



Buyers Up • Congress Watch • Critical Mass • Global Trade Watch • Health Research Group • Litigation Group
Joan Claybrook, President

CASE SUMMARY: WTO INTERNET GAMBLING CASE March 2007

In March 2003, the Caribbean island nation of Antigua challenged three U.S. anti-racketeering statutes (the Wire Act, the Travel Act and the Illegal Gambling Business Act)¹ and four state laws as “barriers to trade” in “cross-border gambling services” under the World Trade Organization’s service-sector agreement called the General Agreement on Trade in Services (WTO GATS).²

The WTO is a 150-member international commercial agency based in Geneva, Switzerland. The GATS was part of the “Uruguay Round” package of trade agreements that was pushed through Congress in 1994 by the Clinton administration utilizing Fast Track trade procedures which bypass normal committee processes and limit debate. GATS rules apply to the service sectors that nations sign up (or “commit”) to be bound by the terms of the agreement. The goal of the agreement is to guarantee foreign service providers access into other WTO members’ markets. Measures that impede that access or are considered “discriminatory” against foreign service providers are challengeable as violating U.S. WTO obligations in the binding dispute resolution system built into the WTO.

In this case, Antigua argued that the cumulative impact of the three U.S. anti-racketeering laws (all three of which predate U.S. entry into the WTO and predate the practice of Internet gambling) prevented the supply of gambling and betting services from Antiguan-domiciled Internet gambling providers to U.S. customers on a cross-border basis. In response, the U.S. trade lawyers argued that they had never committed the gambling sector to WTO rules and anticipated an easy victory. Instead, after years of costly litigation, the United States lost yet another battle at the WTO.

Cross-Border Supply of Gambling and Betting Services

¹ Congress enacted the Wire Act and the Travel Act in 1961 as part of U.S. Attorney General Robert F. Kennedy’s program to combat what he called the “enemy within”— an uncontested empire of organized crime and racketeering. Prosecutions of organized crime jumped from 14 to 373 in the period from 1960-1963. In 1970, as part of the Organized Crime Control Act, Congress passed the Illegal Gambling Business Act aimed at syndicated gambling.

² Gambling laws in Louisiana, Massachusetts, South Dakota and Utah were also challenged. These state laws were ruled to be WTO violations by the first WTO panel, but that ruling was dismissed by the WTO Appellate Body on the grounds that Antigua had not made a prima facie case of inconsistency with the GATS. In other words, these state laws were saved an adverse ruling due to a technicality. These state laws and many others remain in jeopardy of future WTO challenges.

On November 10, 2004, a WTO panel ruled against the United States and on April 7, 2005, the WTO Appellate Body upheld the ruling that in favor of Antigua. Each of these rulings found that regardless of U.S. intent, the U.S. gambling services sector was committed to comply with WTO rules without reservation and that the U.S. laws that implemented the Internet gambling ban were in violation of WTO “market access” obligations. However, the panels also ruled that *if* the United States changed those laws so that they did not allow an exception for cross-state off-site horse race gambling, then the U.S. WTO violation could be excused under an exception for WTO-violating policies designed to “public morals.” The United States was given until April 3, 2006 to change its laws accordingly. When that date passed, without the actions ordered by the WTO panel having been taken, Antigua filed an enforcement case at the WTO. The final ruling made public today is on the follow up case challenging the U.S. failure to implement the WTO panel’s orders.

Antigua’s WTO case was prompted by its unique circumstance. In the past decade, Internet gambling has become a booming industry. A tiny island with few resources, Antigua capitalized on this boom; at one point the nation was home to 120 gambling companies providing significant employment and contributing greatly to the tiny island’s GNP. These firms marketed to U.S. players, and U.S. customers represented the majority of their market. In 1998, U.S. prosecutors decided to crack down on one of the Internet gambling firms. The company and its computer servers were based in Antigua but were owned and operated by an American named Jay Cohen. Cohen voluntarily returned to the United States to fight his prosecution but ended up losing the case in 2000 and was sentenced to 21 months in prison.

