

10-1-2003

Follow the Leaders: A Constructive Examination of Existing Regulatory Tools That Could Be Applied to Internet Gambling

Ronnie D. Crisco Jr.

Follow this and additional works at: <http://scholarship.law.unc.edu/ncjolt>Part of the [Law Commons](#)

Recommended Citation

Ronnie D. Crisco Jr., *Follow the Leaders: A Constructive Examination of Existing Regulatory Tools That Could Be Applied to Internet Gambling*, 5 N.C. J.L. & TECH. 155 (2003).

Available at: <http://scholarship.law.unc.edu/ncjolt/vol5/iss1/10>

This Comments is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Journal of Law & Technology by an authorized administrator of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

Follow the Leaders: A Constructive Examination of Existing Regulatory Tools that Could Be Applied to Internet Gambling

*Ronnie D. Crisco, Jr.*¹

I. Introduction

Many articles have explored the explosive growth of Internet gambling. As of August 2000, over forty percent of American homes has access to the Internet, and an estimated 4.5 million Americans had already gambled online at least once.² Some ambitious forecasts predict that by the year 2006, Internet gambling will become a \$100 billion a year industry.³

Not surprisingly, the appropriate stance on online gambling has been a frequent topic of scholarly debate. A popular trend in existing literature is to compare the two most likely policy responses to Internet gambling in the United States: should it be prohibited, or should we attempt to regulate it in some way? This article begins with the assumption that in either case an effective enforcement scheme will be vital to the policy's success.

To that end, this Comment examines two existing regulatory systems in an attempt to extrapolate possible characteristics of a comprehensive plan to deal with Internet gambling. The first model is the regulation of online securities trading by the Securities and Exchange Commission ("SEC"). The analysis then shifts to the enforcement of consumer protection laws in cyberspace by the Federal Trade Commission's Bureau of Consumer Protection ("BCP"). The intent of this article is not to educate the reader about the substantive law underlying either securities regulation or consumer protection. The intent is to identify techniques that regulators have employed to meet the

¹ J.D. Candidate, University of North Carolina School of Law, 2005.

² David B. McGinty, *The Near-Regulation of Online Sports Wagering* by United States v. Cohen, 7 GAMING L. REV. 205, 205 (2003).

³ Tom Lundin, Jr., *The Internet Gambling Prohibition Act of 1999: Congress Stacks the Deck Against Online Wagering But Deals in Traditional Gaming Industry High Rollers*, 16 GA. ST. U. L. REV. 845, 848 (2000).

unique challenges of regulation and law enforcement on the Internet. Finally, the article determines which, if any, of those techniques could be adapted to the context of online gambling. Ultimately, the regulatory scheme of the SEC proves the more attractive model. A permissive regulatory environment encourages cooperation from website operators, provides incentives for operators to locate within the United States, and narrows the range of police duties shouldered by regulators.

II. Background

The comment begins with a summary of the status of Internet gambling under current federal law. Then, the basis for choosing each analytical model is established. Both models are replete with lessons that policymakers can adapt looking for a comprehensive legislative response to Internet gambling.

A. Current State of the Law

As of November 2003, no law has been enacted which restricts or prohibits Internet gambling, despite the fact that gambling websites numbered in the thousands.⁴

Since 1995, Congress has repeatedly considered legislation that would criminalize all Internet gambling in the United States, but without success.⁵ The most notable legislative initiatives were the Internet Gambling Prohibition Acts ("IGPA") of 1998 and 1999, both introduced by Sen. John Kyl.⁶ The 1998 IGPA easily passed the Senate, but the House Judiciary Committee failed to approve the IGPA before the end of the 105th Congress.⁷ The IGPA of 1999 left out criminal penalties for individual bettors, but

⁴ These figures are from a popular gambling links directory. See AnteUp, at <http://gamblinglinks.com/lm/> (last visited on Nov. 2, 2003) (on file with the North Carolina Journal of Law & Technology).

⁵ Lundin, *supra* note 3, at 849–53.

⁶ *Id.* at 850–51.

⁷ Edward W. Yures, *Gambling on the Internet: The States Risk Playing Economic Roulette as the Internet Gambling Industry Spins Onward*, 28 RUTGERS COMPUTER & TECH. L.J. 193, 213–22 (2002); see also Lundin, *supra* note 3, at 851.

was otherwise identical to its predecessor. It also passed the Senate, only to die in the House.⁸

Despite Congress's inaction, there have been a number of successful state and federal prosecutions of Internet gambling outfits since the mid 1990s.⁹ Prosecutors have pursued most cases under the Interstate Wire Wager Act ("Wire Act").¹⁰ The Wire Act provides that anyone

engaged in the business of betting or wagering knowingly [using] a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event or contest . . . shall be fined under this title or imprisoned.¹¹

As the statutory language suggests, the Wire Act has been interpreted to apply only to sports wagering. This reading, however, is not universal; at least one state court has construed the Wire Act to prohibit virtual casino gambling sites as well.¹² The Fifth Circuit Court of Appeals, on the other hand, announced in *In re MasterCard International, Inc.*, that the scope of the Wire Act excludes virtual casinos by the plain language of the statute.¹³ Exactly how the Wire Act should be read in light of technological advances not contemplated by its drafters is still open for debate.

