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United States General Accounting Office
Washington, DC 20548

September 23, 2002

The Honorable Michael G. Oxley
Chairman
Committee on Financial Services
The Honorable John J. LaFalce
Ranking Minority Member
Committee on Financial Services

The Honorable Spencer Bachus
Chairman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services

The Honorable Sue W. Kelly
Chairwoman
Subcommittee on Oversight and Investigation
Committee on Financial Services

House of Representatives

Subject: *Interim Report on Internet Gambling*

As you requested, we are conducting a study on Internet gambling and the U.S. payments system, specifically the use of credit cards to fund Internet gambling activities. This letter responds to your request for an interim product that summarizes results to date based on this study. As agreed with your office, we plan to issue a final report on our work in November 2002.

In your letter dated September 10, 2002, you noted plans to bring H.R.556, the Unlawful Internet Gambling Funding Prohibition Act, to the House floor for debate later this month. Thus, you asked us to provide this interim product to address four key issues for consideration in the congressional debate. We are providing information on gambling laws of selected states and the principal federal statutes that pertain to Internet gambling and courts' interpretations of those statutes; and preliminary results on the structure of the credit card industry, the policies and procedures that industry participants have implemented relating to the use of credit cards to fund Internet gambling transactions, and the views of law enforcement and industry participants on the vulnerability of the Internet gambling industry to money laundering. These and other questions you asked will be answered more fully in a final report to be issued in November 2002.

To address the legal issues, we researched federal laws; the laws of five judgmentally selected states whose statutes included a wide-range of gambling provisions; case histories; and related studies. We also spoke with representatives of the Department of Justice (DOJ) and the offices of the attorneys general for the same five states. To obtain information on the credit card industry's efforts to deal with Internet gambling, we interviewed officials of the four major credit card organizations, some large issuing and acquiring member banks, third-party processors, and a few banking trade associations. We also interviewed gaming industry and Internet gambling industry experts, knowledgeable state representatives, and law enforcement officials to obtain their views on the susceptibility of Internet gambling to money laundering and on some of the legal issues pertaining to on-line gaming and betting.

The information on the credit card industry's policies and procedures related to Internet gambling addressed in this letter focus primarily on those implemented in the United States and are based almost exclusively on statements that we could not, and did not, verify or corroborate. Internet gambling-related policies and procedures applicable to the international members or partners of the various credit card entities will be discussed further in the final report. We performed our work between March 2002 and September 2002 in accordance with generally accepted government auditing standards.

RESULTS

Currently, both state and federal laws apply to Internet gambling in the United States. In general, gambling legislation is a matter of state law and varies considerably among the states. Internet gambling typically occurs through interstate or international means, with a Web site located in one state or country and the gambler in another. Federal law recognizes the wide variations among state laws and seeks to ensure that neither interstate nor foreign commerce is used to circumvent state statutes. To date, 18 U.S.C. § 1084, commonly referred to as the Wire Act, is the federal statute that has been used to prosecute federal Internet gambling cases. The act prohibits gambling businesses from using interstate or international wires to knowingly receive or send certain types of bets or information that would assist in placing bets. Although the Wire Act has been successfully used to prosecute gambling businesses through the Internet, the statute contains certain ambiguities that may limit its applicability—for example, uncertainty about whether its provisions apply to all types of betting or are limited to sporting events and contests. The DOJ generally takes the view that the Wire Act is not limited to sports-related gambling activities, but case law on this issue is conflicting.

Two types of credit card organizations handle the four major credit cards issued in the United States. Credit card associations are owned by a large network of member financial institutions, which may approve credit card applications and issue credit cards, approve and sign up merchants to accept the cards, or both. The associations define the policies, roles, and responsibilities of their member

institutions and provide the computer systems that transfer transaction data between member institutions and merchants. Full-service credit card companies issue their own brands of cards directly to customers and authorize merchants to accept those cards. Credit card associations and full-service companies have taken different approaches to restricting the use of their cards for Internet gambling. Credit card associations have focused primarily on facilitating the blocking of Internet gambling transactions. Credit card companies have focused primarily on prohibiting Internet gambling sites from becoming credit card merchants.

Representatives of law enforcement agencies, regulatory bodies, and the credit card and gaming industries expressed mixed views regarding the vulnerability of Internet gambling to money laundering. Law enforcement officials believe that Internet gambling can be a significant money-laundering vehicle because of the volume, speed, and international reach of Internet transactions and the offshore locations of Internet gambling sites. In their view, these characteristics can promote a high level of anonymity and make investigations difficult. Banking and gaming regulatory officials did not view Internet gambling as particularly susceptible to money laundering, especially when credit cards that create a transaction record and are subject to relatively low transaction limits are used for payment. Industry gaming officials noted that increased blocking of credit card transactions for Internet gambling could help promote newer forms of electronic payment methods that may be more susceptible to money laundering.

Internet Gambling Is Governed by Both State and Federal Law

Although both state and federal laws apply to gambling in the United States, when gambling takes place within one state, state law predominates. Each state has laws that address whether individuals can legally gamble within its borders and whether gaming businesses can exist within the state. States where gambling is legal regulate the type of gambling that is permissible and the conditions under which gambling businesses can function. Internet gambling is typically an interstate or international matter, however, because the gambler and the Web site are in two different states or even countries. Because gaming over the Internet typically goes through state or international communication lines, such transmissions can violate a number of state laws, although the states may never know that such transmissions occurred. Federal law recognizes the wide variations among the laws of the states and seeks to ensure that neither interstate nor foreign commerce is used to circumvent states' choices. The Wire Act, for example, has been used to prosecute Internet gambling activities when gambling has occurred over state lines.

A Survey of Five States Shows That State Laws Vary Widely

We reviewed the gambling laws of five states—Massachusetts, Nevada, New Jersey, New York, and Utah—to determine how they affect Internet gambling. We selected those states because they offer a wide range of gambling provisions, from

total prohibition to legalized land-based casino gambling.¹ In summary:

Massachusetts has legalized dog and horse racing under the supervision of the State Racing Commission and some statewide lotteries and raffles by certain organizations under the supervision of the State Lottery. Although it prohibits most other types of gambling, including transmitting a bet or wager using the telephone, Massachusetts does not have a statute specifically addressing Internet gambling.

Nevada has legalized land-based casino gambling and has authorized the Nevada Gaming Commission to adopt regulations governing the licensing and operation of Internet gambling only when it determines that interactive gaming can be operated in compliance with all applicable laws. Until such a determination is made, Internet gambling remains illegal in Nevada.

In New Jersey, gambling can be made legal only by referendum, and only land-based casino gambling in Atlantic City, licensed horse racing, state lotteries, bingo and raffles for certain groups, and amusement games have been approved via referendum. Thus, Internet gambling is illegal in New Jersey.

New York has authorized certain lotteries, certain types of pari-mutuel betting on horse races, and bingo, lotto games and local games of chance operated under certain conditions but prohibits most other types of gambling, such as Internet gambling.

Utah prohibits all forms of gambling, including state-run lotteries, and the Assistant Attorney General has stated that Utah believes that gambling from a computer located in Utah would constitute gambling within the state.

