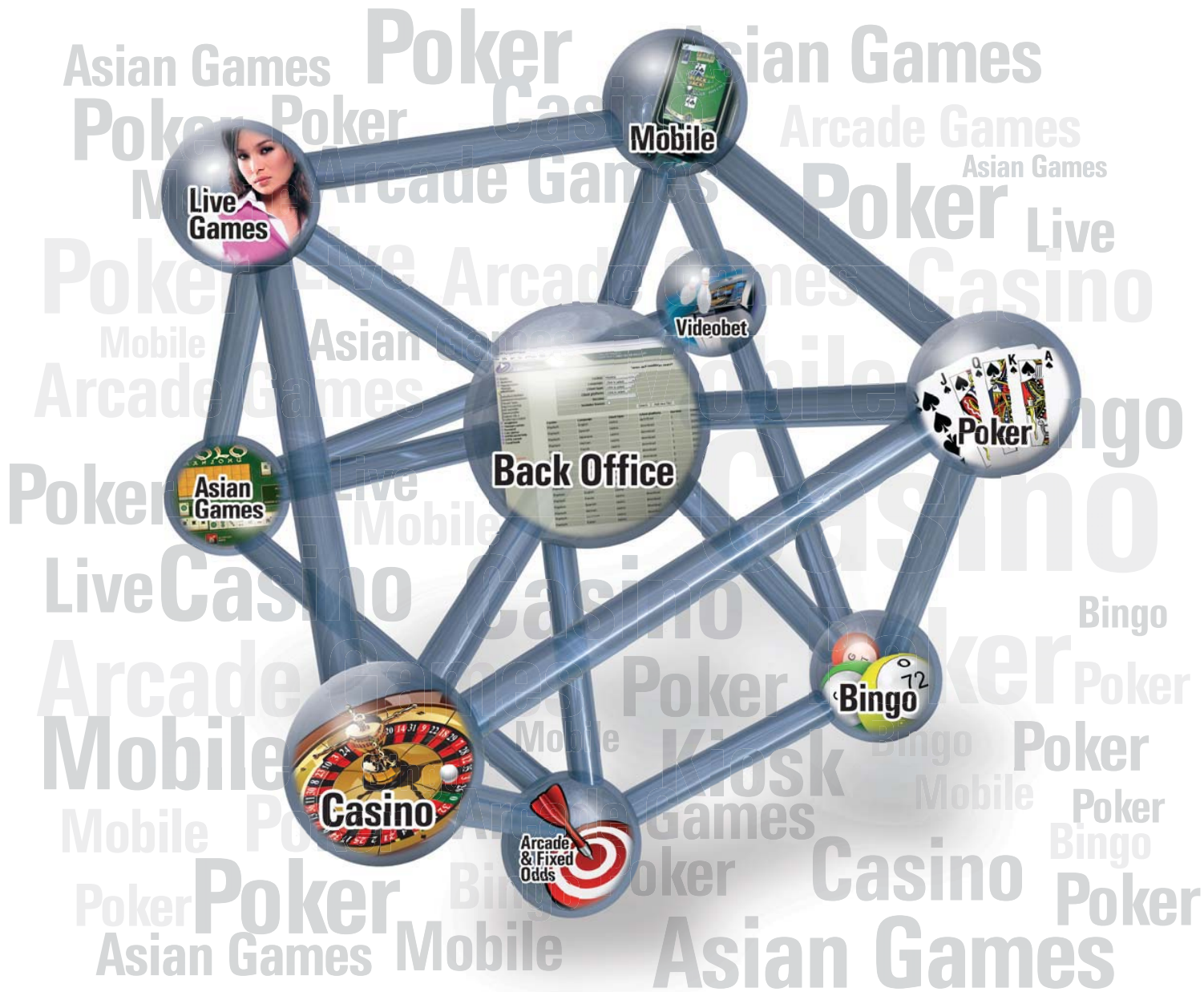




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THE SIDESHOW THAT BECAME A VITAL TRADE ISSUE

BY MARK MENDEL

This discussion is intended to be a concise, but comprehensive summary of the dispute between Antigua and the United States over Internet – or remote gambling. This fascinating case has gone from an unnoticed sideshow to what is currently the most important international trade dispute facing the World Trade Organisation today, with enormous implications for the global trading system.