⁸ Yures, *supra* note 7, at 222.

⁹ See *United States v. Cohen*, 260 F.3d 68 (2nd Cir. 2001); *New York v. World Interactive Gaming Corp.*, 714 N.Y.S.2d 844 (N.Y. Sup. Ct. 1999); *Missouri v. Coeur D'Alene Tribe*, 164 F.3d 1102 (8th Cir. 1999).

¹⁰ 18 U.S.C. § 1084 (2000). In addition to the Wire Act, Internet gambling has also been attacked under other federal statutes like the Travel Act, 18 U.S.C. § 1952, and the Wagering Paraphernalia Act, 18 U.S.C. § 1953(a). See *World Interactive*, 714 N.Y.S.2d at 851–53.

¹¹ 18 U.S.C. § 1084(a).

¹² *World Interactive*, 714 N.Y.S.2d at 851 (holding the Wire Act applicable to a virtual casino website). This ruling can be attributed to the novelty of Internet gambling at the time this case was decided. Before the Wire Act was construed as applying to the Internet, no form of "wire communication" could have sustained a "virtual casino," whereas it now takes relatively little effort to download appropriate software over the Internet allowing one to play classic games of chance.

¹³ 313 F.3d 257, 262 (5th Cir. 2002).

Confusion over statutory interpretation is not the only difficulty courts encounter when dealing with Internet gambling. Jurisdictional issues are also a paramount concern. As of 1999, 80% of all Internet gamblers resided in the United States.¹⁴ Yet, the majority of Internet gambling businesses are located in tax-havens like Antigua and Belize that impose virtually no formal restrictions on these enterprises.¹⁵ Reasons for this trend include the United States' long history of criminalizing gambling and the opportunity to circumvent strict financial disclosure requirements in more business-friendly nations.¹⁶

The Minnesota Court of Appeals succinctly stated the general problem of policing the Internet in one of the earliest online gambling cases. In *Minnesota v. Granite Gate Resorts, Inc.*,¹⁷ the court stated:

We are mindful that the Internet is a communication medium that lacks historical parallel in the potential extent of its reach and that regulation across jurisdictions may implicate fundamental First Amendment concerns. It will undoubtedly take some time to determine the precise balance between the rights of those who use the Internet to disseminate information and the powers of the jurisdictions in which the receiving computers are located to regulate for the general welfare.¹⁸

The problem for courts is not determining that jurisdiction is proper. On the contrary, courts have routinely held that marketing strategies targeting potential gamblers within the United States constitute sufficient contacts for purposes of personal

¹⁴ Antonia Z. Cowan, *The Global Gambling Village: Interstate and Transnational Gambling*, 7 GAMING L. REV. 251, 252 (2003).

¹⁵ McGinty, *supra* note 2, at 205–06; *see also* United States v. Cohen, 260 F.3d 68 (2d Cir. 2001) (upholding the conviction of a defendant operating out of Antigua); *Minnesota v. Granite Gate Resorts, Inc.*, 568 N.W.2d 715 (Minn. App. 1997) (holding defendants subject to personal jurisdiction although their business operated out of Belize).

¹⁶ McGinty, *supra* note 2, at 206; Cowan, *supra* note 14.

¹⁷ 568 N.W.2d at 718.

¹⁸ *Id.*

jurisdiction.¹⁹ The problem is actually asserting jurisdiction. Website operators who hold no assets in the United States and never visit the United States can, in effect, avoid prosecution indefinitely.²⁰ Moreover, the effective application of transnational jurisdictional principles is dependent on the “respect and cooperation among sovereigns and parties.”²¹ However, American courts have not always made fostering comity with foreign judiciaries a top priority.²²

¹⁹ See *Rio Props., Inc. v. Rio Int’l Interlink*, 284 F.3d 1007, 1020 (9th Cir. 2002); *People v. World Interactive Gaming Corp.*, 714 N.Y.S.2d 844, 849 (N.Y. Sup. Ct. 1999).

²⁰ Cowan, *supra* note 14, at 261. Two considerations generally govern the extraterritorial application of United States law: (1) the plain language of the applicable statute, coupled with a respect for legislative intent, and (2) the “international bases of jurisdiction theories which are, in order of preference: subjective territoriality, objective territoriality, nationality, protective principle, passive personality, and universality.” *Id.* These principles begin with the strongest theoretical justifications for asserting jurisdiction (subjective territoriality, or presence of the offender) and from there descend to the weakest theories (protective principles applying where a sovereign itself is offended by a foreign actor’s activities and universal jurisdiction based on the historical ability of nations to punish serious crimes like piracy, slavery, and hijacking regardless of where the offender resides). *Id.* Ultimately, however, these theories are only as useful as the strength of comity between sovereigns. The traditional international law with respect to gambling favored jurisdiction by the nation where the bet was accepted under a contract analysis of acceptance; today, many nations concerned with the growth of Internet gambling, like the United States, have begun advocating that a more effects-based theory of jurisdiction should prevail. Unfortunately, the United States has not done much to encourage cooperation from other nations in Internet-related cases. *Id.* at 264 (discussing a federal case in which France wished to enforce its ban on sales of Nazi memorabilia against Yahoo!, Inc., which had offered such items for auction on its domestic website, though not on its sister site in Europe). The district court held that although French citizens could easily access the U.S. website, respect for the First Amendment precluded enforcement of this particular French law against American citizens. *Id.*

²¹ *Id.* at 263.