The attorneys general of New Jersey and New York have recently initiated actions against Internet gambling entities or institutions facilitating gambling over the Internet. In June 2001, New Jersey's Attorney General filed three separate civil cases against entities operating Internet gambling Web sites that accept wagers for casino-style games, horse races, and sports games from individuals located in New Jersey. These cases are still pending. In addition, in June 2002 New Jersey's Attorney General settled two of seven civil lawsuits that were brought in October 2001, in which the Attorney General sought to enjoin companies engaged in Internet gaming activities from accepting wagers on various sporting events from individuals or entities located in the state. Earlier, on March 18, 2002, a joint resolution was proposed in the state assembly for the formation of an Internet

¹ In addition to the 5 states that we reviewed, we also researched the law of all 50 states to determine if any had enacted specific legislation regarding Internet gambling. We found that five states (Illinois, Louisiana, Oregon, Nevada, and South Dakota) had enacted laws that specifically prohibited aspects of Internet gambling.

Gaming Study Commission, which would conduct a comprehensive study of the social and economic impact of legalizing Internet gambling in New Jersey. An official from the New Jersey Attorney General's office advised us that this resolution has not moved through the legislature. New York's Attorney General recently initiated two separate inquiries into the business practices of financial institutions regarding the possible facilitation of on-line gambling by New York citizens. Settlements in these two inquiries included an agreement by the businesses to discontinue any facilitation of on-line gambling activities in New York. Enclosure I includes additional details on the gambling laws of these five states.

The Federal Government Regulates Gambling That Affects Interstate or International Activity

Although gambling regulation is generally left to the states, the federal government has the authority under the Commerce Clause of the Constitution to regulate gambling activity that affects interstate commerce.² With Internet gambling, bets are generally placed at the computer of an individual in one state and received at a server in either another state or another country. Three federal statutes appear to have direct applicability to on-line gambling: the Wire Act, the Travel Act,³ and the Illegal Gambling Business Act.⁴ To date, only the Wire Act has been applied in the federal prosecution of activity relating to Internet gambling; its provisions are discussed below. These other federal gambling statutes have been used in the closely analogous situation of telephone wagering, including telephone calls to place wagers with offshore bookmakers. Enclosure II contains details on the other two federal statutes that could apply to Internet gambling, plus the Indian Gaming Regulatory Act, which affects gaming on Native American reservations.

The Wire Act prohibits gambling businesses from knowingly receiving or sending certain types of bets or information that assists in placing bets over interstate and international wires. Thus, if an Internet gaming Web site operating in any country (including the United States) receives a bet transmitted by an individual located in the United States, the operator has violated the Wire Act. Therefore, foreign entities offering gambling to U.S. citizens through the Internet would be subject to the Wire Act because they are soliciting business from the United States. Although there have been successful prosecutions under the Wire Act against gambling businesses operating over the Internet, including prosecutions of foreign entities, courts do not agree on the applicability of certain sections of the statute.

First, the Wire Act mandates that a wire communication facility must be involved in order for a violation to occur. Currently, all Internet communications are

² U.S. Const., art. I, § 8, cl. 3 states in relevant part that "The Congress shall have Power ... [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

³ 18 U.S.C. § 1952.

⁴ 18 U.S.C. § 1955.

dependent in some way upon some type of wire communication, such as telephone or data lines. Depending upon how Internet technology develops, however, future Internet communications may no longer be wire communications covered under the Wire Act.

Second, individual courts have reached different conclusions about the types of gambling to which the act applies. The statute prohibits the transmission of “information assisting in the placing of bets or wagers on any sporting event or contest.” This language has led some courts to interpret the Wire Act as covering bets only on contests that involve sports. For instance, in In re MasterCard International, 132 F. Supp. 2d 468 (E.D. La. 2001), the court held that a plain reading of the Wire Act “clearly requires that the object of the gambling be a sporting event or contest.” However, other courts have applied the Wire Act to casino-type gambling and not limited its application to sports betting. In People v. World Interactive Gaming, 714 N.Y.S. 2d 844 (N.Y. Sup. Ct. 1999), a New York court enjoined an Antiguan company from operating or offering casino gambling over the Internet. The Wire Act was among the laws the court held were violated, although the gambling was casino-type gambling and not merely sports betting. Relying in part on the legislative history of the Wire Act, DOJ generally takes the view that the act is not limited to sports-related activities.

Third, the phrase “transmission of a wire communication” is somewhat ambiguous. Depending on how the phrase is interpreted, the act might not apply to Internet gambling in some instances—for example, when information is only received over the Internet. Some courts have held that “transmission” means receiving as well as sending information, while others have held that it means only sending.⁵ In Telephone News System v. Illinois Bell Telephone Co, 220 F. Supp. 621 (N.D. Ill. 1963), aff’d, 376 U.S. 782 (1964), a case involving a number that provided recorded horse-racing information to anyone who called, the court rejected the contention that the word “transmission” meant receiving as well as sending. The court in this case held that a professional bookmaker who used this telephone service to obtain horse racing-information for his bookmaking business did not violate the Wire Act, because the bookmaker did not send gambling information over the Wire but merely received it. However, another court has held that receiving information alone is a violation of the act. In United States v. Reeder, 614 F. 2d 1179 (8th Cir. 1980), the court found violations of the Wire Act when a professional bookmaker located in Arkansas made calls to California and New York sports information services that provided recorded game scores. The court held that the Wire Act forbids the use of interstate facilities for receiving wagering information. Applying this interpretation to the Internet, receiving sports scores for use in the business of wagering could be a violation of the Wire Act.

⁵ United States v. Reeder, 614 F.2d 1179 (8th Cir. 1980); United States v. Stonehouse, 452 F.2d 455 (7th Cir. 1971); Telephone News Sys. V. Illinois Bell Tel. Co, 220 F. Supp. 621 (N.D. Ill. 1963), aff’d, 376 U.S. 782 (1964).

Finally, some confusion exists among the courts concerning the second paragraph of the Wire Act, 18 U.S.C. § 1084(b), which provides that “[n]othing in this section shall be construed to prevent the transmission . . . of information assisting in the placing of bets or wagers on a sporting event or contest from a State or foreign country where betting on that sporting event or contest is legal into a State or foreign country in which such betting is legal.” In other words, transmitting information to assist in placing bets on a certain event is legal if two conditions are met: “(1) betting on the same event is legal in both the place of origin and the destination of the transmission;” and (2) the transmission is limited to information that assists in the placing of bets—that is, it does not include the bets themselves.⁶ However, certain courts have stated that this language means that when the betting activity is legal in both jurisdictions, interstate gambling would not be a violation of the Wire Act.⁷ Most courts disagree with this interpretation of Section 1084(b), and based upon clear statements in the legislative history, DOJ disagrees with this interpretation of Section 1084(b) as well.⁸

