

**INVESTMENT OR CONSPIRACY?
--LEGAL CONCERNS RELATING TO INVESTING IN THE ONLINE
GAMBLING INDUSTRY**

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I. Introduction

Depending on whom you ask, investing in Internet gambling businesses is either a sound financial decision, or facilitation of criminal activity, in violation of United States law. As international stock exchanges – in particular, the London Stock Exchange – have opened up to offerings of online gambling operations, the investment opportunity is becoming legitimized. The potential profits to be realized by those investments have not escaped the attention of respected, established investment houses like Goldman-Sachs, Merrill Lynch, and Fidelity.¹ In fact, these companies now hold hundreds of millions of dollars in shares of online casinos and other betting operations.² The allure of high-end profitability may be causing some investors and advisors to underestimate the potential legal exposure associated with United States-based ownership of online gambling establishments. This article will explore some of the potential legal concerns associated with investing in Internet gambling enterprises, either as a United States citizen or investment fund manager. Nothing in this article is intended as legal advice regarding investment activity, which can only be competently provided by a licensed attorney, after a full evaluation of the specific investments involved, along with a host of additional factors.

II. Department of Justice Position

Indisputably, the United States Department of Justice (“DOJ”) contends that all Internet gambling activity is illegal under federal law.³ A spokesperson for the DOJ recently confirmed this position, but declined to comment further on the hypothetical liability of an investment

¹ M. Richtel, “Wall St. Bets on Gambling on the Web,” *New York Times* (December 25, 2005).

² *Id.*

³ See, correspondence from John G. Malcolm, Deputy Asst. Attorney General, Criminal Division, United States Department of Justice (June 11, 2003). A copy of the letter written to the National Association of Broadcasters (“NAB”) can be found at http://www.igamingnews.com/articles/files/NAB_letter-030611.pdf; *Casino City v. Department of Justice*, Civil Action No. 04-557-B-M3 (M.D. LA. 2005) (unpublished decision).

company or individual investor located in the United States.⁴ However, United States Representative Bob Goodlatte, a staunch anti-gambling lawmaker, claims that these investors are promoting illegal gambling in violation of federal law.⁵ This hard line position has been consistently maintained virtually since the inception of the online gambling industry, despite the lack of any specifically-applicable federal legislation. The underpinnings of this view date back to early American history, wherein gambling was viewed as a “vice” activity, to be banned, instead of a viable form of entertainment to be enjoyed.

The DOJ’s stance on Internet gambling received recent support from the Report compiled by the United States Government Accountability Office, (“GAO”), issued in November 2002, which has been widely interpreted by government officials as warning that online gambling activities could be a haven for money laundering schemes.⁶ Consistent with this view, the United States Attorney’s Office in the Eastern District of Missouri has been investigating media outlets involved with online gambling advertising under the theory that such advertising violates the “aiding and abetting” prohibitions under federal law.⁷ This theory presumes that the underlying Internet gambling activity is illegal, since aiding and abetting cannot occur in a vacuum – it must generally be premised upon a separate, underlying crime (or attempted crime) that has been aided or abetted.⁸ The offense occurs when a defendant willfully associates

⁴ M. Richtel, “Wall St. Bets on Gambling on the Web,” *New York Times* (December 25, 2005) [Jacklyn Lesch, spokeswoman for Department of Justice].

⁵ M. Richtel, “Wall St. Bets on Gambling on the Web,” *New York Times* (December 25, 2005)

⁶ United States General Accounting Office, Report to Congressional Requestors, “Internet Gambling, an Overview of the Issues” (December 2002), which can be found at: www.gao.gov/new.items/d0389.pdf#search='gao%20report%20gambling'

⁷ Kevin Smith, “Stern, Other Media Outlets Pull Gambling Ads,” *Interactive Gaming News* (October 16, 2003), which can be found at: <http://www.igamingnews.com/index.cfm?page=artlisting&tid=4598>.