THE FIRST ROUND

The proceedings began in March 2003 when, as a result of increasing US efforts to prevent Antiguan service providers from offering remote gambling services to American consumers, we requested "consultations" with the US under World Trade Organisation (WTO) rules regarding the maintenance of what we considered illegal measures by the US to prohibit these services. The "consultations" were fruitless, and at the request of Antigua a WTO panel was formed in July 2003 to consider the dispute.

Our claim had four principal components:

- *First*, that under the WTO's General Agreement on Trade in Services (or GATS) the US had made a full commitment to allow the cross-border provision of gambling and betting services to consumers in the US;
- *Second*, that the US had adopted measures and taken actions that effectively prohibited the cross-border supply of these services;
- *Third*, that the measures violated the GATS; and
- *Fourth*, that the measures could not be justified by the US under the "public morals defence" contained in the GATS.

The US, on the other hand, argued that it had made no such commitment and that its laws did not violate the GATS. It also, very late during the course of the proceedings, alleged that even if its laws were contrary to the GATS, they were entitled to be maintained under the "morals defence" on the grounds that so-called "remote" gambling presented "special risks" not present in "non-remote" gambling and that accordingly, the US prohibited *all* forms of remote gambling.

In November 2004, the panel issued its report, in which it ruled that (i) the US had made a full commitment to allow

remote gambling services; (ii) three federal laws—the so-called Wire Act, Travel Act and Illegal Gambling Business Act were contrary to the GATS; and (iii) the US had not been able to demonstrate that the three federal laws were entitled to the “morals defence”. It observed that to maintain the “morals defence”, the US had to prove *both* (1) that the otherwise GATS-inconsistent laws were apparently ‘necessary’ to protect the public morals and health *and* (2) that the defence was not actually a disguised restriction on trade.

THE SECOND ROUND

The US appealed the loss to the Appellate Body of the WTO, and on 7th April 2005 the Appellate Body issued its report on the dispute. This group upheld most of the determinations of the panel, but in certain circumstances for slightly different reasons. However, the Appellate Body also (i) determined that, contrary to the conclusion of the panel, the US *had* shown that the three federal laws appeared to be “necessary” to protect the public morals and health, and (ii) while upholding the ruling of the panel that the US had failed to meet its burden of proof that the defence was not being used as a “disguised restriction on trade”, held that the US had not demonstrated that the federal laws were applied in a manner not constituting a disguised restriction on trade – “in light of the existence of the federal Interstate Horseracing Act” (IHA).

Whereas the panel report was a clear defeat for the US, poor drafting work and faulty consideration of many issues led the decision of the Appellate Body to be ambiguous in a number of material respects. We immediately hailed the decision as a confirmation of our original victory, but conceded that the language of the report probably meant that the US could bring itself into compliance with the GATS in one of two ways – either by (i) allowing Antiguan operators access to the US market or (ii) prohibiting *all* forms of remote

gambling in the US—whether domestic or foreign and whether intrastate or cross-border.

The US jumped upon the lack of coherency of the Appellate Body decision to itself claim victory in the matter, publicly asserting that the WTO had held the US entitled to maintain the illegal laws under the “morals defence”, but that it just had to “tweak” the IHA to make things somehow “clear”. The poor quality of the report combined with the desire of the US to claim victory led to much confusion as to what the decision *really* meant. It took some time before our interpretation of the decision was confirmed correct – but it was.

THE THIRD ROUND

Under WTO rules, the US had a “reasonable period of time” to correct its offending laws. Not surprisingly, we were unable to agree on what the period should be and so under the rules had to request arbitration to set the compliance period. During the course of the arbitration proceeding Antigua argued that the period of time for compliance should not exceed six months. In light of the powerful gaming interests in the US, we believed it very unlikely that the US would prohibit all remote gambling across America. So, we approached implementation from the perspective of the US providing Antiguan service providers with market access to consumers in the US.

Before the Arbitrator, Antigua argued that the US could comply almost immediately with respect to most of the services covered by the rulings either by a reversion back to the pre-1998 government policy that remote gambling services supplied from other countries was not subject to American law. With respect to remaining services, Antigua expressed the belief that the US would need legislation, which we said could be enacted by the US Congress within six months.