Two Types Of Credit Card Organizations Function In The U.S. Market

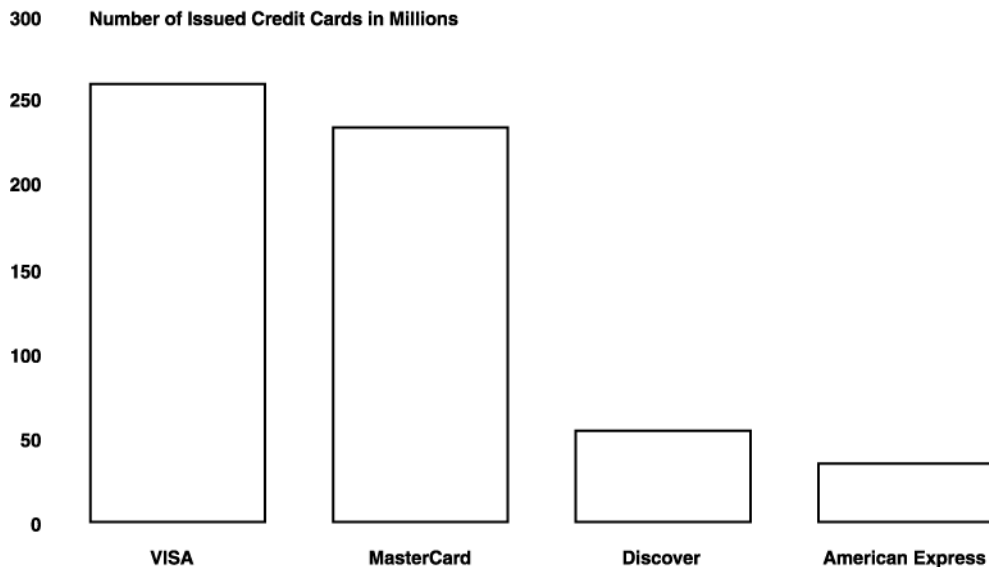
Two types of credit card organizations handle the four major U.S. credit cards: (1) credit card associations such as VISA International (VISA) and MasterCard International Incorporated (MasterCard) and (2) full-service credit card companies such as American Express Company (American Express) and Discover Financial Services, Inc. (Discover). Credit card associations and full-service credit card companies vary dramatically in size, market reach, and organizational structure. As of December 31, 2001, for example, the two major credit card associations had dramatically higher numbers of issued credit cards than the major credit card companies (fig. 1).

⁶ United States v. Cohen, 260 F.3d 68, 73 (2d Cir. 2001). cert. denied, 122 S. Ct. 2587 (2002); Unites States v. Ross, 1999 WL 782749 (S.D.N.Y. 1999).

⁷ United States v. Kaczowski, 114 F. Supp. 2d 143, 153 (W.D. N. Y. 2000); Missouri v. Coeur D’Alene Tribe, 164 F.3d 1102, 1109 n.5 (8th Cir. 1999), cert. denied, 527 U.S. 1039 (1999).

⁸ H.R. Rep. No. 87-967 at 3 (1961).

Figure 1: Total Number of Issued Credit Cards*



*Issued domestically as of December 31, 2001.

Source: *The Nilson Report*, Oxnard, California, Issues 756 (January 2002) and 760 (March 2002).

Credit Card Associations Set Policies, While Members Issue Cards and Acquire Merchants

Each of the two major associations in our review is owned by its member financial institutions. Around 21,500 member financial institutions own VISA, and about two-thirds of them are located in the United States. About 20,000 financial institutions participate in MasterCard worldwide. As described in a prior GAO report, MasterCard has a two-tier membership structure composed of principals and affiliates.⁹ Principal members have a direct membership relationship with the association, while an affiliate's membership must be sponsored by a principal member. For example, a U.S. or foreign bank can apply to become an affiliate member if a principal member agrees to sponsor the bank and the bank satisfies the association's membership criteria and approval process. MasterCard has more than 1,500 principal members that, in turn, have sponsored about 13,500 affiliate members worldwide.

⁹ *Money Laundering: Extent of Money Laundering through Credit Cards Is Unknown* (GAO-02-670, July 22, 2002).

VISA is a private, nonstock, for-profit membership organization composed of competing members. MasterCard, also a membership organization composed of competing members, recently changed its corporate status by creating a stock holding company that substantially owns all the voting power and economic rights in MasterCard. The principal members of MasterCard are also the shareholders of this new stock holding company. Both associations have boards of directors that broadly govern their policies and rules. Member financial institutions elect the VISA International Board, and members are assigned votes based upon their sales volume. Similarly, MasterCard's board is elected by the shareholders of the new stock holding company.

While the associations do not provide credit card services directly to cardholders or businesses, they establish the operating standards that define the policies, roles, and responsibilities of their member institutions and provide the data processing and telecommunications systems that transfer transaction data between members. The member institutions issue the credit cards, sign up merchants to accept credit cards, or both and provide other credit card-related services directly to the cardholders and merchants. Member institutions fall primarily into two categories:

Issuing banks that solicit potential customers, approve applications, and issue credit cards. These banks extend credit to cardholders, establish cardholders' account terms (for example, credit limits and treatment of delinquent accounts), collect the debts, and maintain the accounts and related records on cardholders.

Acquiring banks that solicit potential merchants and approve and license merchants to accept credit cards. These banks, also known as merchant banks, enter into agreements authorizing merchants to accept the association's credit card, submit the card transactions of their merchants into the association's system to obtain payment from issuing banks, and maintain the accounts and related records on their merchant clients.

Full-Service Credit Card Companies Issue Cards and Acquire Merchants

The two full-service credit card companies in our review, American Express and Discover, issue their own brand of cards directly to customers and authorize merchants to accept those cards. Discover, an affiliate of Morgan Stanley and Co., primarily provides credit card services. American Express, a publicly held company, also provides travel, financial, and network services. Both companies are affiliated with a U.S. bank.

American Express and Discover assume primary responsibility for providing credit card services directly to both customers and merchants. They perform all major aspects of issuing cards, including approving applications from customers, mailing cards to customers, authorizing transactions, and sending out bills. They also perform all major aspects of acquiring merchants to accept

their cards, including signing up merchants, distributing credit card terminals, and settling merchant accounts. By acting as both the issuer and the acquirer, the two companies represent what is referred to in the industry as a “closed loop” system. Both companies also own and operate electronic networks for conducting credit card transactions that handle all information on transactions for cardholders and merchants alike.

American Express and Discover market their credit card business to consumers and potential merchants in the United States. Both companies issue cards to individuals, and American Express also issues cards to businesses. In addition, American Express has arrangements in some overseas markets for licensing foreign banks to issue its cards and acquire merchants. As of December 31, 2001, American Express had arrangements with 74 institutions located in 77 countries other than the United States.

Associations and Full-Service Companies Take Different Approaches to Restricting Internet Gambling

Credit card associations and credit card companies have taken different approaches to restricting the use of their cards for Internet gambling. Credit card associations have focused primarily on facilitating the blocking of Internet gambling transactions. Credit card companies have focused primarily on prohibiting Internet gambling sites from becoming credit card merchants.

Credit Card Associations and Their Members Focus on Blocking

Neither VISA nor MasterCard has issued policies to its members that restrict the use of the association’s credit cards for Internet gambling. Instead, both associations have focused on developing procedures to block Internet gambling transactions. Officials from both associations explained that reaching a consensus among the members on a blanket policy throughout the world would likely be difficult. Some members, they noted, are located in countries where Internet gambling is legal and, according to one official, represents an expanding business market. Policy decisions to restrict the use of credit cards for Internet gambling are therefore left up to the discretion of individual member institutions. Association officials note, however, that their members agree with operating regulations for both VISA and MasterCard stipulating that only legal transactions may be introduced into the systems.

