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AN INTRODUCTION TO THE HISTORY AND REGULATION OF ONLINE GAMING

by

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INTRODUCTION

Online gaming (or gambling) is popular worldwide. With the increase in smart phone ownership and general internet access over the last decade, many individuals now have a constant access point to online casinos located around the globe. Online gaming was illegal in the United States until 2011, when states were granted the ability to regulate it after an opinion on the Wire Act of 1961 was issued by the U.S. Department of Justice (DoJ). To date, however, only Delaware, Nevada, New Jersey, and the U.S. Virgin Islands have started regulating online gaming in some capacity. Outside of those jurisdictions, policymakers are faced with the following dilemma: Online gaming is undeniably popular, with numerous websites offering consumers gambling opportunities, but because it is illegal in the United States except in the jurisdictions that are regulating it, consumers may play only on websites that are based overseas in jurisdictions that might not regulate online gambling sites adequately, if at all. In other words, there is an apparent gap between policy and reality, as policy has created an environment in which online gaming is illegal in most United States jurisdictions when, in reality, a large player base continues to play illegally. Advocates of online gaming legalization and regulation assert that it is necessary to protect consumers from unregulated websites, and that doing so could generate tax revenue and create jobs. Opponents, however, claim that regulation would be difficult, and that proliferation of online gaming would create more social ills. While these are not the only arguments, they form the primary ones surrounding legalization and regulation of online gaming.

This issue paper provides background information on online gaming and gambling from international, national, and Michigan-specific perspectives; discusses the history of Federal policy regarding online gaming, including the evolution of that policy and the softening of policymaker and casino operator stances concerning online gaming; addresses the major arguments for and against legalization and regulation; and reports on the status of online gaming in the three states that currently regulate it in some capacity. While a major academic article could be written about many of the individual topics covered in this issue paper, the paper attempts to consolidate some of the research, arguments, and information about online gaming legalization and regulation prepared over the last two decades, so readers may have a broad understanding of the topic.

HISTORY OF INTERNET GAMING

Online Gaming Worldwide

Online gaming has become exponentially popular with the explosion of internet access over the last two decades. However, data detailing how much individuals play and spend on online gaming are not readily available or accessible. Reportedly, online gaming was a $32.0 billion industry in 2014,[1] while in 2011, it had been estimated that online gaming generated almost $30.0 billion annually.[2] Some have speculated on the causes of this growth. For example, it has been suggested that online poker, a game that draws many online players, and betting exchanges have grown for three reasons: They provide financial value for the gambler, without a casino house edge or bookmakers' mark-up on odds; gamblers may win because the games require some element of skill when bets are placed; and gamblers may compete directly with other gamblers instead of a preprogrammed machine with fixed odds.[3]

The online casinos that individuals have been using are almost entirely located outside the United States. The first recorded online casino to accept a wager was based in Antigua in 1996. Subsequently, the industry grew quickly: There were 15 online casino sites by the end of 1996, 650 at the end of 1999, and 1,800 different sites by the end of 2002.[4] As of June 30, 2010, one survey found 2,679 internet gaming sites owned by 665 companies.[5]

Approximately 85 nations had elected to legalize online gaming as of 2011.[6] One author divided those countries into three groups with similar qualities or policy characteristics.[7] The first group consists of small jurisdictions in the Western Hemisphere, which offer low-cost licensing to operators with low tax rates and little or no regulatory scrutiny; they view online gambling strictly as a means of economic development. The second group consists of small jurisdictions in Europe that also regulate online gaming for economic development but have more regulations compared to the first group. The final group consists of larger, developed countries (such as the United Kingdom). Those that fall into the third category face the challenge of their markets being invaded by websites originating from the jurisdictions of the first two groups.[8]

Gambling In the United States

Gambling is a big business in the United States and generates sizeable amounts of tax revenue for governments. In 2011, casinos in the United States earned $35.6 billion and returned $7.9 billion in gambling taxes to states and local units of government, a 4.5% increase from 2010.[9] In 2012, Americans (meaning those in the U.S.) spent $37.3 billion on casino gambling, of which $8.6 billion was returned to states and locals.[10] Every state except Utah and Hawaii (the two states where gambling remains illegal) had some form of legal gambling by 1994.[11]

