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Net Bet Debt


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Abstract

The prospective high returns from gaming operations have introduced the Internet as a new competitor to the hotel and travel industry. With the dawn of the new millennium, an epidemic of gamblers has infected the virtual world and raised legal problems yet to be solved.

Keywords

Gaming, Law, Las Vegas, Internet

Net bet debt¹

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The prospective high returns from gaming operations have introduced the Internet as a new competitor to the hotel and travel industry. With the dawn of the new millennium, an epidemic of gamblers has infected the virtual world and raised legal problems yet to be solved.

Entertainment, hospitality, and travel industries have long recognized their interdependence and enhanced collaboration to satisfy their mutual clientele. Booming mega-resorts featuring a vast choice of attractions appeal to travelers around the world and compete for the disposable income of potential customers. With wagering becoming increasingly socially acceptable and inter-state competition for gaming taxes, many states have liberalized their gaming statutes, rendering the operation of casinos the number one choice of entertainment for many big players in the hospitality industry.

The prospective high returns

from gaming operations have introduced the Internet as a new competitor to the hotel and travel industry. With the dawn of the new millennium, an epidemic of gamblers has infected the virtual world and raised legal problems yet to be solved. The out-of-court settlement of *Providian National Bank v. Haines*² has provided some insight into new Internet provisions for the cyber-currency of choice. Coupled with the National Gambling Impact Study Commission Report and subsequent proposed federal legislation, this case sets the stage for pending litigation. Another case recently filed in California will hopefully solve the question of whether or not gambling on the Internet is legal and also clarify the enforceability of gambling debts in California.

Gaming is entertainment

In 1997, Americans spent \$489 billion in leisure goods, services, and activities. More than \$1

in \$10 was spent on gambling. That is more than was spent on cars, clothes, movies, and food combined.³ It is also important to remember that the gaming industry is only one segment of the growing entertainment/leisure time industry. Each segment competes for the same disposable income, divided up among the industry segments. Legalized gambling has spread throughout the 48 states and the District of Columbia in a myriad of forms, such as Indian casinos, bingo parlors, state lotteries, horse-racing tracks, and riverboats. The newest competitor makes the others look antiquated. This competitor is the Internet. Almost every person in the U.S. can get access to the Internet in one form or another. Whether through work, school, a public library, or at home, there is 24-hour, 7 days a week access to the Internet. Over 100 million people use the Internet world wide, up from some 40 million in 1996.⁴

Like nearly every other business sector during the early 1990s, the gaming industry eyed the Internet as an opportunity to tap a new audience. In 1995, a few websites began taking online bets, and e-gambling quickly snowballed from there. Within a year, online gambling revenues approached the \$100 million mark, and then doubled between 1997 and 1998, to \$650 million,⁵ despite the fact that U.S. federal law prohibits the use of the Internet for gambling. Although the

U.S. Senate has approved the Internet Gambling Prohibition Act, the House has yet to act. Despite the questions over its legality, online gambling is growing at a frenetic pace. In 1997, the few dozen websites comprising the industry earned revenues tallying a little more than \$300 million. Today, at least 700 different websites offer online wagering, and total revenues are expected to surpass the \$1 billion mark by the end of 1999, and by 2002, the figure is expected to reach \$3 billion.⁶

Cyber-casinos accessible to U.S. players are headquartered offshore, from the Caribbean to Europe to Australia. Analysts say that they attract 14.5 million players who bet through 700 on-line casinos and sports books run by 200 companies in 52 countries that sanction Internet gambling.⁷ Whatever the delay is on the U.S. laws, land-based casinos in Nevada as well as others are watching what is happening. Senator Richard Bryan of Nevada has warned that Congress must enact a ban this year to prevent Nevada casinos from expanding onto the World Wide Web.⁸ Although their efforts have been frustrated by the fuzzy jurisdiction that currently pertains to the Internet, some states, Nevada, Louisiana, Illinois, and Texas, have taken their own steps to ban or regulate Internet gambling. If California bans online gambling, for example, can a Californian still place a bet with an online casino based in Antigua, where it is legal? Is the transac-

tion taking place where the server is located, in the country where the cyber-casino is based, where the bet is placed, or somewhere over the wires in between? No one has a clear answer yet. And despite what had been hoped for, the discussion of whether or not gambling on the Internet is legal, or whether or not gambling debts were enforceable in California, will have to wait. But not for long, for another one has been filed in California dealing with similar issues.⁹