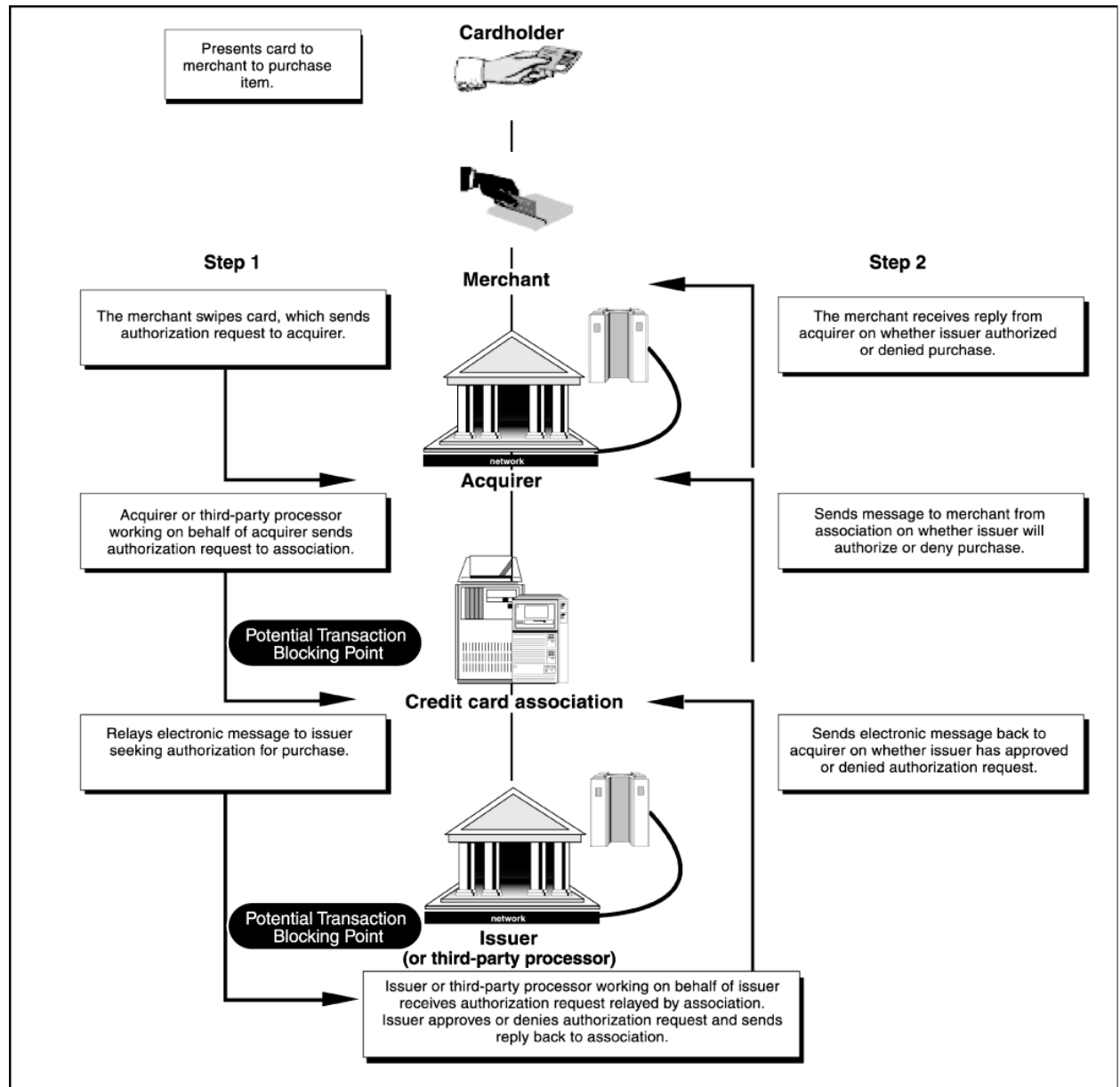
VISA and MasterCard have each developed a system of coding that allows member banks to block Internet gambling transactions. Both associations have had a long-standing uniform coding system designed to facilitate the processing and authorization of credit card payments for member banks. About 4 years ago, each association refined its system to include a cross-indexed scheme of merchant and commerce codes so that Internet gambling transactions could be identified. Internet gambling merchants that accept VISA or MasterCard payments must use a combination of a gaming merchant category code and an

electronic commerce indicator code. These two codes are transmitted through the credit card network to the card issuer as part of the requested authorization message. They inform the card issuer that the transaction is an Internet gambling transaction and enable the issuer to deny authorization for such transactions. This refinement to the coding system enables member institutions to block Internet gambling transactions.

Officials explained that the coding system informs the card issuers that the transaction is an Internet gambling transaction but cannot tell the issuer whether the particular transaction is illegal or not. For example, a U.S. cardholder may visit a country where Internet gambling is legal and while there, use a credit card to pay for on-line gambling transactions. If the credit card issuer has chosen to block Internet gambling transactions and the transaction has been properly coded, authorization for payment will be denied. Although the existing coding system does not capture enough information to distinguish between legal and illegal Internet gambling transactions, an official pointed out that the more fundamental reasons why such distinctions cannot be made are the legal complexities involved in determining which laws govern any particular Internet transaction and the practical limitations of determining where a cardholder may actually be located when engaging in the transaction. As a result, policy decisions to block Internet gambling transactions will likely affect legal Internet gambling transactions along with those that are illegal.

While the issuer is responsible for making the policy decision on whether or not to deny authorization for Internet gambling transactions, the actual blocking of such transactions can occur at different points in the credit card transaction process. The credit card association, the issuer, or a third-party processor can do the actual blocking (fig. 2).

Figure 2: How a Credit Card Transaction Can Be Blocked



Source: VISA and other credit card industry officials.

Information on the number of issuing member banks that have opted to systematically block Internet gambling transactions is not readily available, but association officials noted that many of the largest U.S. credit card issuers have chosen to follow this course of action. Initial contacts with the eight issuing banks we reviewed, which represent more than 80 percent of the purchase volume of cards issued by VISA and MasterCard, indicated that all eight had implemented policies to deny payment authorization for Internet gambling transactions. Officials of a key trade association for community banks and the processor of its members' credit card transactions stated that most, if not all, of

the small community bank issuers have also chosen to block Internet gambling transactions. Issuing banks explained that they are blocking Internet gambling transactions primarily because of on-line gambling's unclear legal status and the financial impact (for example, potential legal costs and charge-offs¹⁰) that can result from customers refusing to pay their gambling charges.

Bank issuers' efforts to block Internet gambling transactions have, according to research conducted by a leading management and market research firm, affected the projected growth of the Internet gaming industry. What was initially projected to be a \$6 billion industry worldwide in 2003 is now expected to be about a \$4.1 billion industry. In the meantime, some Internet casino operators now estimate that four out of every five requests for credit card payment are being denied.

The Associations' Transaction Coding Systems Can Be Compromised

Association officials stated that the effectiveness of efforts issuing banks make to block transactions involving Internet gambling is dependent upon the integrity of the associations' coding systems as implemented by merchants and acquiring members throughout the world. We were told, however, that the coding systems can be compromised in two ways: (1) by Internet gambling merchants that attempt to disguise their transactions by miscoding them, and (2) by cardholders who attempt to circumvent the system by using on-line payment providers.¹¹

Merchants May Disguise Transaction Codes

According to an association official, Internet gambling merchants, knowing that properly coding the transactions could result in a denial of authorization, have a strong incentive to try to disguise their transactions. Issuing bank officials emphasized the difficulty of identifying attempts to conceal Internet gambling transactions, regardless of any proactive efforts to find such instances of miscoding. One official noted that some disguised Internet gambling transactions can be identified only by chance, if at all. We were told that both associations monitor transactions for fraud, looking for and investigating significant changes in merchant account activity and other patterns of suspicious activity. These monitoring efforts, which may identify miscoded transactions from Internet gambling merchants, are designed to detect many different types of fraudulent schemes. Association officials also noted that consumer complaints and concerns raised by issuers have been helpful in identifying coding errors related to Internet gambling.

¹⁰ Charge-offs represent the losses incurred by issuing banks when outstanding credit card debts are not paid.

¹¹ On-line payment providers, such as PayPal, Inc. or SureFire send and receive funds electronically for such uses as on-line auctions and purchases—and possibly Internet gambling. On-line payment providers are also referred to as payment aggregators by members of the credit card industry.