While there are no definitive statistics regarding American involvement in the online gambling industry, there are sources that have provided estimates. One source estimated that between 2000 and 2010, 10.0 million Americans visited websites to place wagers on sporting events, poker games, or other electronic casino-style games. The same source claimed that, from 2003 to 2010, Americans spent about $30.0 billion gambling online.[12] According to a 2004 estimate, the online gaming industry generated between $7.0 billion and $10.0 billion in revenue, with American bettors providing at least half of that amount.[13] In 2005, it was estimated that Americans bet more than $4.0 billion online on casino games, sporting events, and poker.[14] Another source estimated that Americans spent $2.6 billion on illegal offshore gaming websites in 2012.[15] Furthermore, it was estimated that Americans made up nearly 10% of the global online gaming marketplace in 2013, when it was illegal in all but three states.[16]

At a minimum, there has been enough American interest in online gaming to support a market for it. However, this interest might not reflect attitudes on online gaming as a whole, as one survey conducted by Fairleigh Dickinson University in 2010 showed that 67% of Americans opposed internet gaming.[17] Nevertheless, Americans generally have a positive attitude about gambling in an actual casino. According to a survey from 2004, 83% of Americans perceived casino gaming as an acceptable form of entertainment; 90% believed that gambling was a question of personal freedom; and 75% thought that casinos could "be an important part of a community's entertainment and tourism".[18] With statistics showing that Americans have some interest in online gambling, in addition to a broader acceptance of gambling in general, proponents have argued that online gaming could grow exponentially if it were legalized and regulated across the country.

Gambling in Michigan

Like other jurisdictions, Michigan has found gambling to be an important source of local and State revenue. A 2014 report concluded that Michigan ranked seventh out of the 50 states and Washington, D.C., in combined lottery sales, commercial casino gaming revenue, and Indian gaming revenue, with $5.3 billion total in 2012.[19] In 2015, the Michigan Gaming Control Board oversaw activities that produced approximately $13.2 billion in gaming-related gross revenue, and $2.9 billion in gaming-related net win revenue.[20] That 2015 revenue was generated by a gaming industry that included 23 Indian tribe casinos, three commercial casinos located in Detroit (the Motor City Casino, MGM Grand, and the Greektown Casino), 1,055 charitable organizations holding millionaire party events, and two horse racing tracks.[21] Of the 2015 gross revenue, Indian tribal casinos accounted for $7.28 billion, commercial casinos $5.69 billion, and horse racing and millionaire party events slightly less than $200.0 million.

Gambling in Michigan reportedly has followed national trends. The State lottery was legalized in 1972; Indian gaming activity began in the 1980s; parimutuel horse racing was legalized in 1993; and, by the end of 1996, seven Indian tribes were operating 17 casinos throughout the State.[22] A significant event occurred in 1996, when Proposal E was approved in a general election, enacting the Michigan Gaming Control and Revenue Act and authorizing the construction and regulation of up to three licensed Detroit casinos. The Act also created the Michigan Gaming Control Board, which is authorized to license, regulate, and control casino gaming in the State. While efforts to create and regulate casinos in Detroit had been occurring since the 1970s, it was not until the Windsor Casino opened in 1994 that the Detroit casino discussion became serious, as Michigan residents started to leave the State frequently to spend money in Canada.[23]

While the Detroit casinos are regulated by the State, the Indian tribal casinos are not. Because the tribes are considered sovereign nations, they are regulated by the National Indian Gaming Commission and the government of the tribal community.[24] However, the tribes are supposed to sign a compact with the State if they choose to open a gaming facility in Michigan.