Credit cards are common

Online casinos are primarily in existence to entice Internet users to gamble. Typically a user creates an account with the online casino before commencing gambling—whether it is blackjack, roulette, craps, baccarat, solitaire, video poker, keno, or slots. The account is established more often than not with a credit card number. Consumer credit experts say credit cards are already being used increasingly for gambling, and casino debt is becoming more frequent on revolving credit card accounts.¹⁰

According to W. Lewis Garrison Jr., of Garrison and Sumrall P.C., “Ninety percent of all gambling on the Internet is accomplished through the use of credit cards. The credit cards and banking industry are the blood supply to this business.”¹¹ There are now more than 7,000 credit card issuing companies that have made record profits in recent years.¹² The

credit card industry is expected to grow to \$7.4 billion by next year.¹³ The collection agency industry is comprised of 6,000 firms nationwide who work for banks, medical, retail, and service industries. Consumer debt has mushroomed.¹⁴

“There’s a lot of damage you can do to yourself on the Internet with a credit card. You can buy stocks; you can swap currencies. Or you may be a 13-year old, who last April bid more than \$3 million at an online auction house, including \$500,000 for a Van Gogh and \$1.1 million for a Jacksonville, Florida, medical office,” according to Charles Anderer, publisher of *International Gaming and Wagering*. Or one may gamble.

Online casinos are neither governed nor regulated. Anyone with access to a computer and credit cards can wager, and the betting parlors are open 24 hours a day, 365 days a year. Cynthia B. Haines of Northern California was one of the “anyone.” The California case, settled out of court, provided some guidelines for the major credit card companies, MasterCard, Visa, American Express, and Discover Card, when it comes to credit card gambling.

From her home in Northern California, Cynthia Haines used her computer and her credit cards, some 12 Visas and MasterCard¹⁵, and gambled on 50 some sites—engaging in virtual craps, roulette, and blackjack at Caribbean cyber-casinos with such names as Acropolis, Grand Dominican, and Cyberthrill.¹⁶ The

amount gambled varied from \$30,000 to in excess of \$125,000, according to different articles. Providian National Bank sued her, but she countersued. As part of the out-of-court settlement, her credit card debts were wiped out as well as her \$225,000 lawyer's bill and MasterCard adopted a series of rules for card transactions involving Internet casino merchants.¹⁷

New rules are made

MasterCard rules include:

- a requirement that merchants with a MasterCard account post a notice on their websites stating Internet gambling is illegal in certain jurisdictions
- a requirement that merchants ask prospective gamblers to identify the state where they are located and maintain records of this information
- provision of a notice to card issuers of Internet gambling transactions

The impact was substantial. MasterCard International, the payment system network used by thousands of credit cards, would require online casino operators to post warnings before accepting charge cards or payments. With 23,000 member financial institutions, serving consumers in 220 countries and territories, MasterCard has some 700 million MasterCard, Maestro, Cirrus, and Mondex cards in circulation cur-

rently. With more than 16.2 million locations, no card is accepted in more places and by more merchants than the MasterCard card.¹⁸

Visa agreed to forgive the debt and collect the money instead from the gambling sites, and in the future gambling sites are obligated to post an "Internet Gambling Warning" as follows:

Internet gambling may be illegal in the jurisdiction in which you are located, including locations within the United States. Visa cards may only be used for legal transactions. Display of a payment card logo by an online merchant does not mean that Internet gambling transactions are lawful in all jurisdictions in which the cardholder may be located.¹⁹