This enforcement action threw Antigua’s lucrative industry into an uproar. Antigua estimates that it has lost approximately \$24 billion in revenue since 2000.³ In 2003 Antigua launched its suit in the WTO against the United States. The trade suit is reportedly bankrolled by the gambling industry, and the lead attorney representing Antigua is a friend of Jay Cohen’s.⁴

Timeline:

- March 21, 2003, case filed by Antigua-Barbuda at the WTO. Formal title: United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services.
- November 10, 2004, WTO lower panel issues a ruling in favor of Antigua.
- April 7, 2005, WTO Appellate Body issues a ruling in favor of Antigua.
- August 19, 2005, a WTO Arbitrator gave the United States 11 months and 2 weeks to comply with the Appellate Body ruling, a time period which expired on April 3, 2006.
- On March 30, 2007 the WTO enforcement panel ruling was made public. The panel ruled that the United States was not in compliance with the Appellate Body decision: “For the reasons set out in this Report, the Panel concludes that the United States has failed to comply with the recommendations and rulings of the DSB in this dispute.” This ruling

³ Jeffery Sparshott, “Antigua Gambles on Trade Case with U.S.,” *Washington Times*, July 5, 2006.

⁴ Paul Blustein, “Against All Odds, Antigua Besting US in Internet Gambling Case at WTO,” *Washington Post*, Aug. 4 2006

clears the way for sanctions to be imposed on the United States until the United States complies with the WTO ruling.

MAJOR FINDINGS FROM THE 2005 WTO APPELLATE BODY DECISION

1) The United States Committed its Gambling Sector to Meet WTO Rules: The final decision on the merits of the case was issued by the WTO Appellate Body in April 2005. The Appellate Body upheld the lower panel’s ruling that the United States had inadvertently committed gambling services under the GATS when making its original Uruguay Round GATS commitments in 1995. Since the word “gambling” does not appear in the list of services the United States agreed to commit to the GATS, it may not be obvious how the Appellate Body reached this conclusion. The United States maintained that it never intended to commit gambling and that it defied common sense that the U.S. government would have made a commitment in an area that is so sensitive and strictly regulated. The problem for the United States arose from the fact that it made a commitment in a category called “other recreational services.” In the United Nations services classification system relied upon by most WTO members, this category includes “gambling and betting services” as one of many *subcategories*. Thus, the WTO lower panel and the Appellate Body ruled that WTO members were correct to conclude that the United States had committed gambling services.

2) Bans on Prohibited Behavior Constitute a WTO-forbidden “Quota of Zero”: The GATS Market Access article (Article XVI) lists specific measures governments cannot maintain when they make full commitments in a covered service sector. Governments are prohibited from creating or maintaining: numerical quotas, exclusive service suppliers, monopolies, limitations on the number of people employed, joint venture or other kinds of legal entity requirements and limits on foreign capital. The United States contended in the gambling case that a prohibition for a particular service does not violate Article XVI because regulatory bans do not appear on this list. However, the WTO ruled that a ban on behavior was in effect a numerical ban or a “quota of zero.” The United States strenuously objected to this interpretation, saying it “greatly constrains the right of Members to regulate services – one of the objects and purposes of the GATS,”⁵ to no avail. The Appellate Body upheld this key aspect of the lower panel ruling, throwing the doors open to GATS challenges to a wide range of government regulation, including bans on other forms of prohibited behavior that are provided on a commercial basis.

