



**CONGRESSIONAL BUDGET OFFICE  
PRIVATE-SECTOR MANDATES STATEMENT**

July 6, 1998

**S. 474**

**Internet Gambling Prohibition Act of 1997**

*As reported by the Senate Committee on the Judiciary on October 23, 1997*

**SUMMARY**

S. 474 would prohibit gambling over the Internet and other interactive computer systems. Specifically, the bill would amend the Federal Interstate Wire Act to prohibit placing or receiving bets or wagers over the Internet or by other computer means. S. 474 would impose new federal private-sector mandates, as defined in the Unfunded Mandates Reform Act (UMRA), on a number of parties: individuals, businesses that provide computer-users with access to the Internet, entities involved in the business of wagering or betting that use interactive computer services, and certain parties that conduct on-line contests for which prizes are awarded.

CBO estimates that the net direct costs to the private sector of complying with this prohibition would exceed the statutory threshold in UMRA (\$100 million in 1996, adjusted annually for inflation). Assuming that the provisions in S. 474 became effective in October 1998, we expect that the total direct costs of private-sector mandates contained in S. 474 would be between \$2 billion and \$3 billion in that year. By 2003, total direct mandate costs would be between \$2 billion and \$5.5 billion. The lion's share of costs would be imposed on commercial providers of Internet services and on certain legal wager-based businesses, such as horse and greyhound racing tracks that use interactive computer systems.

**PRIVATE-SECTOR MANDATES CONTAINED IN THE BILL**

Section 3 would prohibit persons from placing, receiving, or otherwise making bets or wagers via the Internet and other interactive computer services. In addition, section 3 would prohibit any entity engaged in the business of betting from conducting transactions over the Internet or interactive computer services. Individuals who violate the federal prohibition

could be fined up to \$2,500 and imprisoned for a term of up to six months. Operators of businesses that violate the bill's amendments to the Federal Interstate Wire Act ("Wire Act") would face fines up to \$20,000 and imprisonment for a term of four years.

The Wire Act prohibits entities engaged in the business of betting or wagering from using wire communication facilities to accept bets or wagers or to transmit information that assists persons who place bets or wagers on sporting events or contests. Cable television, the telephone system, and the Internet, which uses a network of phone and data lines to transmit information, are examples of communications media covered by the Wire Act's definition of wire communication facilities. Consequently, it appears that betting or wagering on sporting events or contests over the Internet is already prohibited by current law. Bets placed on horse races, however, including those made using wire communication facilities, are now excluded from the Wire Act and covered separately in federal law under the Interstate Horse Racing Act. It is unclear from the Wire Act's statutory language and its legislative history whether the act prohibits placing or receiving bets on nonsports-related events and nonsports-related contests when wire communication facilities are used. The Justice Department has stated that Internet gambling operations within U.S. borders are covered by the existing provisions of the Wire Act.

Nevertheless, S. 474 would impose several new federal private-sector mandates as defined in UMRA. First, the bill would expand the federal prohibition on placing bets or wagers over wire communication facilities to *individuals*. Specifically, the bill would prohibit individuals, who are not covered by the Wire Act's prohibitions, from placing bets or wagers over the Internet or other interactive computer services. Under existing federal law, the prohibition on the use of wire communication facilities to place bets or wagers applies only to entities engaged in the *business* of betting or wagering. Most states, however, have some statutory prohibition against gambling by individuals outside an environment that is explicitly sanctioned by the state government.

Second, to enforce the prohibition against Internet wagering, providers of Internet services could be required by law enforcement agencies to block access by subscribers to Internet gambling websites. Because most, if not all, Internet gambling websites are based outside U.S. borders, S. 474 would apply section 2 of the Wire Act to Internet service providers (ISPs) and on-line service providers (OSPs) to require them to block access by computer users to gambling websites.