Originally, seven tribes signed compacts with the State in 1993. The compacts were virtually identical to one another. They required the tribes to pay 8% of slot profits to the State and 2% to local governments. However, when the Detroit casinos opened, those tribes claimed a breach of an "exclusivity" provision in their compacts, or security from the State's approving a nearby casino. All seven tribes stopped making payments to the State, but continued to make payments to the local governments. (One tribe, the Keweenaw Bay Indian Community, later reached a settlement with the State that allowed it to operate a second casino in exchange for resuming the 8% payment to the State.) Four more tribes signed compacts with the State in 1998. Two of them, the Little Traverse Bay Band of Odawa Indians and the Little River Band of Ottawa Indians, ceased paying the State profits after the State initiated the Club Keno game, claiming a breach of exclusivity, but the parties eventually reached a settlement. The latest tribe to sign a compact with the State was the Gun Lake Tribe in 2007, bringing the total number of tribes that had signed a compact with the State to 12. However, the Gun Lake Tribe, too, withdrew from making payments to the State when it initiated the internet lottery program, but has since settled with the State. The four tribes that signed compacts in 1998 have all amended their compacts with the State since 2003. Generally, these amendments lowered the amount the tribes pay to the State (from 8% down to a sliding scale ranging from 4% to 6%) in exchange for the tribes' agreeing to an "exclusivity zone" that is restricted up to a certain distance.

In total, there are six tribes that pay the State some profits, as agreed upon under the respective compact, and six that do not pay the State anything. All 12 of the tribes make payments to local governments, but the original seven tribes that signed compacts in 1993 have discretion over how the money is allocated. The four tribes that signed compacts with the State in 1998 and the Gun Lake Tribe have local boards that give the local community some say in how funds are spent. The tribes have made total payments of $644.0 million to the Michigan Strategic Fund and $415.6 million to local governments since 1993, according to the Michigan Gaming Control Board (based on unaudited numbers).

U.S. ONLINE GAMING POLICY EVOLUTION

Before the Wire Act Reinterpretation

Prior to the more comfortable environment in which the online gaming industry finds itself now, Federal and statewide policies and attitudes toward online gambling were often antagonistic and sometimes inconsistent. For example, while policymakers actively denounced online gaming, other online gambling activities, such as horse racing, were accepted without as much protest, even though the DoJ considered them all under the same umbrella.[25] (Pursuant to the Interstate Horseracing Act, many states permitted online betting on horse and dog racing.) Two Federal laws were used to curtail online gaming: the Wire Act of 1961 and the Unlawful Internet Gambling Enforcement Act (UIGEA), which was enacted in 2006. The Wire Act was the primary law interpreted to prohibit online gaming in the United States. The Act prohibits anyone engaged in the business of betting or wagering from knowingly using a wire communication facility to transmit bets, wagers, or information assisting in the placing of a bet or wager on any sporting event or contest, or for the transmission of a wire communication that entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers.

There were many legislative movements throughout the years aimed at prohibiting online gaming. Senator Jon Kyl of Arizona introduced one of the first bills to do so in 1995.[26] The enforcement of such a law would be difficult, however, as most of the online gaming companies operate abroad and often in environments where the gaming is legal. Additional bills introduced over the years attempted to mitigate the enforcement concerns (such as by cutting funding or freezing assets). For example, in 2000, a bill was introduced to prohibit online casinos from collecting money through credit cards, checks, or electronic funds transfers, subject to exemptions for online betting on horse racing, dog racing, and jai alai.[27] Several states, too, enacted provisions prohibiting internet gambling, and several attorneys general issued opinions that internet gambling was illegal in their state.[28]

Despite the participation in illegal online gaming at the time, the DoJ rarely prosecuted members of the online gaming industry because most, if not all, online casinos and gaming sites were operated outside the United States. However, several members of the gaming industry were targeted: In 1998, Jay Cohen, a cofounder of a gambling company called World Sports Exchange, was indicted for operating a sports betting website from Antigua in violation of the Wire Act, and was sentenced to 21 months in prison.[29] In 2001, Federal prosecutors directed their attention to Gold Medal Sports, which operated in Curacao, and several members of the company were sentenced to five years in jail for violating the Wire Act.[30] In 2006, authorities arrested David Carruthers, the chief executive officer of an online gaming company called BetOnSports, on racketeering charges related to his role in that company.[31]

One of the biggest crackdowns on online gaming occurred on April 15, 2011, which became known as "Black Friday". On that date, it was announced that the founders of the three largest internet poker operations that were accepting bets from the United States were indicted. At the time, these three companies, PokerStars, Full Tilt Poker, and Absolute Poker, held 60% of the global online poker market.[32] The online poker industry was crippled overnight; 76 bank accounts in 14 countries were seized.[33] The online poker industry struggled to recover, and there were players who had yet to be refunded their deposits on the sites as of 2013.[34]