²² *Id.*

B. Basis for Selection of Models

This article examines two analytical models that might be applied to Internet gambling. SEC regulation of securities markets will serve as the model for a legal scheme that permits but controls Internet gambling. Although securities traders and gaming site operators rely on very different business models, they share many incentives for cooperation with regulators. Next, this Comment analyzes the FTC's Bureau of Consumer Protection as a model for enforcement of an outright ban on Internet gambling. As it happens, hunting down Internet scams has a lot in common with shutting down gaming websites.

1. Securities and Exchange Commission

In the late 1990s, online brokerage firms took America by storm through their advertising blitz. Between 1994 and 2000, the number of online brokerage accounts in this country jumped from zero to over 13 million.²³ Estimates say that by 2004, that number could balloon to almost 40 million, accounting for half of all individual investment portfolios in the United States.²⁴

Online gambling is experiencing similar growth. Between 1997 and 2000, worldwide profits from online gambling grew from \$300 million to an estimated \$2.2 billion dollars.²⁵ In one year alone, from 1997 to 1998, the number of online gamblers increased from 6.9 million to 14.5 million.²⁶ The Internet has revolutionized both securities trading and gambling, allowing millions of new consumers to participate in the market. The only difference between those two markets is that the SEC was present to witness and respond to the Internet revolution, whereas no governmental agency existed to oversee the rise of online gambling.

²³ Jane K. Winn & Benjamin Wright, *LAW OF E-COMMERCE* § 16.02 (4th ed. Supp. 2003)

²⁴ *Id.*

²⁵ McGinty, *supra* note 2, at 205.

²⁶ Lundin, *supra* note 3, at 848 (quoting Tom W. Bell, *Gambler's Web: Why Online Betting Can't Be Stopped—And Why Washington Shouldn't Bother Trying*, REASON, Oct. 1999, at 25–26).

To see the parallels more clearly, consider what the leading treatise on the law of E-Commerce says about securities regulation:

Financial markets were among the first to systematically incorporate computer networks into their operations and, as a result, are globally integrated electronic markets today. U.S. securities-market regulators have tried to balance the benefits of greater access and the lower costs made possible through the use of new electronic communications systems with the risks created by fraudsters exploiting those very technologies Companies using the Internet as a communications medium need to subject the content of their Web site to the same scrutiny for possible securities-law liability as any other [medium].²⁷

The SEC is responsible for striking that delicate balance between the benefits of Internet communication and the risks of fraud in the United States. The SEC's primary mission is to protect investors and regulate securities markets.²⁸ Investor protection is achieved when investors have access to certain basic information about any security they consider buying, so the SEC strives to maintain a comprehensive, public body of knowledge about all publicly-traded companies.²⁹ The Internet, while greatly enhancing consumers' access to information, has taxed the SEC's ability to make sure that the information available to consumers is genuine.³⁰

Instituting a regulatory framework to control online gambling would entail facing many of the same problems that the SEC confronts online. For example, the global nature of the

²⁷ Winn & Wright, *supra* note 23, § 16.01.

²⁸ SECURITIES AND EXCHANGE COMMISSION, THE SEC: WHO WE ARE, WHAT WE DO, at <http://www.sec.gov/about/whatwedo.shtml> (last modified July 21, 2003) (on file with the North Carolina Journal of Law & Technology).

²⁹ *Id.*

³⁰ For a brief overview of the SEC's approach to regulating securities markets online, visit the SEC's website. Internet Enforcement, at <http://www.sec.gov/divisions/enforce/internet/enforce.htm> (last visited Nov. 2, 2003) (on file with the North Carolina Journal of Law & Technology).

Internet requires extensive cooperation between nations. It also leads to complex jurisdictional squabbles. As noted above, controlling content on the Web is the primary goal of regulation; it would also be crucial to prevent fraud in the gambling context. The SEC has to balance its duty to protect consumers with its need to maintain a spirit of cooperation with the companies operating under its supervision. This is the essential paradoxical nature of any permissive regulatory regime. The federal government will face the same paradox should it choose to regulate Internet gambling rather than prohibit it.

However, there are differences between securities regulation and gambling. First, any regulatory regime for online gaming will not have the same resources available that the federal government expends to regulate financial markets. Second, the securities trading and gambling industries rely on fundamentally different business models. Online securities traders must maintain relationships with other businesses, such as stock exchanges and publicly traded companies, in order to operate. This makes them easier to monitor. Internet gambling imposes no such restraints on website operators. After start-up costs, gambling site operators need only deal with individual gamblers, making it harder for regulators to track entry into the marketplace and to identify companies seeking to defraud consumers.

Despite these differences, the similarities between securities and online gambling are certainly strong enough to support drawing conclusions about the enforcement techniques that might be effective in the regulation of Internet gambling sites.

2. Federal Trade Commission

The FTC exists to protect the nation's economic markets.³¹ The FTC's responsibilities include consumer protection, enforcing federal antitrust laws, and maintaining a competitive marketplace for both consumers and businesses.³² The BCP investigates

³¹ GUIDE TO THE FEDERAL TRADE COMMISSION, at <http://www.ftc.gov/bcp/online/pubs/general/guidetofc.htm> (last visited Nov. 2, 2003) (on file with the North Carolina Journal of Law & Technology).