⁸ Title 18 U.S.C. § 2 provides, in pertinent part: “(a) Whoever commits an offense against the United States or aids, abets, counsels, commands, induces, or procures its commission, is punishable as a principal.”

himself in some way with the criminal venture and willfully participates in it as he would in something he wished to bring about.⁹

The government's theory in this regard has recently produced some results. After years of grand jury investigations and subpoenas, looking into the advertising activities of numerous media outlets in regards to online gambling, the DOJ announced a \$7.2 million settlement with The Sporting News, which had carried advertisements for various gambling websites.¹⁰ Other broadcasting companies have also taken this matter seriously, and have pulled their gambling ads out of fear of prosecution.¹¹ At least one major online gaming conference scheduled for November 2003 in Orlando, Florida, was cancelled in response to the government crackdown against advertising activities.¹²

These actions all focused on gambling advertising. So what about financing or investing? Does the government have a legal leg to stand on?

III. Legal Analysis

A. Overview

Despite the broad pronouncements from the DOJ as to the illegality of all forms of online gambling activity, the legal reality is, of course, a bit more complicated. Numerous factors, such as the physical location of the gambling enterprise, the defendant's degree of involvement with the business, the type of gambling activity offered, and the legal status of online gaming in the host jurisdiction, all play a part in the potential legal exposure of a particular individual who

⁹ *U.S. v. Indelicato*, 611 F.2d 376, 385 (1st Cir. 1979); see also, *United States v. Longoria*, 569 F.2d 422, 425 (5th Cir. 1978).

¹⁰ E. Swoboda, "US DOJ I-gaming Ads Investigation Continues; Sporting News Settles for \$7.2 million," *Interactive Gaming News* (January 28, 2006).

¹¹ "Stern, Other Media Outlets Pull Gambling Ads," *supra*.

¹² Press Release, "DOJ Serves Illegal Subpoenas for Online Gaming," *WinnerOnline.com* (October 30, 2003).

owns, operates or is otherwise involved with an online gambling venture. Each of these factors could play a significant role with respect to the legality of investing in online gambling businesses.

B. Locus of Gambling Activity

One significant question that must be considered in evaluating these legal issues is: Where does the “illegal” gambling activity occur? Obviously, United States law does not apply to the activities of all persons throughout the world. While the complex issues of international law, extraterritorial statutory application, personal jurisdiction and extradition treaties are all outside the scope of this article, it suffices to say that foreign entities and individuals are generally not required to comply with the dictates of United States’ law. Exceptions to this general principle exist, for example, where the foreign business activity is intended to produce “effects” in the United States.¹³ There can be no dispute that most offshore gambling websites solicit and service United States bettors. However, the impact of that activity on the ability of the United States to regulate foreign gambling establishments remains unsettled.

In this regard, it should also be noted that mere individual betting activity by United States players has generally been insufficient to constitute a violation of federal gambling law.¹⁴ Therefore, U.S. player activity should not be found sufficiently “illegal,” so as to justify imposition of criminal liability on those associated with foreign gaming operations, under federal law. However, at least one appeals court considered the existence of United States bettor activity in determining that the Wire Act applied to an Antiguan sports betting operation.¹⁵ All this begs the questions of where is the betting or wagering activity occurring? To the extent that the

¹³ *U.S. v. Noriega*, 746 F.Supp. 1506, 1512 (S.D. Fla. 1990).

¹⁴ See: *United States v. Rowland*, 592 F.2d 327 (6th Cir. 1979) (“Anyone who participates in a gambling business other than a mere bettor is subject to criminal liability”); see also, *U.S. v. Baborian*, 528 F.Supp. 324, 328-29 (D. RI 1981), [discussing the legislative history to the Wire Act.]

¹⁵ *U.S. v. Cohen*, 260 F.3d 68 (2d Cir. 2001), *cert. den.* 536 U.S. 922, 122 S.Ct. 2587, 153 L.Ed.2d 777 (2002).

operation is really being operated from overseas, by foreign citizens, application of United States' law is a dicey proposition for the government, making it more difficult to impose liability on investors.