3) Narrow Ruling on Public Morals: Because the United States lost in its attempts to prove it had not committed gambling nor violated the GATS, it had to draw on the one exception to the agreement that might apply – the exception for measures “necessary to protect public morals.” It did this as a last resort, arguing right up to the appellate stage that it did not need to rely on this escape hatch that allows governments to maintain their measures even if they are found to have violated the terms of an agreement. The United States argued that the unique nature of Internet gambling fosters gambling addictions, make it difficult to screen out teenagers and crack down on fraud. Overturning the lower panel’s ruling, the Appellate Body found that the three challenged laws affecting remote gambling could be justified using this exception. However, the

⁵ World Trade Organization, “United States — Measures Affecting the Cross-Border Supply of Gambling and Betting Services (AB-2005-1) — Appellant Submission of the United States,” Jan. 14, 2005, para. 112, at 54.

panel ruled that a fourth law, the Interstate Horse Racing Act (IHA), was a problem, as it allows the placement of bets remotely across state lines but not from foreign operations. In short, the WTO gave the United States the option of either allowing all Internet gambling or repealing the Interstate Horseracing Act.

4) State Gambling Laws Also in Jeopardy: While this case concerned Internet gambling specifically, the most significant outcome for U.S. states was the WTO tribunal's determination that U.S. negotiators had inadvertently committed the entire gambling sector – meaning all federal, state and local measures regulating gambling – to GATS requirements. This means that an array of common state gambling regulations that would likely not be covered by the narrow “public morals” exception for Internet gambling are now subject to challenge before future WTO tribunals. This includes gambling bans (GATS-prohibited zero quotas), limitations on the number of casinos or slot machines (GATS-prohibited numerical limits), state lotteries (GATS-prohibited monopolies) or exclusive Indian gaming rights (GATS-prohibited discrimination against foreign operators). The very diversity of state gambling laws makes them more susceptible because they would be unlikely to qualify for the “public morals” defense if they are allowed in one state and not another.

Recognizing the WTO's continued threat to state laws, in 2005 29 state attorneys general urged the U.S. Trade Representative (USTR) to take action at the WTO to safeguard state gambling laws from future WTO challenges – specifically by withdrawing the gambling sector from WTO jurisdiction.⁶ While this is the only way to effectively protect a service sector from future and potentially even more costly WTO suits, the Bush administration has thus far failed to heed this request. Given this history of colossal mistakes by U.S. trade negotiators and citing an ongoing lack of communication with states about the GATS' impact on state law, in 2006 a number of concerned governors took executive action to safeguard their states' sovereignty and regulatory options from the GATS by explicitly asking the USTR to remove their states from GATS coverage.⁷

TODAY'S RULING: SANCTIONS ARE NOW IN ORDER, AS ENFORCEMENT PANEL FINDS THAT UNITED STATES HAS FAILED TO COMPLY WITH WTO TRIBUNAL'S ORDER

According to the ruling made public today, the United States has since failed to comply with the WTO Appellate Body ruling. While U.S. trade officials may have been considering withdrawing the gambling sector from WTO jurisdiction, it appears they have rejected that option as too costly. The WTO allows countries to modify the service sectors covered by the agreement but only if they compensate their trading partners for lost business opportunities when a sectoral commitment is changed or withdrawn. Later U.S. trade officials said they would “clarify” that all forms of online betting are illegal in the United States, apparently by modifying

⁶ See Letter to U.S. Trade Representative Rob Portman from Utah Attorney General Mark Shurtleff and 28 other state attorneys general, May 31, 2005, available at: http://www.citizen.org/documents/29AGs_GATS_May2005.pdf.

⁷ Governors letters are available at:

<http://www.citizen.org/trade/subfederal/services/comm/index.cfm?ID=14959&relatedpages=1&catID=104&secID=2422>.

the IHA. They appear to have rejected this option as well, no doubt given strong opposition by the horse-racing industry and their friends in Congress.

In the end, the U.S. strategy in the WTO has been simply to argue that the Wire Act prohibits the interstate transmission of bets or wagers, *including wagers on horses*. This was news to the horse-racing industry as the Justice Department has never taken enforcement action on this premise. Recently however, U.S. trade officials have begun to tout a nonspecific Justice Department “civil investigation” relating to a potential violation of Wire Act as evidence that they are enforcing the law in the United States.