In November 2001, one of the credit card associations implemented an Internet gambling audit program to help minimize the extent of coding errors related to Internet gambling. Rather than monitoring actual transactions, the program focuses on monitoring Internet gambling Web sites to identify merchants that may be disguising their credit card transactions. The association's staff sample Internet gambling Web sites and test the reliability of their coding efforts by submitting "dummy" transactions. When an Internet gambling merchant is cited for using incorrect codes, the responsible acquiring bank can be fined \$25,000 per merchant outlet. To date, the association has imposed more than \$100,000 in penalties on six acquiring banks for improper coding by merchants.

Using On-line Payment Providers Can Obscure Transaction Codes

Issuing banks also view as problematic cardholders' use of on-line payment providers to pay for their Internet gambling activities. These entities enable consumers to use their credit cards to set up accounts with many kinds of Internet-based merchants, including on-line casinos. Because credit card transaction codes can be obscured as the transactions pass through such intermediaries, issuing banks cannot determine whether credit card funds are being used for Internet gambling. Rather than developing an audit program to address Internet gambling issues, one association has chosen to focus attention on dealing proactively with these on-line payment providers, which it views as a potential loophole in the system. An official explained that the association has a policy of not doing business with on-line payment providers without an understanding with the provider's acquirer that any funds obtained by the provider through the association's systems will not be used for Internet gambling unless the transaction is properly coded. The official cited an example in which such an understanding could not be reached and the provider stopped accepting cards bearing the association's brand rather than comply with the coding requirements.

Officials of the other association noted that it is the on-line payment providers' responsibility to ensure that credit cards are not used to pay for Internet gambling activities, unless the funds transfer is explicitly coded as an Internet gambling transaction at the time of the authorization. This coding enables issuers that have decided to block Internet gambling transactions to deny authorization for those made through an on-line payment provider. Officials were aware that at least one major on-line payment provider was regularly using the Internet gambling transaction codes when they were warranted.

Full-Service Companies Focus on Keeping Internet Gambling Sites from Becoming Merchants

American Express and Discover have companywide policies that restrict the use of credit cards for Internet gambling, but officials stated that the restrictions apply to all gambling activities because the companies do not, as a matter of policy, want to do business with such high-risk industries. To address Internet gambling,

both credit card companies have developed specific procedures to help ensure that Internet gambling sites do not become credit card merchants. First, Internet businesses applying to become merchants are screened, generally through routine visits and reviews of the applicants' Web sites, to verify that they accurately represent the business they are in and that they are not engaged in any gambling activities. Second, the companies seek to ensure that existing Internet credit card merchants do not discreetly transform into Internet gambling sites—something that, according to officials, has been known to happen. To this end, one of the credit card companies told us it has contracted with a third-party vendor to assist with the implementation of an Internet monitoring system to identify improper use of its card on the Internet. This initiative entails identifying and testing Internet gambling sites that attempt to secure payments using the company's credit card, including existing merchants that may have expanded into Internet gambling activities. Company officials noted that the vendor has also identified several Internet gambling sites that were illegally using the company's logo to provide legitimacy to their Web sites. We were told that the other company uses its own employees, rather than an outside vendor, to conduct similar reviews of Internet gambling sites in general and of the company's existing Internet merchants in particular.

In spite of these efforts, company officials recognize that some Internet gambling sites that attempt to secure credit card payments may still go unidentified. Thus, as part of their overall efforts to monitor fraud, both companies have also implemented procedures to monitor transactions for patterns that might indicate Internet gambling activity. However, like issuing bank officials, credit card company officials acknowledged that identifying Internet gambling transactions after the fact is difficult. They also agreed that on-line payment providers represent a challenge to credit card companies that are trying to restrict the use of their cards for Internet gambling. Officials for both companies stated that they have reached an agreement with one major on-line provider stipulating that the provider will block Internet transactions using technology the companies provide and are working on similar agreements with other on-line payment providers. According to recent news articles, the on-line payment provider that agreed to block Internet gambling transactions has been purchased by an entity that is now requiring it to stop facilitating Internet gambling transactions altogether.

Views Differ on the Vulnerability of Internet Gambling to Money Laundering

Representatives of law enforcement agencies, regulatory bodies, and the credit card and gaming industries expressed mixed views regarding the vulnerability of Internet gambling to money laundering. Law enforcement officials believe that Internet gambling can be a significant vehicle for laundering criminal proceeds, specifically at the relatively obscure "layering" stage of money laundering.¹² The

¹² Money laundering can occur in three stages—the placement, layering, and integration stages. In the placement stage, funds generated from illicit activity are converted to monetary instruments or

officials cited several characteristics of Internet gambling that they believe make it vulnerable to money laundering, including the volume, speed, and international reach of Internet transactions and the offshore locations of Internet gambling sites. In their view, these characteristics can promote a high level of anonymity and give rise to difficult jurisdictional issues.

Law enforcement officials acknowledge the lack of adjudicated cases, but continue to believe that there are many potential ways of laundering money through Internet gambling sites. The Financial Action Task Force, an international body aimed at combating money laundering,¹³ expressed concerns similar to those of U.S. law enforcement agencies and identified Internet gambling as an area requiring greater regulatory scrutiny on an international as well as national level. Although specifics were not provided, a February 2001 task force report stated that some member jurisdictions had evidence that criminals were using Internet gambling to launder their illicit funds.¹⁴

Banking and gaming regulatory officials did not view Internet gambling as being particularly susceptible to money laundering, especially when credit cards, which create a transaction record and are subject to relatively low transaction limits, are used for payment. Likewise, credit card and gaming industry officials did not believe Internet gambling posed any particular risks in terms of money laundering. As noted earlier, the credit card industry has other reasons for restricting the use of credit cards in Internet gambling transactions. In general, gaming industry officials did not believe that Internet gambling was any more or less susceptible to money laundering than other electronic commerce businesses and noted that the financial industry—which is responsible for the payments system—is better poised to monitor for related suspicious activity in the area. A few officials did acknowledge that on-line casinos were basically an extension of brick-and-mortar casinos and should probably be subject to similar anti-money laundering requirements.

Industry gaming officials also cautioned that Internet gambling could become more susceptible to money laundering as U.S. financial institutions continue to block the payment of Internet gambling activities through credit cards. They explained that credit cards would likely be replaced by the promotion and use of newer forms of electronic payments that may not be subject to the same level of

deposited into financial institutions. In the layering stage, the funds are moved to other institutions and accounts through various activities to obscure their origins. Finally, in the integration stage the funds are used to acquire legitimate assets or fund further activities.

¹³ The Financial Action Task Force is considered the largest and most influential intergovernmental body seeking to combat money laundering. Established in 1989, the task force has 31 members, including the United States. Its activities include monitoring members' progress in implementing anti-money laundering measures, identifying current trends and techniques in money laundering, and promoting the adoption of the organization's standards.

¹⁴ *FATF—XII: Report on Money Laundering Typologies (2000-2001)*, February 2001.

record-keeping or transaction limits as credit cards are thus more susceptible to money laundering. In addition, officials pointed out the likelihood that some emerging electronic gambling schemes that make identifying gamblers and enforcing regulations more difficult would become more popular. Such schemes could include, for example, player-to-player wagering that allows individuals to place bets directly with other bettors without the involvement of a bookmaker or operator. According to gaming officials, the absence of the bookmaker or operator who normally assigns the odds or monitors the betting action increases the potential for illegal activity, including money laundering, to occur.