Providian National Bank, the sixth-largest U.S. credit card issuer, is one of the original banks suing Haines. It announced that it would no longer process gambling transactions for its 11 million customers.²⁰ It also was ranked seventh in complaints to the Office of the Controller of Currency regarding allegations of misleading customers about a credit card protection plan. It has agreed to pay more than \$300 million in restitution, a record settlement for an enforcement action involving the U.S. Office of the Controller of Currency. Providian still faces lawsuits across the country by customers, amidst class actions and consolidated actions in federal courts.²¹

American Express decided this year to bar the use of their credit cards in cases in which the company can determine the business is an online gambling operation. Discover Card also adopted a similar policy. Credit card issuers can identify online gambling merchants through a so-called category code assigned to such businesses. Transactions can be automatically denied merchants with these codes. U.S. studies show that Visa had 49 percent, MasterCard 28 percent, American Express 17 percent, and Discover 6 percent of the bank credit card market.²²

Risk is lessened

The settlement frees the credit card companies from the risk of having their affiliations with online casinos declared illegal. "Her case [*Haines*] does hit a real pressure point with credit card companies. If she wins, the boys at CyberCash are going to be very happy, because people will just migrate from credit cards to using 'e-cash,' which is untraceable," according to Philip McGuigan, an attorney at Gordon & Glickson who specializes in net gambling.²³

Another interesting aspect to this case was that a Canadian company that sells gaming software to online casinos taking bets bankrolled the costly settlement of *Haines*. It was never sued. Companies like this, according to analysts, will help the booming Internet gaming industry explode from the \$1 billion in 1999 to \$10 billion in three years.²⁴ Apart from

covering Haines's legal bill, Cryptologic of Toronto paid more than \$160,000 to settle the matter. Cryptologic paid attorney's fees and also paid \$5,000 to Provident National Bank of San Francisco and as much as \$10,000 to 11 other credit card issuers.²⁵

"Cryptologic paid it because Visa required them to pay it as their status as the responsible Visa affiliate. They just didn't pay it out of the blue," according to Ira Rothken, Haines' attorney. But according to Jenny Solursh, senior VP of Cryptologic, "Visa asked us to help them out and we agreed to, even though we weren't named in the suit specifically. We wanted to maintain our future relationship with Visa. It has been a great relationship with them. The issue is behind us."²⁶

One of the reasons that the National Gambling Impact Study Commission [NGISC] recommended passage of laws that would prohibit the recovery of any credit card debts from online gambling²⁷ is that by refusing to process transactions with cyber-casinos, credit card companies might slow the growth of Internet gambling.

Commission is created

The National Gambling Impact Study Commission Act of 1996 was Public Law 104-169 of the 104th Congress. This act created the National Gambling Impact Study and Policy Commission.²⁸ According to the act, the commission was created because of the following:

- The most recent federal study of gambling in the United States was completed in 1976.
- Legalization of gambling has increased substantially over the past 20 years, and state, local and Native American tribal governments have established gambling as a source of jobs and additional revenue.
- The growth of various forms of gambling, including electronic gambling and gambling over the Internet, could affect interstate and international matters under the jurisdiction of the federal government.
- Questions have been raised regarding the social and economic impacts of gambling, and federal, state, local and Native American tribal governments lack recent, comprehensive information regarding those impacts.
- A federal commission should be established to conduct a comprehensive study of the social and economic impacts of gambling in the United States.