Nevertheless, before the Black Friday crackdown, there appeared to be a shift in the policy approach to online gaming as some parties and policymakers started to appreciate the idea of legalization and regulation. In 2010, Congressmen Jim McDermott and Barney Frank sponsored bills to tax, license, and regulate online gaming, while still prohibiting any sports betting or gaming that conflicted with a state law.[35] Physical casinos, which previously were hostile toward online gaming and feared that it could "cannibalize" casino profits, took interest in the idea of online gaming regulation. A trade group representing some of the major casinos in the United States started working on a proposal to Congress to begin regulating online gaming in 2010.[36]

Wall Street investment companies already understood the potential revenue that regulated online gaming could generate. Some of the major investment companies had purchased hundreds of millions of dollars in shares of online casinos traded in different international markets by the mid-2000s.[37] The investment companies purchased the shares knowing that there were legal risks but believing that those risks did not outweigh the potential profits the investment companies could realize.[38]

The divide between policy and reality before the Wire Act was reinterpreted (as discussed below) was widely displayed when the restrictions policymakers were trying to impose on the online gaming industry created trade conflicts with the countries where the online gaming companies were located. On November 10, 2004, the World Trade Organization (WTO) released its ruling on a trade dispute between Antigua and the United States regarding online gaming and found that the United States was violating international trade rules by restricting the use of credit cards for online gambling purposes.[39]

The Wire Act Reinterpretation

In 2009, New York and Illinois asked the U.S. Department of Justice for an opinion as to whether in-state online lottery transactions would violate the Wire Act. On September 20, 2011, the DoJ responded to the request and determined that a ban on interstate gambling over "wire communications" in the Wire Act applied only to sports betting. In the opinion, the DoJ noted that the Criminal Division of the DoJ had raised concerns that the Wire Act could have criminalized conduct that would be lawful under the UIGEA (which prohibits certain "unlawful internet gambling" and financial transactions related to gambling but allows interstate gambling as long as it does not violate state law). The DoJ found, however, that it was not necessary to address the statutes' interaction, because the Wire Act applied only to wagering on sporting events or contests, which the lotteries proposed by Illinois and New York did not involve. The change in interpretation created an opportunity for states, subject to certain restrictions, to regulate online gaming.

The year 2011 marked a major turning point in policymakers' attitudes toward online gaming as a whole, and the United States saw a multitude of proposals to implement, regulate, and tax some form of online gaming, with some of those proposals being adopted. On June 10, 2011, the Nevada Legislature, in anticipation of the DoJ interpretation, passed a law that legalized and allowed the state to regulate online poker.[40] In March 2011, Illinois became the first state to allow consumers to purchase lottery tickets online. Delaware opened up its first phase of online gaming in August 2013, offering residents limited online gaming opportunities;[41] the state currently offers poker and other casino games online.[42] In November 2013, New Jersey, too, began to offer its residents the opportunity to play poker or wager on other casino games online through its regulated system.[43] In 2014, California, Mississippi, New York, and Pennsylvania all introduced legislation to implement and regulate online gaming.[44] In 2015, legislators in those states and Illinois, Massachusetts, and Washington introduced bills that would authorize and regulate online gaming.[45] In the summer of 2016, the Pennsylvania House of Representatives narrowly passed a bill that would legalize and regulate online poker, meaning that Pennsylvania would have joined Delaware, Nevada, and New Jersey to become the fourth state to legalize and regulate a form of online gaming if the bill had passed the Senate and been signed by the Governor of Pennsylvania.[46] (Reportedly, online gaming is still a high priority for some Pennsylvania legislators.)