We will issue our final report in November 2002. We obtained technical comments on the legal and money laundering sections of a draft of this letter from DOJ. Treasury reviewed the money laundering sections and had no technical comments. We are sending copies of this letter to the Chairman and Ranking Minority Member of the Senate Committee on Banking, Housing, and Urban Affairs and to the Ranking Minority Members of the House Subcommittee on Financial Institutions and the House Subcommittee on Oversight and Investigation, Committee on Financial Services. The letter will be available on GAO's Internet home page at <http://www.gao.gov>.

Please contact Barbara Keller, Assistant Director, or me at (202) 512-8678 if you or your staff have any questions concerning this work. Key contributors to this work include Evelyn Aquino, Emily Chalmers, Jason Holsclaw, Elizabeth Olivarez, Sindy Udell, and Darleen Wall.

Sincerely yours,

A handwritten signature in black ink, reading "William O. Jenkins, Jr." in a cursive script.

William O. Jenkins, Jr.
Director, Financial Markets and
Community Investment

Gambling Laws in Five States and Their Effect on Internet Gambling

This enclosure discusses the details of the gambling laws in the five states—Massachusetts, Nevada, New Jersey, New York, and Utah—that we judgmentally selected to reflect the wide variations in state gambling laws.

Massachusetts: Illegal to Transmit Any Bet over the Telephone

Massachusetts does not have a statute specifically making it illegal to bet over the Internet, and there have been no court cases in Massachusetts that the Massachusetts Attorney General's office is aware of that have applied the state's gambling laws to Internet gaming. Massachusetts law makes it illegal to transmit any bet or wager over the telephone.¹⁵ Massachusetts also prohibits the establishment of unauthorized lotteries, numbers games, and other games of chance in the state.¹⁶ Under this statute, chance must predominate over skill in the results of the game in order for gambling to have occurred.¹⁷ Further, it is criminally punishable to be found in Massachusetts with any apparatus, books, or device for registering bets.¹⁸ Finally, Massachusetts outlaws gaming in a public place¹⁹ and running a gaming house.²⁰ Massachusetts does allow some forms of gambling to be run by the State Lottery, a division of the Massachusetts Department of the Treasury.²¹ The State Lottery is responsible for regulating statewide lotteries,²² scratch tickets,²³ pull-tabs,²⁴ beano,²⁵ raffles by certain organizations,²⁶ and keno.²⁷ The State Lottery requires every licensee of lottery games to post a notice about compulsive gambling.²⁸ Massachusetts also has legalized dog and horse racing under the supervision of the state racing commission.²⁹

Nevada: Among the First States to Make Internet Gambling Illegal

In 1997, Nevada became one of the first states to make Internet gambling illegal.³⁰ The Nevada statute provides that operators of on-line gambling sites who accept wagers from gamblers located in Nevada are guilty of a misdemeanor.³¹ However,

¹⁵ Mass. Ann. Laws. ch. 271, §17A (2002).

¹⁶ Mass. Ann. Laws. ch. 271, § 7 (2002).

¹⁷ United States v. Marder, 48 F. 3d 564, (1st Cir. 1995), cert. denied, 514 U.S. 1056 (1995).

¹⁸ Mass. Ann. Laws. Ch. 271, § 17 (2002).

¹⁹ Mass. Ann. Laws. ch. 271, § 2 (2002).

²⁰ Mass. Ann. Laws. ch. 271, § 5 (2002).

²¹ Mass. Ann. Laws. ch. 10, § 22-58 (2002) ("state lottery law").

²² Id.

²³ Id.

²⁴ Id.

²⁵ Mass. Ann. Laws. ch. 10, § 37 (2002).

²⁶ Mass. Ann. Laws. ch. 271, § 7A (2002).

²⁷ Mass. Ann. Laws. ch. 10, § 27A (2002).

²⁸ Mass. Ann. Laws. ch. 10, § 38A (2002)

²⁹ Mass. Ann. Laws ch. 6, § 48 (2002).

³⁰ Nev. Rev. Stat. Ann. 465.091-465.094 (1997).

³¹ Id.

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the statute creates an exception if the bet is transmitted to a licensed person or establishment in Nevada and the wager “complies with all other applicable laws and regulations concerning wagering.”³²

In June 2001, Nevada enacted legislation allowing the Nevada Gaming Commission to adopt regulations governing the licensing and operation of Internet gambling.³³ The statute allows the Gaming Commission to adopt rules regulating Internet gambling only when the commission determines:

- that interactive gaming can be operated in compliance with all applicable laws;
- that interactive gaming systems are secure and reliable;
- that the systems provide reasonable assurance that players will be of lawful age and communicating only from jurisdictions where it is lawful to make such communications; and
- that such regulations are consistent with the public policy of the state to foster the stability and success of gaming.

Nevada sought the DOJ’s guidance on federal laws that may be applicable to interactive gaming. In response, DOJ provided Nevada with a letter advising that federal law prohibits gambling over the Internet, including casino-style gaming. In addition, DOJ indicated that interactive gambling activities occur in both the jurisdiction where the bettor is located and the state or foreign country where the gambling business is located.

Nevada has declared that the state’s public policy is that “the gaming industry is vitally important to the economy of the state and the general welfare of the inhabitants.”³⁴ However, all gaming establishments must be licensed to protect the “public health, safety, morals, good order and general welfare of inhabitants of the state.”³⁵ It is illegal for any person to operate any gambling game or gaming device without being licensed.³⁶ Any game played for money or property triggers the licensing requirement. There is an exemption for social gambling as long as no money is made in operating the game.

New Jersey: Internet Gambling Not Approved by Required Public Referendum

In New Jersey, only gambling that has been authorized by public referendum is legal, and Internet gambling has not been authorized by public referendum. The New Jersey constitution prohibits the legislature from authorizing gambling unless the specific type of gambling, any restrictions on it, and control of it have been approved by public referendum.³⁷ In addition, New Jersey’s criminal code

³² Nev. Rev. Stat. Ann. 465.094.

³³ Nev. Rev. Stat. 463.750.

³⁴ Nev. Rev. Stat. Ann. § 463.0129 (2002).

³⁵ *Id.* at 1(d).

³⁶ Nev. Rev. Stat. Ann. § 463.160 (2002).

³⁷ N.J. Const., Art. 4, Sec. VII, Para. 2. (“No gambling of any kind shall be authorized by the Legislature unless the specific kind, restrictions and control thereof have been heretofore

prohibits the promoting of unauthorized gambling,³⁸ and its civil code bans any form of unauthorized gambling as well.³⁹ As an unauthorized form of gambling, Internet gambling is prohibited under New Jersey law. However, the New Jersey legislature has introduced legislation that would allow the Atlantic City casinos to operate Internet casinos from their own floors so that bettors could wager on line on real-time games being conducted at the casinos.⁴⁰ However, an official from the New Jersey Attorney General's office informed us that this legislation never progressed last term and has not been reintroduced. On March 18, 2002, a joint resolution was proposed in the New Jersey Assembly for the formation of an Internet Gaming Study Commission, which would consist of legislators, executive branch officials, and members of the public with expertise or interest in gaming in the state. The commission would conduct a comprehensive study of the social and economic impact of legalizing Internet gambling in New Jersey. An official from the New Jersey Attorney General's office has informed us that this resolution has not yet passed.