C. Degree of Involvement

While something more than United States betting activity may be required for United States law to apply, just about any affiliation with, or involvement in, gambling operations has historically been sufficient to implicate criminal liability. Even waitresses and janitors have been found to be sufficiently involved with gambling operations be subjected to criminal liability under the Organized Crime Control Act, 18 U.S.C. § 1955.¹⁶ Some courts differ, however, and conclude that only conduct that is strictly “necessary” to the operation of the gambling business is sufficient to implicate criminal exposure.¹⁷ Nonetheless, those who finance illegal gambling businesses have generally been subject to criminal prosecution and conviction.¹⁸ Therefore, investment of funds in a gaming enterprise appears to justify potential liability. But, since illegal gambling operations were not historically listed on foreign stock exchanges, the question of United States ownership of equity shares in such operations has never been evaluated from a criminal liability perspective. A viable argument can be made that passive investors in activity that is not clearly illegal should not be subjected to criminal penalties, due to lack of criminal intent or “*mens rea*.” With more and more investors getting involved with the online gaming industry, the opportunity for the courts to consider this question may not be far off.

¹⁶ See: *U.S. v. Rotchford*, 575 F.2d 166 (8th Cir. 1978) (Waitress); *U.S. v. Merrell*, 701 F.2d 53 (6th Cir 1983) (Janitor).

¹⁷ *U.S. v. Boss*, 671 F.2d 396 (10th Cir. 1982).

¹⁸ See: *U.S. v. Ceraso*, 467 F.2d 653 (3d Cir. 1972) (Payment of telephone bills of bookmaking operation sufficient to establish financial backing of the operation).

D. Nature of Gaming Activity

Another factor that will weigh significantly in the liability evaluation is the specific type of gambling activity offered by the online gaming operation that is the subject of the investment. Federal law does not appear to treat all games of chance equally. This concept is best illustrated by the applicability of the Wire Act, 18 U.S.C. § 1084, which is most often cited as the basis for criminalizing online gambling operations. While much has been written about this particular federal law, and its relationship to Internet gambling, for these purposes it is important to recognize that the statute was only intended to apply to the business of wagering on sporting events, and not to other common forms of casino gambling.¹⁹ This limited applicability has been judicially recognized in the online gambling context as well. In 2002, the Fifth Circuit Court of Appeal affirmed a lower court's holding that the Wire Act applies only to sports betting, and not to other forms of Internet gambling on games of chance.²⁰ In accordance with this distinction in applicability, it could be argued that investing in non-sports-related Internet gambling operations is much safer than taking an equity position in an offshore sports book. These nuances often escape the lay investor, however, thereby resulting in heightened risk.

Other federal anti-gambling statutes vary in their applicability to certain forms of prohibited gaming activity. For example, the Travel Act, 18 U.S.C. § 1952, prohibits certain travel-related acts conducted in connection with "unlawful activity." The term "unlawful activity" is defined to include "any business enterprise involving gambling...in violation of the laws of the state in which they are committed or the United States."²¹ Therefore, one must look

¹⁹ *Baborian, supra.*; *Cohen v. U.S.*, 378 F.2d 751 (9th Cir. 1967), *cert. den.* 389 U.S. 897, 88 S.Ct. 217, 19 L.Ed.2d 215 (1967); *U.S. v. Stonehouse*, 452 F.2d 455 (7th Cir. 1971); *Telephone News Sys., Inc. v. Illinois Bell Tel. Co.*, 220 F.Supp. 621 (N.D. Ill. 1963), *aff'd* 376 U.S. 782, 84 S.Ct. 1134, 12 L.Ed.2d 83 (1964).

²⁰ *In Re MasterCard International, Inc. Internet Gambling Litigation*, 132 F.Supp.2d 468 (E.D. La. 2001); *aff'd* 313 F.3d 257 (5th Cir. 2002).

²¹ *Id.*

to other federal anti-gambling statutes, or state gambling prohibitions, to discern the precise nature of the activity prohibited by the Travel Act.