Although there are many examples of attitudes toward online gaming changing within the last five years, there are still those who oppose it entirely. The Restoration of America's Wire Act, introduced on March 26, 2014, was an effort to amend the Wire Act and specify that any bet or wager, not just sports betting, was subject to the Act, and specify that the term "uses a wire communication facility for the transmission in interstate or foreign commerce of any bet or wager" included any transmission over the internet carried interstate or in foreign commerce, incidentally or otherwise.[47] Effectively, the bill would have made it illegal for states to legalize and regulate online gaming. The bill, however, died in 2014.[48] It was reintroduced with minor changes in 2015 but failed again.[49] Another effort occurred in 2016 when a provision was added to a Senate appropriation bill stating that the Judiciary Committee did not recognize the DoJ 2011 interpretation of the Wire Act. The House of Representatives, however, did not include the statement in its version of the bill.[50]

CURRENT PROPOSALS AND POLICY

Many policymakers and academics have given opinions on how to approach the legalization and regulation of online gaming. One report poses questions that policymakers could address when determining online gaming policy. First, policymakers may have to ask if online gaming is desirable, and, if so, how it should be developed; on the contrary, if it is not desirable, then how should it be controlled? Second, which level of government would be best suited to regulate and develop, or control, online gaming? Third, because the activity occurs in cyberspace, how could governments acquire revenue from online gaming and its related activities? Finally, what kinds of social costs could be involved in online gaming?[51] Legislative action that would legalize and regulate online gaming creates additional questions for policymakers, such as what games should be legalized, what law enforcement tools should be used to combat illegal online gaming, how to approach the licensure of online poker operators overseas, what would be a competitive tax rate and licensing fee for potential operators (while certain jurisdictions, such as those in the Caribbean, charge almost no taxes and have minimal licensing fees), and how to exclude unlicensed operators.[52] Despite the numerous questions, regulation has become an intriguing idea for many policymakers.

As noted above, each state has the ability to regulate online gaming while abiding by certain Federal restrictions. Some have criticized this approach, arguing that it can lead to licensing and vetting costs for vendors that operate in multiple jurisdictions.[53] Others have argued that, while states should be allowed to determine if gambling occurs within their borders, allowing states to establish their own online gaming regimes would result in a "legal patchwork" that would create an inefficient regulatory overlap, confuse consumers, and not make economic sense. On the other hand, if more states were to legalize and regulate online gaming, it has been suggested that

Federal policymakers would be motivated to act.[54] This could be beneficial, some believe, as Federal policymakers could alleviate some of these potential concerns by creating a uniform regulatory structure to protect consumers and using law enforcement tools to exclude offshore operators that are subject to little regulation, if any.[55]

Arguments For Legalization and Regulation

The primary argument for online gaming legalization and regulation is consumer protection. Specifically, proponents argue that consumers' money needs to be safe and the games must be conducted appropriately and fairly, and consumers need to be confident that these requirements will be met.[56] While this may sound obvious, it actually could be difficult to accomplish; creating such an environment would require the development of a policy addressing many different elements. For example, some recommend that regulations should do the following: ensure that only trustworthy operators qualify for licenses; set standards for the fairness of games (including testing of the gaming environments); specify customer identification procedures and auditing policies; prevent player collusion; control uses of software (such as "bots" that play games automatically) that may be used to cheat other players or ruin the integrity of the games; and create programs that prevent money laundering. Moreover, further planning would be required to coordinate and implement each of these issues effectively. For example, online gaming operators would have to provide extensive information about their business and its history for purposes of investigation and inspection;[57] and customer identification procedures would have to include information that allowed the players to be identified as residents within the jurisdiction where the gaming was legalized, confirmation that the individuals were legally allowed to gamble (i.e., not minors), exclusion protocols for individuals who cheated or otherwise violated online gaming rules, and proper evaluation of financial transactions to determine money laundering risks.[58]

While the creation of the necessary systems to guarantee the integrity of the games and a safe playing environment for consumers might appear daunting, advocates of online gaming regulation argue that it is quite possible to implement effectively. Some claim that these issues, such as protections from player collusion and money laundering schemes, already have been addressed by online gaming operators that have years of experience operating abroad, or more recently in Delaware, Nevada, and New Jersey. Online gaming providers could track every hand or game played and every transaction that occurred.[59] Some providers assert that they can detect fraudulent behavior after developing a "pattern" of what is normal gambling behavior after recording many games and transactions, and that these patterns have been identified after lengthy operation in other jurisdictions. Supporters, therefore, believe that the regulation technology has been proven through successful implementation of online gaming within jurisdictions that allow it.