³² *Id.*

individual companies and entire industries, litigates in administrative and federal courts, and teaches businesses and consumers to protect themselves from market pitfalls.³³

The FTC brought its first consumer protection action against a fraudulent online operator in September 1994. Over the next five years, the FTC brought 100 similar actions against nearly 300 businesses and individuals on behalf of millions of American online consumers.³⁴ At the outset, the FTC held extensive hearings to educate itself about the Internet and decide what principles should guide its policies in the new marketplace.³⁵ From those hearings, consensus emerged on several issues: (1) existing consumer protection principles should apply to e-commerce; (2) enforcement efforts should be tailored to avoid unnecessary restraints on business and trade; (3) self-regulation should be encouraged where possible; and (4) public/private sector cooperation should be cultivated.³⁶

To apply basic consumer protection principles online, the FTC searches for and prosecutes website operators engaging in fraudulent or deceptive practices. Like their colleagues at the SEC, the FTC regulators have faced explosive growth in the online marketplace since the mid-nineties. Between 1996 and 1998, online advertising revenues swelled from around \$300 million to almost \$2 billion dollars worldwide, with domestic advertising revenues expected to exceed \$10 billion by 2004.³⁷ Meanwhile, consumer purchases online amount to billions of dollars each year.³⁸

³³ FEDERAL TRADE COMMISSION, THE BUREAU OF CONSUMER PROTECTION, at <http://www.ftc.gov/ftc/consumer/home.html> (last visited Nov. 2, 2003) (on file with the North Carolina Journal of Law & Technology).

³⁴ FEDERAL TRADE COMMISSION STAFF, THE FTC'S FIRST FIVE YEARS: PROTECTING CONSUMERS ONLINE, ii (1999), at www.ftc.gov/os/1999/12/fiveyearreport.pdf (on file with the North Carolina Journal of Law & Technology) [hereinafter THE FTC'S FIRST FIVE YEARS].

³⁵ *Id.* at 1. Hearings were conducted beginning in 1995. They included members of the BCP, the information technology industry, the online business community, privacy and consumer advocates, government representatives, and Internet technology experts.

³⁶ *Id.*

³⁷ *Id.* at 2.

³⁸ *Id.*

Thus, as was noted with respect to the SEC, FTC regulators must patrol a large Internet marketplace comparable to the market for online gambling. Moreover, the character of online fraud bears a closer resemblance to online gambling than does the securities trade. Anyone with enough capital and technical knowledge to construct a website can perpetrate an online scam. Like the online gambling entrepreneur, all a scam artist needs is access to consumers.³⁹

Just as there are important differences between securities and online gambling regulation, differences exist between the FTC's enforcement scheme and online gambling. The incentive to locate outside the United States is much greater for online gambling businesses. The FTC most often confronts two basic types of offenders: con-artists purposefully seeking to defraud consumers and legitimate businesses that run afoul of consumer protection laws.⁴⁰ Neither class of offender has a strong incentive to flee the jurisdiction of the United States; con artists anticipate that their scams may be discovered, forcing them to fold up and relocate on short notice, while legitimate companies are encouraged to conform with the law by market forces and institutional pressure to maintain their place in the business community. Gambling site operators can also take advantage of adaptable Internet technologies, but their overall migration toward foreign jurisdictions suggests that business is best when it can be sustained without government intrusion.⁴¹

³⁹ See generally *United States v. Cohen*, 260 F. 3d 68 (2d Cir. 2001) (involving a defendant who left a lucrative position trading in options and derivatives to become an online bookmaker in Antigua); Cowan, *supra* note 14, at 252 (examining the global reach of the Internet and the ease with which it is adapted for gambling).

⁴⁰ THE FTC'S FIRST FIVE YEARS, *supra* note 34, at 7.

⁴¹ See Lundin, *supra* note 3, at 858; Cowan, *supra* note 14, at 251–55.

III. Analysis

A. Securities and Exchange Commission

1. The Approach

Securities regulation is a dense, polygonal field of law that can be exasperating to comprehend even for experienced securities law practitioners. To simplify, the analysis in this article focuses on how the SEC has responded to and utilized new technologies to more effectively regulate securities trading.⁴²

As an example, consider the evolution of the Electronic Data Gathering, Analysis, and Retrieval system ("EDGAR"). The SEC established EDGAR in 1984 to expedite the receipt, processing and dissemination of financial disclosure information.⁴³ The function of the system was to standardize the format of disclosures and to give investors fast access to information about publicly traded companies.⁴⁴ Of course, fast access in the 1980s was vastly different from what is considered fast access today. In 1998, the SEC undertook a major project to modernize EDGAR for the Internet age. Today, companies and consumers alike can access EDGAR over the Web to learn about companies or to file documents.⁴⁵

A similar publicly-accessible database for Internet gambling sites could provide valuable information to consumers, such as ownership, geographic location, and most importantly past regulatory violations. Website operators could also use the database to reassure customers of their legitimacy by linking their websites directly to their database entries.