The Wagering Paraphernalia Act, 18 U.S.C. § 1953(a), on the other hand, applies to bookmaking, wagering pools on a sporting event, numbers games, policy, bolita or “similar” games.²² Finally, the Organized Crime Control Act, 18 U.S.C. § 1955, (“OCCA”), looks solely to state law to determine whether a violation of the Act has occurred.²³

As is evident, the particular nature of the online gambling activity offered by the specific website operation under investment consideration will bear heavily on the potential applicability of federal anti-gambling statutes. Therefore, this aspect of the business model is critical when conducting the legal exposure evaluation. Further complicating this issue is the fact that each state has its own set of gambling prohibitions, some of which specifically apply to Internet gambling activities.²⁴ Other states’ laws are silent, while still others are considering their options, in this regard. Therefore, the applicability of some federal laws will depend on the current status of state law, as it relates to online gambling.

The brokerage house, fund manager, or individual investor, should therefore be keenly aware of the nature of the gambling services offered by any Internet gaming operation that is considered for potential investment, given the risk variable generated by this factor. The specific nature of the gaming activity provided by the websites in question must be carefully considered in determining the risks associated with any potential investment in this industry.

²² 18 U.S.C. § 1953(a).

²³ The Organized Crime Control Act, 18 U.S.C. § 1955, defines an “illegal gambling business” as one which, *inter alia* “is a violation of the law of a state or political subdivision in which it is conducted.”

²⁴ At least seven (7) states have enacted some prohibitions relating to online gambling. Those states are: Illinois, Louisiana, Nevada, Oregon, South Dakota, Wisconsin, and Indiana. Bills pertaining to this issue are pending in several other states.

E. Legal Status of Gaming in Offshore Jurisdiction

Another issue which must be considered in evaluating the risks of investing is the legality of the gaming operation in its host country. The question here is whether online gaming is legal or licensed in the country where the website is based. While the courts have not been particularly sensitive to the claims that the location of the website's server should control the legality of the gaming activity, the legal status of online gambling in the website's principal place of business, i.e., where the transactions occur, should enter into the legal analysis. Unfortunately, early court decisions on this issue have not been particularly favorable or well-reasoned. For example, in one case,²⁵ a New York trial court found that an Antiguan corporation operating an online casino used by residents of the State of New York could be subjected to the jurisdiction of the court, even though the website's server was located in Antigua, and the entity was licensed to conduct Internet gambling in that location. Similarly, the Second Circuit Court of Appeal in *United States v. Cohen*,²⁶ was not receptive to claims that the gambling activity took place in jurisdictions which embrace, and even license, online gambling activity.²⁷ The Defendant in that case, Jay Cohen, was ultimately convicted and sent to prison, despite the fact that the sports betting services he offered were provided via licensed Antiguan corporations.²⁸

Nonetheless, as courts become more knowledgeable and sophisticated on the issues of online transactions, they are likely to pay closer attention to the thorny issues generated by deciphering the legal status of gaming transactions in their jurisdiction of origin. This is particularly true given the political pressure generated by the claim initiated in the World Trade Organization ("WTO") by Antigua and Barbuda against the United States in connection with its

²⁵ *People ex. re. Vacco v. World Interactive Gaming Corp.*, 714 N.Y.S.2d 844 (Sup. Ct. 1999).

²⁶ 260 F.3d 68 (2d Cir. 2001), *cert. den.* 536 U.S. 922, 122 S.Ct. 2587, 153 L.Ed.2d 777 (2002).

²⁷ *Id.* at 76 (However, here, the legality of the gaming in the host jurisdiction was only considered in connection with the issue of "*mens rea*," i.e., whether the government proved criminal intent).

²⁸ *Id.* at 78.

extraterritorial enforcement of anti-gambling legislation to the detriment of the claimants, allegedly in violation of international trade agreements.²⁹ This claim called the world's attention to what has been portrayed as 'bullying' by the United States against developing nations, who's gambling policies may be different than that of the DOJ.

Although the Appellate Body of the WTO reversed the decision rendered by the initial Panel, in favor of the claimants,³⁰ the DOJ has since apparently backed off its previous enforcement efforts against offshore corporations involved in Internet gambling activities. Indeed, no federal prosecutions of record have been initiated based solely on gambling violations against offshore casinos since the WTO debacle. Although the ruling itself may not force significant changes in United States gambling legislation, its real world impact may be to significantly reduce the previous vigor with which the federal government had threatened to pursue Internet gambling operations directed at United States' citizens, conducted from offshore entities. This change may also reduce the practical risks of prosecution facing investors in such entities.