Another key argument for legalization and regulation is the economic benefit. As shown above, a lot of money has been and continues to be spent on online gaming by consumers across the United States. Policymakers could capture some of that revenue through taxation, and halt the flow of money from local areas to foreign companies and countries.[60] Further, the online gaming industry could create jobs for residents located in the jurisdiction where the gaming operates. According to a 2010 economic estimate, the legalization of online poker alone would create approximately 10,000 high-tech jobs in the United States and generate about $2.0 billion in tax revenue annually.[61]

Additionally, many claim that online gaming could be implemented responsibly to alleviate social concerns. Many jurisdictions that allow online gaming require some type of problem gambling help tools, such as a hotline help number, counseling, or features that enable a person to lock himself or herself out of gambling on a website for a period of time or set a specific betting limit. Moreover, a study from the University of Nevada, Las Vegas showed that online gambling does not increase the rate of gambling addiction.[62] The study used data from a 2010 British gambling prevalence study and a 2006 survey conducted in Ontario, Canada. The researchers found that participation in online gambling does not have a causal effect on problem gambling observed throughout the general population. A second study from the State University of New York at Buffalo made a similar point.[63] According to an article describing the study, researchers at the university's Research Institute on Addictions compared separate telephone surveys from 1999 to 2000 and from 2011 to 2013 and found that, despite an increase in gambling opportunities over time, rates of problem gambling remained stable.

Finally, supporters claim that the legalization and regulation of online gaming would remove the current contradiction between policy and reality, as many Americans gamble online even though it remains illegal in most jurisdictions.[64]

<u>Arguments Against Legalization and Regulation</u>

Opponents of online gaming legalization and regulation have several arguments. Some believe that online gaming would create more social difficulties, as legalization and regulation would be like "opening a casino in every home in America, 24/7, 365 days a year",[65] making gambling too convenient and accessible.[66] The argument continues that, without the necessary protections and extra funds to assist those with gambling problems, online gaming could aggravate gambling-related addictions, bankruptcies, and crime.[67] If this is true, policymakers may have to consider appropriating more money for problem gambling services when considering online gaming legislation. Data from a 2013 study show that the total amount of public funding allocated to problem gambling services in the United States was $60.6 million.[68] (The study noted that 11 states did not provide any dedicated funding for problem gambling services, and that California spent the most on those services with an $8.7 million investment.) According to further statistics from the study, the states that invested in problem gambling services spent between $0.01 and $1.42 per capita, with an average of $0.32 per capita across the country; the average cost of problem gambling treatment, per client treatment episode, was $1,174.[69]

Many opponents believe that online gaming truly exacerbates problem gambling habits, contrary to the reports and studies claiming that it does not. Reportedly, up to 9.0 million adult Americans and around 500,000 adolescents between the ages of 12 and 17 have gambling problems.[70] Some have declared that developing technology provides increased opportunity to manipulate the addictive characteristics of gambling activities in order to enhance their appeal.[71] One academic article from 2005 proposed reasons for increased use of gambling technology: Governments are fixated on revenue generation; governments and the gaming industry appear to be using marketing tools to increase revenue; there appears to be a global gaming expansion strategy; technology provides more convenient gambling; and technology makes gambling more socially acceptable to traditionally low-frequency gamblers.[72] Further, the article cited accessibility, affordability, anonymity, convenience, escape, immersion or dissociation, disinhibition, event frequency, interactivity, simulation, and associability as variables for the acquisition and maintenance of some online behaviors, which could be attributed to online gaming. The authors concluded that addictions are about rewards and the speed of acquiring those awards, something that online gaming lends itself to with solitaire-style games, fast-paced play, and overall accessibility.[73]

Some have raised further issues concerning legalization and regulation, such as protection of the vulnerable (minors, problem gamblers, drug or alcohol abusers, the learning impaired, etc.); concern about internet gambling in the workplace; the use of electronic cash (which can be seen as less "real" than physical cash and lead to a suspension of judgment); increased odds of winning in practice modes (or providing consumers better odds in "practice" modes to entice them to gamble with real money); unscrupulous operators; embedding (or associating a gambling site with other internet searches); continuous online gaming pop-ups; online customer tracking (or collecting data about customers and eroding privacy or creating tailored advertisements); and the use of nongambling brands to lead consumers to the gambling sites.[74]