In general, the ISP and OSP markets are comprised of companies that provide individuals and businesses with computer-based access to the content posted on the Internet, electronic mail (e-mail) and e-mail addresses, and some additional features in exchange for a monthly or annual subscription fee. OSPs differ from ISPs in the range of services they provide. Like

ISPs, on-line service providers offer subscribers e-mail capabilities and links to the Internet. However, OSPs typically offer a much wider assortment of additional information services—such as news or sports-based bulletin boards or "chatrooms" where computer-users can converse—that only subscribers may access. For example, America On-Line, which is the nation's largest provider of Internet services with approximately 11 million subscribers, is an OSP.

The Wire Act provides for notification of common carriers, which includes ISPs and OSPs, by law enforcement agencies that their facilities are being used or will be used to transmit or receive gambling information illegally. After so notifying ISPs and OSPs, law enforcement agencies could require Internet service providers to block access to gambling websites. S. 474 does not specify the means or mechanism required to block access to gambling websites. Nevertheless, the requirement would constitute a new enforceable duty and therefore meets the definition of a private-sector mandate in UMRA.

Third, S. 474 would effectively prohibit certain legal wager-based businesses that use computers and wire communication facilities, such as horse and greyhound racing tracks, from placing or receiving bets over interactive computer services. Section 3 defines the term "interactive computer service" in a way that is sufficiently broad such that horse and greyhound racing tracks would be prohibited from accepting most types of off-track or simulcast (intertrack) betting. Restricting those activities, which are permissible under current federal law, constitutes a new private-sector mandate.

In addition, S. 474 would prohibit horse or greyhound racing tracks from receiving bets from individuals via the Internet. Provisions of the Interstate Horseracing Act of 1978 appear to allow Internet wagering on horse races if prior approval is obtained from state authorities. Though no states have granted tracks the authority to accept wagers over the Internet and it is now used only to transmit wagering information—for example, handicapping data—many entities in the legal racing industry have explored the expansion of their business practices to the Internet. Any expansion of horse and greyhound racing track wagering activity to the Internet would be prohibited if S. 474 were enacted.

Finally, S. 474 broadly defines "bets or wagers" such that the bill would impose a new private-sector mandate on certain entities that conduct contests over the Internet. Section 2 defines "bets or wagers" to include contests where participants stake or risk something of value and, in the event of a certain outcome, will receive something of value. Consequently, many operators of Internet contests where participants pay an entry fee and nontrivial prizes are awarded would be prohibited from engaging in those activities.

Section 2 of the bill defines "bets or wagers" in a manner sufficiently broad to prohibit many activities of Internet contest operators. Participants in Internet contests frequently risk something of value, such as an entry fee, in exchange for the opportunity to win cash or prizes in the event of a specific outcome. The activities of some "fantasy baseball" or "fantasy basketball" leagues, for example, would meet the definition of bets or wagers in S. 474. In those leagues, individuals often pay a fee to select a fantasy team comprised of real professional players to compete against other teams in the league. Fantasy teams whose players perform best on the basis of specific statistical criteria, such as the most home runs or strikeouts, can win cash or in-kind prizes. The activities of those leagues, in addition to several other types of Internet contests, would be prohibited if S. 474 were enacted.

### **ESTIMATED DIRECT COST TO THE PRIVATE SECTOR**

CBO estimates that the direct costs of new private-sector mandates contained in S. 474 would exceed the statutory threshold in each of the first five years that the mandates were effective. In 1999, new mandates would impose total direct costs on the private sector of between \$2 billion and \$3 billion. Direct costs would likely increase in each year and, by 2003, the mandate costs imposed on the private sector would total between \$2 billion and \$5.5 billion.

Commercial providers of Internet services and participants in the horse and greyhound racing industries would shoulder most of the costs of private-sector mandates contained in S. 474. CBO estimates that the mandate on commercial providers of Internet services to block access by subscribers to gambling websites would impose direct costs between \$700 million and \$1.3 billion in 1999, and between \$800 million and \$3.8 billion by 2003. These estimates encompass a broad range because the cost and technological feasibility of implementing the bill's requirements are very uncertain. The technology to block access to gaming websites on a continuous basis is still in its developmental stage and not ready for mass distribution. The mandate that would effectively prohibit a significant portion of legal simulcast and off-track wagering activity in the horse and greyhound racing industries would have a direct effect on the revenues of those industries of \$1.2 billion to \$1.7 billion per year.