IV. Pending Legislation

It should be noted that the legal landscape applicable to online gambling, and consequently to investment activity therein, may change significantly if certain Republican legislators have their way. Representative Leach (R-IA) and Senator Kyl (R-AZ) have repeatedly introduced prohibition legislation directed at prohibiting the funding of Internet gambling transactions by financial institutions, and others.³¹ Although the bills have consistently

²⁹ World Trade Organization, "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services - Report of the Panel," (November 10, 2004); World Trade Organization "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services: Report of the Appellate Body," (April 7, 2005).

³⁰ *Id.*

³¹ E.g. Unlawful Internet Gambling Enforcement Act of 2005 (H.R.4411).

been defeated for a variety of reasons, including the failure to properly “carve out” exceptions for recognized forms of Internet-oriented gambling such as off-track betting on horse racing, online sale of state-run lottery tickets, or possible future involvement in the industry by powerful casino interests, each year is a new battle. Past legislative defeats have also been blamed on admitted-criminal Jack Abramoff’s questionable influence peddling on Capitol Hill, on behalf of the Internet gambling industry.³² Passage of the legislation at this time could be seen as an opportunity for lawmakers to clean house, and divorce themselves of past unsavory associations. In the event that Representative Leach’s legislation, or something similar, is enacted into law, the opportunity for U.S. investors to put money into virtually any form of online gambling operation may quickly dry up. However, at present, all existing federal legislation was created before the development of the Internet, and therefore may not specifically apply to gambling online, despite repeated contrary assertions by federal law enforcement officials.

V. Impact on Investment Activity

Investing in an offshore gambling enterprise, even one listed on a publicly-traded foreign stock exchange, can be risky business. Government officials have made their position clear: All online gambling is illegal. Investing in an illegal business, particularly one that has a nexus with the United States – in this case, in the form of customers’ wagering activity – can be punished under various legal theories. As noted above in regards to advertising liability, the DOJ could claim that contributing funds to an allegedly criminal enterprise makes the investor guilty of “aiding and abetting” illegal activity. Of course, the government may encounter difficulty in proving that an underlying crime occurred, if the online gambling activity is legal and licensed in the jurisdiction of origin, or if the specific games offered by the business are not covered by

³² B. Vallerius, “I-gaming Prohibition Becoming a Priority for Republican Leaders,” *Interactive Gaming News* (January 24, 2006).

existing federal statutory provisions. However, assuming those roadblocks are cleared, liability could be imposed since it has historically attached to those who knowingly contribute funds to criminal activity.

Another option would be reliance on the conspiracy theory of criminal liability. In order to prove one guilty of criminal conspiracy, the government must prove knowledge of, and voluntary participation in, and agreement to violate the law.³³ While numerous potential defenses may exist for the innocent investor, who believed that the gambling activity was legal and licensed, federal conspiracy charges are serious business. The defendant charged with criminal conspiracy can face up to 5 years in a federal prison.³⁴ Therefore, due care must be exercised when considering any agreement to contribute funds to online gambling activities.

VI. Conclusion

Despite the unhesitating acceptance of Internet gambling shares in major brokerage houses' portfolios, the legal issues remain murky. These unsettled legal issues may result in potential criminal exposure for investors. Acknowledging this theoretical risk, the practical reality associated with prosecuting a well-respected investment house, or otherwise innocent individual investor, based on mere ownership of shares in a publicly-traded online gambling business, indicates that the real risk of prosecution is minimal. Law enforcement officials may get farther by merely threatening future prosecution, thereby leaving the legal issues unresolved, but significantly decreasing the number of potential investors who are willing to take a risk.

³³ Title 18, U.S.C. § 371; *U.S. v. Bright*, 630 F.2d 804, 813 (5th Cir. 1980).

³⁴ Title 18, U.S.C. § 371.

In sum, like many highly profitable investment opportunities, online gambling investments do involve some risk. However, the down side with this investment may not just be just the loss of principal; it could involve loss of liberty.

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