Arguably, the SEC's most critical response to the Internet revolution has been offering guidance to companies, brokers,

⁴² This analysis does not delve into the implications of the Sarbanes-Oxley Act of 2002. While the Act has been and will continue to be an immensely popular topic of scholarly debate, it is left outside the scope of this inquiry due in large part to the fluid and unfolding nature of the law at the present time. Time, and future authors, will assess any impact Sarbanes-Oxley has on Internet gambling.

⁴³ Winn & Wright, *supra* note 23, § 16.03[A].

⁴⁴ *Id.*

⁴⁵ *Id.*

consumers, and other interested parties on how to take advantage of new technologies without breaking the rules.⁴⁶ In April 2000, the SEC released an interpretive guide for all types of securities issuers on the appropriate use of electronic media.⁴⁷ This guide attempts to clarify the legal implications of topics such as electronic delivery of documents, consent, website content, and online offerings.⁴⁸ For example, if an issuer of securities is concerned with being liable for third-party information, like stock advice, hyperlinked to the issuer's website, it could consult the SEC guide. Assuming the issuer plays no part in preparing the linked information, they might still be liable if the issuer endorsed or "adopted" the information.⁴⁹ The SEC's guide spells out the factors it deems relevant to deciding whether hyperlinked information has been "adopted" by the linking party.⁵⁰

The SEC also has tried to keep pace with an evolving marketplace by regulating online brokerage firms, which have experienced an explosive surge in popularity.⁵¹ The SEC's basic problem has been deciding how to best apply standard regulatory principles to new transaction scenarios. Take, for example, a broker's traditional duties of "suitability" and "best execution."⁵² The suitability doctrine requires broker-dealers to recommend only those investments that they conclude are suitable for the investor.⁵³ The doctrine of best execution requires broker-dealers to seek the most advantageous terms reasonably available for a customer's transaction.⁵⁴

⁴⁶ THE FTC'S FIRST FIVE YEARS, *supra* note 34, at i.

⁴⁷ Use of Electronic Media, SEC Release No. 3-856, Exchange Act Release No. 3-2728, Investment Company Act Release No. 24426, 65 Fed. Reg. 25843 (April 28, 2000).

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.* The factors include: (1) the context of the hyperlink, (2) the risk of confusion, and (3) the presentation of the hyperlinked information.

⁵¹ SEC, ONLINE BROKERAGE: KEEPING APACE OF CYBERSPACE, *at* <http://www.sec.gov/pdf/cybrtrnd.pdf> (Nov. 22, 1999) (on file with the North Carolina Journal of Law & Technology).

⁵² *Id.*

⁵³ *Id.* at 24.

⁵⁴ *Id.* at 35.

The SEC has had difficulty drawing a line between stock information that is merely provided by an online broker for the investor's review and information that constitutes a recommendation. The difficulty is that information posted on a website may not be directed at any specific investor, and one cannot assess suitability without knowing for whom the information must be suitable. There is general agreement, however, that some basic form of the suitability doctrine should apply online.⁵⁵ As for best execution, the SEC believes it is essential for online brokers to regularly re-evaluate how orders are executed. As technologies change, so do the standards of service required of brokers to meet their legal duties.⁵⁶ This is the same philosophy that underlies best execution in all securities trading, but with special emphasis on Internet technologies that can expedite those transactions. Similar regulatory questions would have to be answered for Internet gambling. For example, should we allow websites engaged in sports bookmaking to offer gamblers "tips," advice, or other information meant to influence their wagers? If so, within what limits?

The SEC also confronts problems when foreign securities issuers use the Internet to gain access to American investors and vice versa. In the past, reaching foreign markets required the use of a regulated intermediary, but the Internet has made these intermediaries largely obsolete.⁵⁷ The SEC, however, has taken the position that use of the Internet does not warrant modification of the principles that have traditionally governed international securities trading.⁵⁸ For example, a critical issue is whether the United States securities laws should be applied to certain international transactions. The obligation to comply with U.S. registration requirements depends on whether a foreign issuer takes steps reasonably designed to avoid targeting U.S. investors. Such steps include posting prominent disclaimers on websites and requiring location information from users visiting the site.⁵⁹

⁵⁵ *Id.* at 28.

⁵⁶ *Id.*

⁵⁷ Winn & Wright, *supra* note 23, § 16.06.

⁵⁸ *Id.*

⁵⁹ *Id.*

Similar procedures could also be required of offshore gambling sites, assuming that permitting these websites to operate domestically will not fully eliminate the presence or influence of some offshore operators.

2. Enforcement

Enforcement is an important subcategory of any regulatory scheme, and it will be particularly important for the purposes of this analysis. The SEC has approached e-commerce by taking advantage of new technologies, while maintaining traditional standards of practice within the industry. Policing a regulatory system requires many of the same enforcement techniques as a prohibitive approach when industry actors cannot or will not meet those standards.

The SEC's Enforcement Division has established a special Office of Internet Enforcement ("OIE") to handle securities law violations online.⁶⁰ Expanding Internet access nationwide supplies scam artists with a steady diet of naïve new investors to prey upon. The OIE targets specific problems such as "the offer and sale of bogus investments, market manipulations, online trading facilities, spamming, unregistered Internet advisors and investment newsletters, and off-shore broker-dealers and other financial service entities."⁶¹ The SEC uses its own website to educate investors about potential fraud, while the OIE team engages in more traditional investigations, relying on special search engines and complaints from investors to identify violators.⁶² Additionally, the OIE operates an "Early Intervention Program" to handle non-fraudulent securities violations occurring on the Internet.⁶³ Agents contact entities suspected of violating the SEC's offering rules, offer guidance to bring them into compliance, and refer cases of continued non-compliance to the OIE.⁶⁴

⁶⁰ *Id.*

⁶¹ *Id.* § 16.05.