The prohibition against betting by individuals via the Internet would impose no direct costs, as defined in UMRA. Finally, CBO cannot estimate the direct costs imposed on operators of Internet contests at this time because of a lack of reliable information.

Internet Service Providers. S. 474 would make commercial Internet service providers (ISPs) and on-line service providers (OSPs) bear the day-to-day responsibility for enforcing the prohibition against Internet gambling by individuals. It is unclear how costly it would be for

ISPs and OSPs to comply with the new mandate because no computer-based operation has ever been required to implement a restriction as broad as the one contemplated in this legislation. Therefore, CBO's estimate of direct costs encompasses a broad range. In 1999, the direct costs imposed on ISPs and OSPs could be between \$700 million and \$1.3 billion. By 2003, because of the explosive growth in Internet usage, direct mandate costs could be between \$800 million and \$3.8 billion.

Firms that track usage of the Internet estimate that there are about 5,000 commercial providers of Internet services nationwide and more than 60 million Internet users in the United States. The market for Internet services has annual revenues of approximately \$10 billion and is growing at a rate of 2 percent to 3 percent per month.

ISPs and OSPs could use two methods to block access to gambling websites by their subscribers. First, they could hire additional workers to scan the Internet for sites that offer gambling opportunities. Upon determining that a specific website would enable subscribers to commit a gambling-related violation of the Wire Act, ISPs and OSPs would configure their computer systems to block access to those websites. Alternatively, ISPs and OSPs could contract with companies that provide software programs (so-called "filters" or screening programs) that restrict access by subscribers to objectionable sites. Companies that offer filtering services would search the Internet for websites that offer gambling opportunities. Those companies would note the unique Internet address for the gambling website and enter that address into a computer program, which would effectively be a database of all illegal gambling sites. Subsequently, ISPs and OSPs could purchase that database and download it daily. Contracting with filtering companies would likely be the most cost-efficient option for ISPs and OSPs to comply with the new private-sector mandate.

Because the market for filtering services is new and the Internet is changing so rapidly, CBO can provide only a broad range for the estimate of direct costs that would be imposed on ISPs and OSPs. Direct costs include the costs to ISPs and OSPs of purchasing the services that block access to gambling websites, acquiring specialized computer equipment to screen data packet transmissions at ISP and OSP "points of presence" on the Internet, and configuring computer equipment to make those services fully operational. As noted earlier, the future size of the market is unclear. Many individuals have multiple accounts at different locations—for example, one at home and another at work—and some have subscriptions with multiple ISPs and OSPs. As a result, the number of Internet subscriptions for which gambling access must be blocked could be greater than the number of persons who use the Internet. By 1999, the total number of Internet subscriptions in the United States could exceed 70 million, and by 2003, the number could approach 200 million.

Assuming the filtering option is selected by ISPs and OSPs, CBO estimates that the direct cost of the mandate on ISPs and OSPs to block access by subscribers to gambling websites would be between \$700 million and \$1.3 billion in 1999, and between \$800 million and \$3.8 billion by 2003. Based on limited available information, in 1999, it could cost ISPs and OSPs, on average, as little as 75 cents per subscriber per month to block gambling website access. In addition, it could cost ISPs and OSPs about \$1 per subscriber per year to install, configure, and operate the computer equipment that enables providers to block subscriber access to gambling websites. At 75 cents per subscriber per month, the annual direct costs of the mandated services would be about \$630 million plus another \$70 million for associated start-up costs. However, if filtering service costs are closer to \$1.50 per month per subscriber, direct mandate costs in 1999 would be about \$1.3 billion.

With technology-based applications, it would not be unusual for the future cost of equipment and services to fall or remain flat. Assuming that mandate costs in 2003 could be as low as 25 cents per subscriber per month or as high as \$1.50 per subscriber month, the direct costs to ISPs and OSPs for filtering services in 2003 would be between \$800 million and \$3.8 billion. In general, those costs would be passed on to consumers and businesses in the form of higher subscription fees.

