expenses and to pay other stake holders) to the off-track wager recipients and gives too little power to the horse owners. However, the revenue sharing scheme is not mandated by the IHA and could be changed in negotiations among the relevant parties, and the balance-of-power issue is not so much a flaw in the IHA as a need (as perceived by the horse owners) for an exemption to antitrust laws permitting them to organize.[23] In any event, Internet gambling on poker and games of chance involves fewer stakeholders (primarily the bettors, operators, their vendors, financial transaction processors and the states) and different issues than the horse racing industry, whose stakeholders include not only those aforementioned, but additionally, the racehorse owners, tracks, trainers, jockeys, breeders and off-track betting facilities.[24] The often stated concern in respect of Internet gambling in the United States, that a federal regime is necessary to avoid a chaos of inconsistent licensing requirements, has not been borne out by the experience of the IHA, and in regard to operational rules, the states are cooperating – albeit belatedly – to streamline such rules.

The Federal Government has historically viewed the regulation of gambling as primarily reserved to the states pursuant to the Tenth Amendment of the United States Constitution, except when a federal law was required to ensure necessary cooperation among them.[25] The uniqueness of the Internet suggests a need for federal legislation with respect to Internet gambling, but legislation only to assist the states and ensure that they cooperate with each other in regard to licensing, security and operational rules. "The State wields police power to protect its citizens' health, welfare, safety, and morals. On account of ties to organized crime, money laundering, gambling addiction, underage gambling, and other societal ills, '[t]he regulation of gambling enterprises lies at the heart of the state's police power.'"[26] There is no need for a federal licensing regime and overlay as has been contemplated thus far in proposed federal legislation, and in particular, the Federal Government should not dictate to the states which online games may be permitted within their borders. ◆