Opponents also argue that online gaming cannot be regulated as easily as others suggest, and that online gaming environments cannot be controlled in the same manner as physical casino environments. A memo from the FBI in 2009 to Congressman Spencer Bachus regarding online gaming stated that, while vendors could create safeguards to deter cheating and collusion, they may not have any incentive to do so.[75] The memo also stated that geolocation systems, which identify where an individual is logging-in online, and proof of personal identification can be bypassed or tricked. According to McAfee, a cybersecurity company, there is free software that can direct internet traffic through a series of relays to conceal users and their locations and usage from surveillance, defeating any attempt to monitor online activities.[76] Users also can employ proxy servers to make a connection appear as if it is coming from another location or country. These services could minimize the obstacles that participants must overcome to use online gaming platforms for criminal means, such as money laundering. Also, while vendors may be able to determine whether an account is created by a consumer who is legally able to gamble, there is nothing to stop him or her from giving a minor access to the consumer's device connected to the online gaming website.

Another argument against the legalization and regulation of online gaming is that it will "cannibalize" physical casino revenue. Online gaming and physical gaming at gaming facilities are either complements or substitutes.[77] One study, using online gaming data from 1999 to 2006 released when the trade dispute between Antigua and the United States occurred, determined that the two industries were substitutes, and that a $1 increase in online gaming revenue was estimated to coincide with a $0.28 decrease in commercial casino revenue during the pre-UIGEA period.[78] The author of an article about the study, however, indicated that it was conducted using a rather limited data set and that some online gaming products with purposeful co-marketing could create industry complements. The author cited a more recent study showing that the industries are complementary, and suggested a reconsideration of the conclusion that the two industries are substitutes.

DELAWARE, NEVADA, AND NEW JERSEY

On April 30, 2013, Nevada became the first jurisdiction in the United States to legalize and begin regulating online gaming (in this case, online poker).[79] Delaware followed when it executed the first phase of the state's online gaming service in August 2013 and subsequently allowed residents to gamble.[80] New Jersey was the third state to commence online gaming operations, opening up websites to residents in November 2013.[81] In all three states, only physical casinos may apply for online gaming licenses, but Nevada and New Jersey casinos are allowed to coordinate with online gaming partners of their choice.[82] While many were excited about the launch of online gaming in all three states, most were focused on New Jersey as the barometer of online gaming success, as it was a larger market offering a complete roster of online gaming (slots, blackjack, poker, roulette, etc.). Nevada's gambling law was considered to be too narrow and Delaware's market too small to demonstrate the success of the venture.[83] (According to the United States Census Bureau, Delaware's population was estimated to be 945,934, and New Jersey's population was approximately 8,958,013, as of July 1, 2015.)

Many expected the launches to generate sizeable amounts of revenue for each state, as each was a pioneer in a new territory that was considered popular; one estimate had online gaming generating an additional $300.0 million to $400.0 million for the New Jersey general fund.[84] New Jersey Governor Chris Christie was expecting online gaming to generate $1.0 billion for the state's casinos in the first year, which would bring in $150.0 million in tax revenue;[85] other sources claimed that Governor Christie's administration expected closer to $180.0 million in tax revenue. Some estimates, however, were more reserved and predicted tax revenue as low as $35.0 million over the first year for New Jersey.[86] H2 Gambling Capital estimated that online gaming would produce around $300.0 million for New Jersey casinos with $45.0 million in tax revenue, and that the industry could explode in value, approaching $9.0 billion by 2018, if more states, especially California, were to legalize and regulate online gaming.[87] Estimates for Nevada ranged from around $3.0 million in tax revenue annually to more than $50.0 million if Nevada's online poker were expanded beyond the state's borders.[88] Delaware projected as much as $3,750,000 in tax revenue in the first year of regulation.[89] While most were optimistic, others believed that online gaming simply recycled money, and would not create wealth or contribute to Gross Domestic Product.[90]