In June 2001, New Jersey's Attorney General filed three separate civil cases against entities operating Internet gambling web sites that accept wagers for casino-style games, horse races, and sports games from individuals located in New Jersey. These cases are still pending. However, we understand that settlement discussions are under way. In addition, in June 2002 New Jersey's Attorney General settled two of seven civil lawsuits that it filed on October 16, 2001, which sought to enjoin companies engaged in Internet gaming activities from accepting wagers on various professional and collegiate sporting events from individuals or entities located in New Jersey. In *State v. www.intercasino.com*, New Jersey entered into a settlement agreement with defendants who agreed that any licensing or related agreements these companies may enter into in the future will contain a provision prohibiting licensees from accepting sports bets from persons located within New Jersey. In another action also filed on October 16, 2001, *State v. www.intertops.com et al.*, defendants agreed to implement and maintain good faith measures designed to prevent individuals operating computers in New Jersey from placing wagers on its site.

In New Jersey, land-based casino gaming was legalized for gambling in Atlantic City in 1976 through voter referendum. The New Jersey Legislature established the Casino Control Act, which provides for the regulation of the casino industry.⁴¹ The responsibility for regulation rests with the Division of Gaming Enforcement and the Casino Control Commission. New Jersey has licensed racing under the New Jersey Department of Law and Public Safety. Bingo and raffles are legalized

submitted to, and authorized by a majority of the votes cast by, the people at a special election or shall hereafter be submitted to, and authorized by a majority of the votes cast thereon by, the legally qualified voters of the State voting at a general election, except that, without any such submission or authorization.”).

³⁸ N.J. Code § 2C:37-2.

³⁹ N.J. Code § 2A:40-1.

⁴⁰ 2002 New Jersey Assembly Bill No. 568.

⁴¹ N.J. Stat. § 5:12-1 et. seq. (2001).

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for certain groups,⁴² as are amusement games.⁴³ New Jersey allows a lottery run by the state.⁴⁴ In addition, New Jersey has a Council on Compulsive Gambling to address compulsive gambling issues that arise out of the gambling that takes place in the state.⁴⁵

New York: State Courts Have Found Internet Gambling Illegal

Unauthorized betting and gambling are illegal in New York. With certain exceptions, New York has expressly prohibited betting in both its constitution⁴⁶ and its General Obligations Law.⁴⁷ In addition, New York's General Obligation Law renders "void" all contracts based on those bets and New York's Penal Law prohibits the promotion of gambling.⁴⁸ The New York Supreme Court has interpreted the state's prohibition against unauthorized gambling and its promotion as extending to Internet gambling. In People v. World Interactive Gaming Corp., 714 N.Y.S. 2d 844 (N.Y. Sup. Ct.1999), the court held that the New York Attorney General could enjoin an on-line gambling casino from offering gambling to residents of New York State over the Internet. In addition, New York's Attorney General recently initiated two separate inquiries into certain business practices of Citibank (South Dakota), N.A. and PayPal, Inc. regarding their facilitation of on-line gambling by New York citizens. These inquiries resulted in a settlement in which, among other things, PayPal agreed to stop processing any payments involving PayPal's New York members for on-line gambling merchants. Citibank agreed to block and decline authorization for bank card transactions that were coded and submitted to Citibank as on-line gambling transactions. Officials from the Attorney General's office told us that the potential claims against Citibank and PayPal involved the provision of New York's General Obligation Law that renders contracts based on illegal gambling void. Another legal theory was based on New York's criminal facilitation law, which makes it illegal to promote gambling.⁴⁹

New York has authorized certain types of gambling. New York has legalized certain lotteries operated by the state and certain types of pari-mutuel betting on horse races, as well as bingo, lotto games, and local games of chance authorized by vote of the electors in the jurisdiction where the activity is conducted. In addition, only bona fide religious, charitable, and nonprofit organizations may operate these games, and the net proceeds from the gambling must be exclusively

⁴² N.J. Stat. § 5: 8-1 - 8-77 (2001).

⁴³ N.J. Stat. § 5: 8-78 - 8-118 (2001).

⁴⁴ N.J. Stat. § 5: 9-1et. seq. (2001).

⁴⁵ N.J. Stat. § 5: 5-159 (2001).

⁴⁶ N.Y. Const. art. I, § 9.

⁴⁷ N.Y. Gen. Oblig. L. § 5-401 ("All wagers, bets or stakes, made to depend on any race, or upon any gaming by lot or chance, or upon any lot, chance, casualty, or unknown or contingent event whatever, shall be unlawful.").

⁴⁸ N.Y. Penal Law § 225 et seq.

⁴⁹ NY Penal Code §§ 225.05 & 225.10.

for the charitable organization.⁵⁰ New York also allows licensed pari-mutuel corporations to maintain telephone betting accounts for wagers placed on races offered by such corporations from both in-state and out-of-state residents.⁵¹ New York has created the New York State Racing and Wagering Board to regulate its legalized gambling activities⁵² and has executed certain tribal-state compacts under the Indian Gaming Regulatory Act of 1988.⁵³

Utah: All Forms of Gambling Are Illegal

Internet gambling is prohibited in Utah, along with all other forms of gambling.⁵⁴ Utah's Assistant Attorney General has stated that using the Internet to gamble in Utah is illegal.⁵⁵ Utah's constitution provides that the Utah legislature "shall not authorize any game of chance, lottery or gift enterprise for any pretense or purpose."⁵⁶ Gambling is defined to include "risking anything of value for a return or risking anything of value upon the outcome of a contest, game, gaming scheme, or gaming device when the return or outcome is based upon an element of chance and is in accord with an agreement or understanding that someone will receive something of value in the event of a certain outcome, and gambling includes a lottery."⁵⁷ The promotion of gambling and possession of gambling devices are also illegal.⁵⁸ Utah does not have a state lottery.

⁵⁰ N.Y. Const. art. I, § 9.; McKinney's Exec. Law §§ 430-439-a (bingo) and McKinney's Gen. Mun. Law § 185 et seq. (local games of chance).

⁵¹ McKinney's Rac., Pari-Mut. Wag. & Breed.Law § 1012.

⁵² McKinney's Rac., Pari-Mut. Wag. & Breed.Law § 101.

⁵³ McKinney's Exec. Law § 12.

⁵⁴ Utah Code Ann. § 76-10-1102 (2001).

⁵⁵ Steven Oberbeck, "Gambling in Utah: Are Cybercasinos on a Roll?" Salt Lake Tribune (May 24, 1998).

⁵⁶ UT Const. Art. VI, § 27 (2001).

⁵⁷ Utah Code Ann. § 76-10-1101 (1) (2001).

⁵⁸ Utah Code Ann. § 76-10-1104 & 1105 (2001).

Other Federal Gambling Laws Applicable to Internet Gambling Activity

Three federal statutes appear to have direct applicability to online gambling: the Wire Act, the Travel Act, and the Illegal Gambling Business Act. In addition, the Indian Gaming Regulatory Act (IGRA) establishes the regulatory framework for gambling on Native American reservations. To date, only the Wire Act has been used in the federal prosecution of Internet gambling activity. The other federal gambling statutes have been used in the closely analogous situation of telephone wagering, including telephone calls to place wagers with offshore bookmakers. This enclosure discusses the applicability of the two remaining federal gambling statutes to Internet gambling.

In addition, this enclosure describes the IGRA, which recognizes the gaming rights of Native Americans. Certain types of gaming on Indian reservations are permitted under IGRA, and tribes have exclusive authority to regulate them. But tribes must negotiate an agreement with the state or states where the reservation is located in order to conduct casino-style gambling. One court has examined the issue of whether Internet gambling involving a server located on an Indian reservation would be considered gambling on the reservation. If so, the prosecution of such gaming by the state would be preempted by IGRA.