Finally, CBO's estimate assumes that ISPs and OSPs would not, in the absence of legislation, purchase, install, and operate filtering services with the capability to block subscriber access to gambling websites. However, as an added service, many ISPs and OSPs have started offering subscribers the ability to block access to Internet content that they find objectionable, such as gambling or material of a sexual nature. To the extent that ISPs and OSPs provide website blocking capabilities independent of S. 474 and those systems could be reconfigured with relative ease to restrict access by subscribers to gambling websites, the direct costs of the mandate would be significantly lower.

Simulcast and Off-Track Betting. New private-sector mandates in S. 474 would impose significant direct costs on the horse and greyhound racing industries. Under current law, businesses in those industries use computer-based applications to conduct their operations. Those applications meet the definition of interactive computer service in S. 474. Thus, S. 474 would effectively prohibit most simulcast and off-tracking wagering activities of racing tracks. CBO estimates that the direct effect on the revenues of the horse and greyhound racing industries would be between \$1.2 billion and \$1.7 billion annually.

Forty-three states allow some form of horse racing and fifteen states allow greyhound racing. Within those states, most tracks offer some form of off-track, simulcast, or intertrack wagering. Simulcast and off-track betting occurs when a bet is tendered on a race that occurs off the grounds of the betting facility. Patrons of horse tracks in Florida or California, for

example, may bet on races that are run in Illinois. Bets are pooled and analyzed by a central computer, known as a totalizator, which subsequently generates odds and payout information for each entry in the race.

In 1997, approximately \$17 billion was wagered on horse and greyhound racing. Of that total, between 50 percent and 60 percent was wagered through simulcast betting. Therefore, S. 474 would affect about \$8.5 billion to \$10 billion in gross betting revenues of the racing industry. Assuming that 14 percent to 17 percent of gross betting revenues are retained to cover track expenses and to pay the purses of race winners and participants, S. 474 would reduce private-sector revenues by \$1.2 billion to \$1.7 billion per year over the next five years.

This estimate assumes that the gross betting revenues of the parimutuel industry would remain essentially unchanged through 2003. It also assumes that on-track wagering would not rise in response to the prohibition on simulcast wagering. Moreover, the estimate assumes that no states would have allowed horse or greyhound racing tracks to accept wagers over the Internet during the first five years that the prohibition was effective. However, if, in the absence of S. 474, tracks would be authorized by states to accept Internet wagers, the direct effect of the bill on private-sector revenues would likely rise by several hundred million dollars.

Over the last decade, growth in gross parimutuel betting revenues has been flat or negative, although one area of revenue growth for horse and greyhound racing tracks has been intertrack wagering. If those trends continue and simulcast betting is prohibited, it is possible that some horse and greyhound racing tracks would be forced to close or to file for bankruptcy. In addition, significant segments of the horse breeding industry would likely experience losses as a result of the prohibition.

Prohibition on Gambling by Individuals. The net direct cost of a new mandate in S. 474 that would prohibit gambling by individuals over the Internet or other interactive computer systems would be zero. In most states, it is illegal for individuals to gamble outside an environment where gambling has been explicitly sanctioned by the state government, such as horse racing or state-controlled lotteries. As a result, a federal prohibition on the use of wire communications facilities to gamble would not impose new restraints on individuals in those states.

In addition, in those states where it is legal to gamble, individuals who wager, on average, incur dollar losses with greater frequency than they receive winnings. That is, the likelihood that people will lose while participating in a gambling event is greater than the likelihood they will win. Statistically, the outcomes of games of chance—such as blackjack ("21") or

roulette—are biased in favor of the operator. Consequently, a new private-sector mandate restricting the ability of individuals to participate in games of chance would impose no direct costs.

Internet Contest Operators. CBO has been unable to obtain reliable information on the number of Internet contest providers that charge entry fees, the revenues or income generated by those operations, and estimates of potential growth in that market. Consequently, we cannot estimate the direct costs that the new private-sector mandate would impose on operators of Internet contests by prohibiting their activities.

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