Reality quickly showed how wrong the optimistic estimates were for each state. By the end of May 2014, a month before the state's fiscal year ended, New Jersey had collected around $9.3 million in tax revenue from online gaming.[91] Delaware received no net contributions to the state budget from online gaming in fiscal year 2013-14 due to delayed implementation of the gaming services.[92] Between May 2013 and April 2014, online poker generated $700,000 in tax revenue for Nevada. Moreover, Ultimate Poker, one of Nevada's three licensed online poker websites, shut down in November 2014 because of the limited revenue it received and the small pool of players.[93] In 2014, financial services firm Morgan Stanley decreased its market projection for the U.S. online gaming industry by 30%, from $5.0 billion to $3.5 billion by 2017, after studying the first months of online gaming operations conducted in the three states.[94]

There are several theories as to why online gaming within those states had such a difficult first year. Some New Jersey officials described issues with geolocation technologies and payment processing, as banks sometimes would not allow consumers to deposit money on the gaming websites or refused to participate altogether.[95] One research report written by Morgan Stanley estimated that about 60% of online gaming transactions in New Jersey were rejected, while half of the affected users made no other efforts to fund their accounts.[96] It appears that the assumed learning curve associated with being the first states to legalize and regulate online gaming was underestimated.

This is not to say, however, that online gaming has not generated any meaningful revenue, tax or otherwise. Online casinos in New Jersey saw double-digit growth throughout 2015.[97] According to New Jersey revenue reports, online gaming had generated roughly $50.0 million in tax revenue through August 2016. Nevada stopped reporting online poker data in December 2014, but had generated a little over $8.1 million in total revenue up to that point.[98] Online gaming in Delaware produced net revenue approaching $6.0 million between November 2013 and July 2016.[99] Furthermore, as of November 2015, MasterCard and Visa were reportedly approving roughly 70% and 62% of credit card transactions funding New Jersey online gaming accounts, respectively.[100]

While the early results of online gaming in the three states may have disappointed those with expectations that it could provide ample tax revenue, consumer protection through regulation appears to be effective. Director David Rebuck of New Jersey's Division of Gaming Enforcement stated his belief that New Jersey had proven that online gaming could be regulated successfully.[101] As of November 2015, Mr. Rebuck reported that only two people had been found to have successfully placed bets online from locations outside of New Jersey.[102] He also indicated that cooperation within the industry was important to improve regulatory systems.[103] For example, the signing of a gambling pact between Delaware and Nevada in 2014 not only allowed for a larger pool of poker players between the two states to broaden their poker market, but also required regulatory cooperation between the states. According to Mr. Rebuck, states that start regulating online gaming should partner with New Jersey, as it already has the infrastructure in place to ease the regulatory difficulties those states could experience.[104]

CONCLUSION

While legalized and regulated online gaming is still confined to four U.S. jurisdictions (the three states discussed above and the U.S. Virgin Islands), it appears to be gaining momentum. As noted above, in 2016 Pennsylvania acted on legislation that would have legalized and regulated online gaming. In Michigan, too, the Senate took up proposed legislation that would have legalized and regulated online gaming.[105] If both states were to enact legislation that allowed some form of online gaming, the U.S. Congress could be motivated to address online gaming regulation nationally. Furthermore, cooperation with Delaware, Nevada, or New Jersey, as suggested by some, could ease the transition from prohibition to regulation and avoid some of the difficulties states could face during the infancy of online gaming's regulation.

Regardless of how enticing online gaming legalization and regulation may or may not be, policymakers are faced with the decision of whether to address online gaming in some manner. The number of actors involved, such as tribal, private, and international casino operators, online or otherwise, complicates the issue. Questions regarding jurisdiction and technology also abound, with some arguing that online gaming can be successfully regulated while others suggest that there are more difficulties than advertised. Also, understanding the gambling mores and history within a state may be important when crafting an online gaming policy, especially if that state has many tribal gaming facilities. All of these issues are compounded by the social and moral dilemmas surrounding gambling and the consequences of expanding it. Studies and data concerning the topic often conflict, providing ambiguous results and differing recommendations. It is up to policymakers to find the best approach to online gaming and determine whether legalization and regulation are the answer.

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