⁶² *Id.*

⁶³ Thad A. Davis, *A New Model of Securities Law Enforcement*, 32 CUMB. L. REV. 69, 85 (2002).

⁶⁴ *Id.*

In March 2001, the SEC announced the results of its fifth nationwide Internet fraud sweep—eleven actions brought against twenty-three individual and corporate defendants.⁶⁵ Those eleven actions cover virtually all known securities fraud techniques including: false promises of an impending initial public offering (“IPO”) using spam e-mails; baseless financial projections released online to pump up stock prices; dummied credentials posted by self-styled “expert” stock analysts; and illegal payments made to analysts for supposedly objective performance reports.⁶⁶ Enforcement is a key component of any regulatory scheme. It punishes those who do not respect the regulations and deters other potential violators. This is equally true of online gambling, securities trading, or any other market.

3. Is it Working?

The OIE has enjoyed substantial success in its early years, thanks in large part to effective cooperation between offices.⁶⁷ The Divisions of Corporate Finance and Market Regulation, the Office of Compliance Inspections and Examinations, and the Office of the General Counsel all help shoulder the responsibility of identifying online violations.⁶⁸ In addition, the OIE has grown and diversified at a pace that allows it to keep up with an exploding Internet marketplace, opening ten new branch offices devoted solely to Internet enforcement since 2000.⁶⁹ The OIE is also supplemented by the CyberForce, a group of over 200 lawyers and investigators who shoulder much of the surveillance responsibilities to identify

⁶⁵ John Reed Stark, *The SEC Speaks in 2002: Materials Submitted by Chief, Office of Internet Enforcement*, in 1298 PLI/CORP ANT 331, 333 (Annette L. Nazareth and Paul F. Royce eds., 2002) (compiling extensive information about each action from the 2001 OIE sweep in the Practising Law Institute’s Corporate Law and Practice Course Handbook Series).

⁶⁶ *Id.* at 334.

⁶⁷ John Reed Stark, *Enforcement Redux: A Retrospective of the SEC’s Internet Program Four Years After Its Genesis*, 57 BUS. LAW. 105, 123 (2001) (noting that in the OIE’s first four years, it brought almost 300 enforcement actions against more than 900 individuals).

⁶⁸ *Id.* at 111.

⁶⁹ *Id.* at 113.

potential violators, using many of the same techniques as the FTC, which are described below.⁷⁰

As impressive as this program sounds, one must ask whether this array of resources is put to optimal use. Only about 10% of litigation matters filed by OIE between October 2000 and September 2001 “resulted in parallel criminal proceedings.”⁷¹ This means the only effective penalties meted out were modest civil fines and injunctions against future violations.⁷² This is relevant to online gambling because it suggests that compliance with the regulations is dictated by economics. If simply paying the fines for noncompliance allows operators to generate greater revenues, there is little incentive to follow the rules.

B. Federal Trade Commission

1. The Approach

The BCP set out to prevent consumer fraud on the Internet armed with only a set of loosely-defined goals. Chief among these goals was the FTC’s belief that basic consumer protection principles should govern the Internet marketplace to whatever extent possible.⁷³ The FTC boasts three major tools used to investigate and identify consumer fraud online: (1) the Consumer Sentinel database, (2) the Internet Lab, and (3) Surf Days.⁷⁴ Each of these tools could find some direct application to policing Internet gambling.

The Consumer Sentinel database was established in 1997 to collect and catalogue hundreds of thousands of consumer fraud complaints from across the United States and Canada.⁷⁵ Law enforcement officials can access the database via a secure website that also provides automatic updates and a means of communicating with far-away colleagues. Entries in the system

⁷⁰ *Id.*

⁷¹ Davis, *supra* note 63, at 85–86.

⁷² *See id.*

⁷³ THE FTC’S FIRST FIVE YEARS, *supra* note 34, at 1.

⁷⁴ *Id.* at 4–7.

⁷⁵ *Id.* at 4.

come mostly from consumers calling the FTC's toll-free telephone number or utilizing its online complaint form. However, a growing range of organizations, such as the Better Business Bureau and the National Consumer League, also contribute data.⁷⁶ An Internet Fraud Rapid Response Team complements the database by analyzing incoming complaints to identify emerging scams and initiate litigation where appropriate.⁷⁷ Obviously, a complaint-based database will be of less value in the Internet gambling context. Consumers who visit gambling websites are unlikely to lodge many complaints because they are complicit. Enforcement personnel would have to depend on other sources and their own searching efforts to gather information about illegal Internet gambling.

The FTC's Internet Lab is the infrastructure of its online investigation efforts. The lab maintains the most advanced computing technology so that investigators do not fall behind the latest scams. Special software programs help FTC investigators navigate the dense galaxy of websites and "capture" fraudulent sites to preserve them as evidence in subsequent enforcement actions.⁷⁸ An agency charged with prohibiting Internet gambling would certainly utilize a similar program to meet their infrastructure needs.