Gambling over the Internet May Violate the Travel Act

The Travel Act provides criminal penalties for anyone who undertakes interstate or foreign commerce with the intent to distribute the proceeds of any unlawful activity.⁵⁹ Under the Travel Act, unlawful activity includes any business enterprise involving gambling in violation of the laws of the state in which the gambling takes place or of the United States. Thus, gambling over the Internet violates the Travel Act because an interstate facility, the Internet, is used to conduct gambling. For instance, in People v. World Interactive Gaming Corp., 714 N.Y. S. 2d 844 (N.Y. Sup. Ct. 1999), the court stated that gambling conducted over the Internet with bets placed in New York, where gambling is illegal, and received in Antigua, where gambling is legal, violates the Travel Act. In this case, the New York Attorney General brought an action to enjoin an Antiguan company from offering gambling in New York over the Internet.

Similarly, in United States v. Kaczowski, 114 F. Supp. 2d 143, 153 (W.D. N.Y. 2000) the court found that defendants' bookmaking in New York violated the Travel Act when they transmitted wagers made in the state by telephone to the West Indies. Additionally, in United States v. Smith, 209 F. Supp. 907, 916 (E.D. Ill. 1962) the court held that the Travel Act can be used to prosecute interstate gambling conducted over the telephone wires because the wires transmit the data (the voices of the gamblers) in the same manner that physical goods are moved across the ground. The court found that the telephonic "voice packets" of gambling information violated the Travel Act.

⁵⁹ 18 U.S.C. § 1952 (1994).

The Illegal Gambling Business Act Makes It a Crime to Operate an “Illegal Gambling Business”

The Illegal Gambling Business Act⁶⁰ makes it a crime to operate an “illegal gambling business,” which is defined as any gambling business that meets three conditions:

it is in “violation of the law of a State . . . in which it is conducted,”
it involves at least five people (not even the same five people) at all times during a 30-day period, and
it “has been or remains in substantially continuous operation for a period in excess of thirty days or has a gross revenue of \$2,000 in any single day.”

Operating a gambling Web site for over 30 days in a state under such conditions would violate this act. A Web site could meet these conditions, including the requirement that at least five individuals be involved in its operation. These five people do not need to be directly involved in the gambling but must only be considered “necessary and helpful” to the operation. Computer operators, computer maintenance crews, accountants, and owners could all be included as “necessary and helpful” in the operation of an Internet gambling Web site.

Like the Wire Act, the Illegal Gambling Business Act applies only to gambling businesses, not individual gamblers. The Illegal Gambling Business Act does not require that the casino operators be convicted in state court,⁶¹ but the gambling activity must violate state law. The proof requirements associated with the Illegal Gambling Business Act are minimal. The government must prove only that the business met the three conditions.⁶² The 30-day requirement will be satisfied if there is a “repeated pattern of gambling activity.”⁶³

The Indian Gaming Regulatory Act’s Application to Internet Gambling Is Unclear

Certain types of gaming on Indian reservations are permitted under the Indian Gaming Regulatory Act,⁶⁴ with the type of gambling determining the regulatory jurisdiction. Tribes have exclusive authority to regulate social games and traditional tribal gambling. With federal oversight, tribes also have authority to regulate bingo and nonbanking card games. However, tribes wishing to conduct casino-style gambling must successfully negotiate an agreement with the state or states where the gambling will be conducted. The resulting “Tribal-State Compact” will govern the specifics of the tribal casino.

⁶⁰ 18 U.S.C. § 1955 (1994).

⁶¹ United States v. Murray, 928 F.2d 1242, 1245 (1st Cir. 1991).

⁶² United States v. DiMuro, 540 F.2d 503, 508 (1st Cir. 1976), cert. denied, 429 U.S. 1038 (1977).

⁶³ United States v. Nerone, 563 F.2d 836, 843 (7th Cir. 1977); United States v. Allen, 588 F.2d 1100, 1104 (5th Cir. 1979), cert. denied, 441 U.S. 964 (1979).

⁶⁴ Pub. L. 100-497, 102 Stat. 2467 (1988) (Found at 27 U.S.C. § 2701, et. seq.).

Issues regarding state and federal authority over gambling on Indian reservations were addressed in a 1987 Supreme Court decision.⁶⁵ In California v. Cabazon Band of Mission Indians, the Supreme Court upheld the right of tribes as sovereign nations to conduct gaming on Indian lands. The Court limited the rights of states to regulate gaming on Indian lands if gaming is permitted for any other purpose. As a result of this Supreme Court ruling, Congress in 1988 passed IGRA, which recognizes Native American gaming rights and provides for a statutory scheme of state regulation of gaming on Indian lands.⁶⁶

IGRA divides gaming into three classes. Class I gaming, which is regulated exclusively by the tribes, includes traditional forms of Indian gaming played in connection with tribal ceremonies.⁶⁷ Betting on horse racing at a tribe's annual powwow qualifies as traditional gaming. Class II gaming includes bingo, pull-tabs, and nonbanking card games authorized or not explicitly prohibited by state law. States have no role in the regulation of Class II gaming occurring on Indian lands. Class III gaming includes all forms of gaming that are not Class I or Class II. This category includes casino games, slot machines, and pari-mutuel wagering. Class III gaming may be conducted by an Indian tribe only if the state in which the tribe is located permits such gambling for any purpose by any person, organization, or entity; if the tribe and the state have negotiated a tribal-state compact that has been approved by the Secretary of the Interior and the compact permits such gambling; and the governing body of the tribe has adopted a gaming ordinance that has been approved by the National Indian Gaming Commission.

A recent case addressed some of the issues concerning Internet Gambling and raised the question of whether Internet gambling takes place on tribal lands when bettors use their home computers to access Internet lotteries via computer servers. State of Missouri v. Coeur D'Alene⁶⁸ involved the question of whether the state of Missouri could prevent a Native American tribe in Idaho from accepting money from Missouri residents via a lottery Internet site. The tribe removed the case from Missouri state to federal court, where the complaint was dismissed because the cause of action was preempted by IGRA. When the case reached district court, the state asked to have it moved back to state court, alleging that the activities of the U.S. Lottery in Missouri were not on Indian lands and that the district court did not have jurisdiction because state, not federal, law determined the legality of the activity. The district court denied the request and dismissed the case on the grounds of the tribe's sovereign immunity. The Eighth Circuit Court of Appeals reversed the district court's denial of the motion, asserting that the district court was first required to determine whether the gaming at issue occurred on Indian lands, in which case the denial was appropriate, or off Indian

⁶⁵ California v. Cabazon Band of Mission Indians, 480 U.S. 202 (1987).

⁶⁶ Gary C. Anders, Indian Gaming: Financial and Regulatory Issues, 556 *Annals Am. Acad. Pol. & Soc. Sci.* 98, 99 (1998) (citation omitted).

⁶⁷ 25 U.S.C. §§ 2703 (6), 2710.

⁶⁸ 164 F. 3d 1102 (8th Cir), cert. denied, 527 U.S. 1039 (1999).

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lands, in which case the denial was not appropriate. Once at district court, the state again moved to return the case to state court. On September 21, 1999, the district court granted the state's motion. It is unclear whether the issue of where the gambling occurred was resolved. However, the issue of where Internet gambling takes place has been addressed in United States v. Cohen, 260 F.3d 68 92d Cir. (2001), which held that the transmission of bets and wagers from New York to a foreign country where such betting was legal violated both the laws of the United States and of the state of New York, where the bettor was located.

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