However, the status of U.S. law is not as clear as the Justice Department would like it to be. While the Justice Department may argue that the 1961 Wire Act applies to horse races, the 1978 IHA appears to allow remote betting between two states where horse racing is legal. In 2000, the horse-racing industry succeeded in getting amendments to the IHA that specifically permitted the use of Internet technology in the transmission of interstate off-track wagers. In addition, at least one state explicitly permits at-home online gambling for horse racing, and online gamblers can find many Internet horse racing sites that appear to be based in the United States, such as YouBet.com. The conflict between the Wire Act and the IHA has not been resolved by Congress or the courts.⁸ Moreover, the Justice Department has been involved in a broad regulatory crack-down on *foreign* Internet gambling operators, arresting two senior British executives when they visited the United States in 2006, but has apparently failed to pursue similar action against domestic simulcasting operations or U.S.-based Internet horse-racing sites.

Given the inconsistencies in federal law and federal prosecutions, Antigua requested the formation of a compliance panel at the WTO, which ruled this week that the United States is out of compliance with its 2005 ruling. Antigua appears to be weighing the most effective way to apply trade sanctions against the United States. Antigua’s WTO lawyer told the *Washington Times* that the country might get the attention it deserves from the United States “if Antigua produced Microsoft Office and sold it for five dollars a copy.”⁹ WTO members are allowed to suspend benefits under other WTO agreements to force compliance with a tribunal ruling. In this instance, Antigua’s lawyer is threatening the suspension of WTO’s protections for intellectual property rights.

CONGRESS PASSES NEW GAMBLING LAW; NEW WTO SUIT THREATENED

In 2006, after years of debate, Congress passed a more direct ban on Internet gambling called the Unlawful Internet Gambling Enforcement Act. The new law more stringently regulates Internet gambling by making it a crime for banks and credit card firms to process and pay Internet gambling bets but makes no changes to IHA. Thus, critics contend that the law protects remote gambling operations domestically while at the same time blocking foreign operators from

⁸ According to the National Coalition Against Legalized Gambling, the executive branch believes the 1961 Wire Act overrides the IHA even though the IHA is a more recent statute because *neither* statute exempts IHA transactions from the Wire Act.

⁹ Jeffery Sparshott, “Antigua Gambles on Trade Case with U.S.,” *Washington Times*, July 5, 2006.

providing the same services to U.S. customers. “This puts the United States on a direct collision course with the WTO over free trade in services,” argued Antigua’s ambassador to the WTO.¹⁰

When Congress passed the new law over a weekend in October 2006, a “black Monday” for publicly-traded European Internet gambling firms followed. The value of the world’s largest gambling sites crashed dramatically on the London Stock Exchange. For instance, shares for PartyGaming, which generated 78% of its revenue from U.S. customers, fell 58%.¹¹ Not only is online gambling legal and regulated in much of Europe, but U.S. players represent a giant portion of the market. The largest publicly-traded firms issued statements saying they would no longer accept bets from U.S. customers.

Thus, it is not surprising that the European Union’s top financial regulator recently threatened a WTO case against the new law. In January 2007 Charlie McCreevy, the EU’s internal market commissioner, told the *Financial Times* that the new law “is probably a restrictive practice and we might take it up in another forum,” adding that the case could go to the WTO.¹² A successful suit on behalf of the EU could place the United States in jeopardy of even more severe punitive sanctions from one of our largest trading partners.

¹⁰ “Antigua-Barbuda Responds to U.S. Gaming Legislation,” *Caribbean Net News*, Oct. 6, 2006.

¹¹ Eric Pfanner, “Online-Gambling Shares Plunge on Passage of U.S. Crackdown Law,” *New York Times*, Oct. 3, 2006. While the bill has wreaked havoc on publicly trade companies, it may have benefited smaller, private companies who accept bets via institutions outside the United States. For instance PokerStars.com appears to be thriving and posted a message on its web page telling clients that in their view the new U.S. law does not prohibit *individuals* in the United States from playing online poker. The company is based in San José, Costa Rica, and apparently processes credit card transactions through a subsidiary in the Isle of Man.

¹² Tobias Buck, “EU calls US betting law ‘protectionist’” *Financial Times*, Jan.30 2007