Finally, "Surf Days" aid the FTC enforcement system and would be a good model for monitoring online gambling. On Surf Days, the FTC joins with more than 250 other law enforcement agencies, both domestic and abroad, to scour the Web for online fraud.⁷⁹ These massive sweeps lead to many of the FTC's Internet fraud prosecutions. Surf Days start by targeting a specific type of fraud to investigate. Then, the FTC coordinates with other participating agencies during a three to four hour period of intense searching online. Websites found in violation through this process are saved as evidence, and the site operators are warned about the

⁷⁶ *Id.*

⁷⁷ *Id.* at 5.

⁷⁸ *Id.*

⁷⁹ Release, FTC, Combating Internet Fraud and Deception, *at* www.ftc.gov/bcp/internet/cases-netsum.pdf (May 2001) (on file with the North Carolina Journal of Law & Technology).

potentially illegal content. The FTC conducts follow-up visits about a month later and if the offending material remains, an enforcement action can be filed.⁸⁰ Surf Days would be a useful tool for identifying illegal gambling websites, especially in the absence of a reliable incentive for consumers to report the illegal activity.

2. Enforcement

The FTC's investigation and enforcement power is derived from the Federal Trade Commission Act, which grants it broad power to prevent and punish unfair trade practices.⁸¹ Members of the FTC's Bureau of Consumer Protection may issue civil investigative demands, which function much like subpoenas, to compel the production of testimony, documents, and other tangible things related to any matter under investigation.⁸² These and other basic investigative powers would be the cornerstone of a prohibition on Internet gambling. Once gambling sites are identified, regulators would rely on statutory powers like those of the FTC to gather evidence on those websites.

"The basic consumer protection statute enforced by the Commission is section 5(a) of the FTC Act, which provides that 'unfair or deceptive trade practices in or affecting commerce are declared unlawful.'"⁸³ The enforcement process has two components, administrative and judicial. These are best thought of as "spheres" of authority because they substantially overlap and depend on one another.

First, a complaint setting out the FTC's allegations is issued against the purported offender.⁸⁴ The offender may then consent to a final order, forgoing any judicial review, or contest the

⁸⁰ *Id.* Typically, twenty to seventy percent of operators remove the offending content before further action is necessary.

⁸¹ 15 U.S.C. §§ 41-47 (2002).

⁸² FEDERAL TRADE COMMISSION, OFFICE OF THE GENERAL COUNSEL, A BRIEF OVERVIEW OF THE FEDERAL TRADE COMMISSION'S INVESTIGATIVE AND LAW ENFORCEMENT AUTHORITY, at www.ftc.gov/ogc/brfovrvw.htm (Sep. 2002) (on file with the North Carolina Journal of Law & Technology).

⁸³ *Id.* (quoting 15 U.S.C. § 45(a)(1)).

⁸⁴ *Id.*

complaint.⁸⁵ If the offender contests, there is a trial before an administrative law judge ("ALJ"). If either party is dissatisfied with the ALJ's decision it can appeal to the full Commission. Beyond this, the offending party may petition for review by an appropriate court of appeals, and finally, the Supreme Court.⁸⁶

The administrative process, however, can produce only an order requiring the offender to cease and desist from practices found to violate consumer protection laws.⁸⁷ In order to obtain civil penalties for noncompliance, equitable relief, or monetary damages for consumer redress, the FTC must seek assistance from the courts. Consequently, the FTC often finds it advantageous to circumvent the administrative process altogether and proceed directly to district court where preliminary and permanent injunctive relief as well as monetary damages can be obtained in one easy step.⁸⁸ Likewise, if Internet gambling is ultimately prohibited, courts will probably remain an active participant in the enforcement scheme.

3. Is It Working?

It is difficult to assess how the FTC's efforts to curtail online fraud stack up against the problems they face. Commentators generally agree that the FTC has played an important role in policing fraud online. However, it is unclear whether the FTC's actions have reduced actual instances of fraud.

⁸⁵ *Id.*

⁸⁶ 15 U.S.C. § 45(c). According to section 5(c) of the FTC Act, the appropriate court of appeals is any within whose jurisdiction the respondent "resides or carries on business or where the challenged practice was employed." *Id.* It is unclear, however, how this rule is applied in a case involving the Internet.

⁸⁷ Federal Trade Commission, *supra* note 82, at 5.

⁸⁸ *Id.* The FTC's overview of its enforcement power is quick to point out, however, that there are advantages to the administrative process, particularly the opportunity to make the initial finding of fact, which a court is obliged to accept if supported by substantial evidence. For a detailed summary of Internet-related prosecutions undertaken by the FTC, including orders entered and the amounts of monetary relief awarded, *see* Release, FTC, Commission Enforcement Actions Involving The Internet and Online Enforcement, at www.ftc.gov/bcp/internet/cases-Internet.pdf (Feb. 13, 2003) (on file with the North Carolina Journal of Law & Technology).