In 1976 when the first Gaming Commission study was undertaken, the scenario was significantly different. Then only two states permitted casino gambling, and 48 did not. Now it has switched; 48 permit some form of gambling, and only two states do not. Thus,

two decades later, the NGISC, after two years of study, and spending \$5 million, issued its recommendations. Among the 76 were three particular areas of concern, and the concern of the *Haines* case:²⁹

- **Recommendation #1:** The commission recommends that Internet gambling should be prohibited within the United States, and that strategies developed include Internet service providers, credit card companies and money transfer agencies. [5.2]
- **Recommendation #2:** The commission recommends the passage of legislation stating that any credit card debts incurred while gambling on the Internet are unrecoverable, [5.2] and
- **Recommendation #3:** The commission recommends that states, tribal governments, and pari-mutuel facilities ban credit card cash advance machines and other devices activated by debit or credit cards from the immediate area where gambling takes place. [7.1]

In every state in the Union, with the exception of Louisiana, a common vintage statute identified as the "Statute of Anne" was dubbed "the most important development in English gambling law prior to the American Revolution." Its main objective could be viewed

as the prevention of gaming on credit.³⁰ This law of the land has established that gambling debts are not collectible unless one has a specific piece of legislation that has changed the law.

New Jersey changed its law in 1977 by stating that “checks given for gaming purposes are valid instruments, enforceable at law in the courts of New Jersey.”³¹ And, five years later, facing a change in the tax code and with debts being collected in New Jersey before Nevada, in 1983, Nevada established that “a credit instrument given to an unrestricted licensee” was collectible in the courts of the state.³²

There is certainly no love lost between gambling and collecting gambling debts, as viewed by the customer, and the various states in which they reside. For example, in the earliest case on record in California, *Bryant v. Mead*, 1 Cal. 441 (1851), the court refused to enforce the gambling debt on the grounds that wagers which tend to excite a breach of the peace, or are *contra bonos mores*, or which are against the principles of sound policy, are illegal. No contract arising out of such illegal transactions can be enforced. The case cited as authority in the *Haines* case, an example of the public policy grounds on which gambling debts are not enforceable in California, is *Erickson v. Desert Palace, Inc.*³³ The court said: “The judiciary cannot protect pathological gamblers from themselves, but we can refuse to

participate in their financial ruin. Whether or not the gambling occurs on the Internet doesn’t matter, they are still uncollectible.” U.S. Attorney General Janet Reno stated last year that “the Internet is not an electronic sanctuary for illegal betting.”³⁴

Legislation is pending

By typing the word “gamble,” more than 10,000 virtual casinos, betting shops, and bingo halls open up. All one needs is a credit card.³⁵ Legal experts say it is unclear whether those bettors and online casinos—mainly in foreign countries—are breaking U.S. anti-gambling laws. The 38-year-old federal Wire Act prohibits taking bets on sports by phone or wire, which some interpret to include the Internet.

Legislation pending in both houses of Congress would clear up that ambiguity by prohibiting all forms of gambling on the Internet.³⁶ For more than a year Congress has been trying to craft stricter rules on cybergambling. Obviously, new legislation is needed in recognition of the power and problems posed by expanding technology. The ambiguity of existing federal law was one reason that Senator Jon Kyl (R-Ariz.) introduced legislation to outlaw gambling over the Internet altogether. The Senate Bill corrected the potential loophole by specifically outlawing Internet gambling. It also clarified the act to make all types of gambling—sports betting and casino games—illegal over

the wire. The most controversial aspect of the bill was that it broadened the class of potential violators of the law to include gamblers as well as operators. It would have left it a federal crime to place bets over the wire, a policy power normally left to the state. Senator Richard Bryan (D-Nev.), a co-author of the Kyl bill, said his preference "is to have the most restrictive gambling ban possible. It's not in the best interest of this country to have a generation of youngsters gambling from home."³⁷

Some areas not covered

The proposed legislation contains a number of exemptions. It does not cover horse or dog racing, which utilize electronic pari-mutuel systems. It also allows for state lotteries and for "fantasy sports leagues" to run on the Internet. It also exempts casinos and sports books that participate in pari-mutuel betting networks. Otherwise, businesses that offer online gambling could be fined at least \$20,000 and their principals sent to jail for up to four years. The bill gives authorities the ability to compel Internet service providers to pull the plug on illegal sites.³⁸ Most recently, sponsors to the Kyl bill negotiated with Indian tribes about possible exemptions for reservation gambling. Ultimately, they agreed on an amendment that permits tribes to pursue "closed loop" electronic gaming, enabling reservations in various states to link slot jack-

pots, a similar system to Nevada's Megabucks.³⁹

Suits are filed

Since the filing of Haines in California, a number of class-action suits have been filed using similar or the same causes of action across the country. While it seems undisputed that gambling debts are unenforceable, less solid are a dozen suits—filed within the last few months—that say Visa, MasterCard, and numerous credit card issuers are involved in criminal enterprises because they do business with cyber-casinos.⁴⁰