The FTC's efforts may ultimately be futile, as shown by the narrow likelihood of a single complaint resulting in federal action. Losses to individual consumers often involve relatively low dollar amounts, so not surprisingly few remedies are available.⁸⁹ In fact, the only option available to fraud victims is filing a complaint with the FTC, but there is no guarantee that any relief will be forthcoming. The FTC primarily looks at three factors before taking legal action pursuant to a consumer complaint: (1) whether there is a significant detriment to consumers, (2) whether there is a pattern or practice at work as opposed to an isolated incident, and (3) whether legal action a viable option.⁹⁰ Under these criteria many individual complaints go unanswered, at least until the scam in question victimizes enough consumers to make it worthwhile for the FTC to invest its limited resources to prosecute the case.⁹¹

Perhaps to make its efforts more effective, the FTC has diversified by supplementing traditional law enforcement methods with consumer education programs and by advocating self-regulation in cyberspace. Proponents of the self-regulation philosophy argue that helping website operators compete effectively within the law combats fraudulent activity while also enhancing market-based incentives for operators to eliminate fraudulent or deceptive content on their sites in order to retain customers.⁹² Educating consumers, especially those new to online shopping, is also a priority.⁹³ The FTC employs an array of techniques to help consumers learn how to avoid becoming victims of cyber-scams, including dozens of online guides, partnerships with merchants who link FTC information to their websites, and

⁸⁹ Kristen Weisse, *Remedies for Internet Fraud: Consumers Need All The Help They Can Get*, 14 LOY. CONSUMER L. REV. 205, 212 (2002).

⁹⁰ *Id.* at 213 (noting that these are three of the primary factors the FTC considers in such cases, but this list is not exhaustive).

⁹¹ *Id.* The SEC has similar problems to the extent it relies on consumer complaints. The problem may be ameliorated somewhat, though, by its regulatory, and generally more cooperative, relationship with regulated entities outlined in the SEC section of the analysis.

⁹² *Id.* at 220; see also THE FTC'S FIRST FIVE YEARS, *supra* note 34, at 19.

⁹³ See generally THE FTC'S FIRST FIVE YEARS, *supra* note 34, at 16.

special “teaser” sites designed to simulate typical scams and teach consumers to identify and avoid them.⁹⁴

IV. Conclusions

The conclusions to be drawn from this analysis all share a common theme: the probability is high that regulation will be more successful than prohibition in achieving its respective goals. First, prohibition of the kind enforced by FTC has little chance of substantially curtailing the prohibited conduct. Regulation, on the other hand, provides strong incentives for compliance through market forces and cooperation with businesses. Second, jurisdictional and transnational concerns are minimized by regulation since firms are encouraged to operate domestically. Finally, to the extent policing misconduct will still be important under a regulation regime, methods like the FTC’s will still be available and do not have the handicap of being dependent on consumer complaints.

The FTC enforcement scheme is the simpler model to understand and apply. Although the FTC as a whole has many responsibilities that parallel those of the SEC, this Comment has focused only on the investigation and prosecution of consumer fraud online. Internet scams are identified and prosecuted, but is the FTC having a substantial impact on criminal behavior? The answer is “probably not.” The federal government does not want to spend huge sums of taxpayer dollars to enforce a prohibition on Internet gambling under a scheme that only prosecutes a small percentage of offenders. Regulation, however, limits the range of prohibited conduct and the right scheme of fines and penalties will help persuade site operators to stay within the rules. Appropriate sanctions would also help mold the online gambling marketplace such that compliant businesses are also the most profitable.

⁹⁴ *Id.*; see also Consumer Alert FTC, Going Shopping? Go Global! A Guide for E-Consumers, at <http://www.ftc.gov/bcp/online/pubs/alerts/glblalrt.htm> (Oct. 2001) (on file with the North Carolina Journal of Law & Technology); Release, FTC, Dot Cons, at <http://www.ftc.gov/bcp/online/pubs/online/dotcons.htm> (Oct. 200) (on file with the North Carolina Journal of Law & Technology); see generally Combating Internet Fraud and Deception, *supra* note 79.

A second conclusion supported by the analysis pertains to international jurisdictional issues. The SEC and FTC are both limited in this regard by the extent of cooperation from sister agencies around the world. The SEC, though, has an advantage obtaining such cooperation because foreign governments want to make sure their investors and companies have access to American markets. There would be a similar incentive for those governments to cooperate with Internet gambling regulators. The rationale for cooperation would be to encourage some website operators to stay put instead of relocating back to the United States. Conversely, a definitive prohibition on Internet gambling would solidify the current trend of offshore operation and all its attendant jurisdictional obstacles.

Finally, no matter what policy the United States might adopt with respect to online gambling, it must police frauds and scams. The FTC and the SEC have developed similar techniques for identifying illegal activity on the Internet. The FTC's Bureau of Consumer Protection, however, is substantially more dependent on consumer complaints. This would not be a reliable method for identifying Internet gambling websites, however, since we can safely assume that most people who visit gambling websites choose to gamble and will not complain. The complicity of online gamblers also makes consumer education programs like the Consumer Sentinel database far less effective. A strict prohibition on Internet gambling would place regulators in a similar position to the FTC, making it difficult to say with confidence that a majority of Internet gambling operators are prosecuted. Therefore, if online gambling is allowed in some limited fashion, the regulator's job becomes more manageable, reducing the range of illegal activity to be policed, and creating an incentive for website operators to work with regulators so their businesses can run smoothly.