Filed in March in U.S. District Court for the Northern District of Alabama, the action alleges violations of the Racketeer Influenced and Corrupt Organizations Act. *Maple v. Capital One Bank*, No. 99-0665, alleges that Internet casinos, credit card companies, and banks joined to form an illegal enterprise to facilitate illegal gambling and to collect gambling debts incurred by cardholders who place bets. David T. Maple of Birmingham, Alabama, visited the website of the Parisian Online Casino on February 8, 1999. After disclosing his Capital One MasterCard number, which enabled him to play blackjack on line, he promptly lost \$49.95.⁴¹ According to attorney W. Lewis Garrison, he is representing plaintiffs in four lawsuits filed in Alabama.⁴²

A San Bruno, California, man, Fred Marino, is readying his own lawsuit to get out of paying \$100,000 in credit card gambling

bills. He said he was helpless: "I felt I had to gamble to make my losses back up," adding that he "ended up maxing out all my cards and losing my home."⁴³ The lawsuit, *Marino v. American Express*, alleges that the credit card companies participate in and profit from illegal online gambling by issuing merchant accounts to Internet Casino Operators who accept bets from web surfers located in California where such gambling is illegal. The credit card companies and affiliated banks are paid a fee, usually between 2 percent and 5 percent for each illegal online gambling transaction. In addition, consumers pay American Express and Discover Card interest and late fees on the gambling loans.⁴⁴

In one class-action complaint filed in a San Francisco federal court, North Carolina resident Mark D. Eisele blamed San Francisco-based Visa and his credit issuer for his \$15,000 gambling loss.⁴⁵ He claims that he made \$9,398 in bets last year on a Visa card issued by First Citizens Bank and was hit with \$8,348 in interest charges and other bank fees.⁴⁶

In August 1999, a lawsuit seeking class-action status was filed in federal court in Manhattan against MasterCard and a bank that issued the credit cards, charging the companies with racketeering. "If credit card companies choose to engage in these illegal bookie operations, they run the risk of not being able to collect debts," says Minneapolis lawyer Barry Red, who represents

plaintiffs in the Manhattan lawsuit and seven others nationwide.⁴⁷

In October 1999, a Wisconsin federal judge dismissed a similar suit against Purchase, N.Y.-based MasterCard, holding that the indebted gambler had not proven that the banks plotted illegal activity, as is required for a successful suit under federal racketeering laws. This was the case of *Ari Jubelirer v. MasterCard International Inc., et al.*, No. 99-C-256-S, W.D., Wis. Similar cases are pending in several courts.⁴⁸

The stakes have risen in the latest lawsuits involving online wagering. It is a new industry with no connection to casinos, and is entirely dependent upon the e-currency of the 21st Century, the credit card. The major credit card issuers face a dilemma, whether online wagers are illegal transactions, and whether such gambling credit transactions are unenforceable in the courts. Already MasterCard, Visa, American Express, and Discover Card have entered into settlements outside the courtroom. The use of credit for entertainment purposes still involves decisions as to where it is spent. If credit is used only to gamble, then other segments of the entertainment/leisure industry may not have the customer. The big players in the hospitality industry have to address the possibility of not being able to collect outstanding debts. They need to factor bad debts into their business modes. Profits are made from such decisions, as well as losses. The Inter-

net is a new competitor to the entertainment, hospitality, and travel industry. What affects it may just affect everyone.

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