In contrast, the US told the Arbitrator that it needed only to "[clarify] the relationship between the IHA and pre-existing federal law" to comply with the rulings. The US went on to argue that it would require at least 15 months to accomplish this through legislation which would "have the effect of clarifying that relevant US federal laws entail no discrimination between foreign and domestic service suppliers in the application of measures prohibiting remote supply of gambling and betting services."

The Arbitrator decided to give the US a little less than a year to comply, and this period passed on 3th April 2006 without any laws being adopted by the US to implement the rulings. Shortly thereafter however, the US submitted a status report to the WTO, saying that it was in compliance with the Rulings *based solely* upon a statement of the US Department of Justice in which it said it "views the existing criminal statutes as prohibiting the interstate transmission of bets or wagers, including wagers on horse races. The Department is currently undertaking a civil investigation relating to a potential violation of law regarding this activity. We have previously stated that we do not believe that the Interstate Horse Racing Act . . . amended the existing criminal statutes."

The US further told the WTO "in view of these circumstances, the US is in compliance with the recommendations and rulings of the [WTO] in this dispute." Antigua expressed its disagreement with the US' claim, noting that the quoted statement was just a restatement of one of the arguments made by the US to the panel and the Appellate Body during the course of the original proceedings.

THE FOURTH ROUND

Because the US said it was "in compliance" and because we strongly disagreed, in June 2006 Antigua again sought recourse under WTO rules by requesting consultations with the US over the matter. Again, not surprisingly these consultations did not result in agreement so on 6th July 2006 Antigua requested the establishment of yet another WTO panel to resolve this latest disagreement.

In this next round of proceedings, we advanced what the straightforward argument that since the US had *done nothing* at all to come into compliance with the rulings, it could not, therefore, be in compliance. The US returned with the incredible claim that it actually *was* in compliance, and that what the WTO had *really* asked of the US was for it to convince this new "compliance" panel that the three laws were not in fact "disguised restrictions on trade" so that the US would, in its view, thus be entitled to the "morals defence" after all.

As might be expected, we were taken aback by this absurd assertion, and claimed that the US was not entitled to reargue its original, failed case before the compliance panel – but that even if it were, it would *still* lose. Antigua pointed out that not only had the US failed to "tweak" or "clarify" that the IHA prohibited remote gambling, but in fact had done the *opposite* with the late-September 2006 legislation known as the "Unlawful Internet Gambling Enforcement Act" or UIGEA. Further, the UIGEA confirmed an argument we had made to the original panel but that the Appellate Body had inexplicably bungled – that US law did not actually prohibit "remote gambling" at all, but really just prohibited most remote gambling that crossed a border. *Wholly-intrastate*

remote gambling was, is and remains completely untouched by federal law.

- In its report, issued this past March, the panel made precisely the findings we had asked it to make. The three major findings were:
- The US had taken no action to comply with the rulings and thus remained out of compliance;
- The US was not entitled in to reargue the case that failed before the first panel and the Appellate Body; and
- Even assuming that the US was entitled to reargue its failed case, based upon the evidence presented the US "morals defence" case would *still* fail.

The panel also made findings or came to conclusions that were not directly related to compliance but that have had a significant impact on the case going forward. These include:

- A key ruling that the US was *not entitled* to maintain its offending measures;
- An important clarification that, because the US measures were inconsistent with the GATS and the US did not satisfy *both* parts of the "morals defence" exception, it had *lost* in the original proceeding;
- A clarification that the "morals defence" of the US was based upon an assertion that its laws do not discriminate *at all* between domestic and foreign service providers—that is, that remote gambling is *completely* prohibited in the US;
- With respect to the IHA itself, a conclusion that the language of the statute appears to allow interstate remote gambling notwithstanding the Wire Act;
- Based upon evidence provided to the panel by Antigua regarding State regulatory schemes for remote gambling on horse racing as well as facts regarding specific operators, a conclusion that there is "a flourishing interstate remote account wagering industry on horseracing in the US operating in ostensible legality";
- A key finding that the Wire Act does *not* prohibit remote wagering within the US if wagers do not cross State lines, affirming our argument that the individual States themselves are by and large free to permit or to prohibit remote gambling within their own borders as they see fit;
- A key observation that, in light of recent prosecutions by the US of foreign operators combined with a clear lack of prosecutions of domestic operators, remote, interstate, wagering under the IHA is "tolerated, even if not authorized under federal law"; and
- With respect to the UIGEA, key observations that the US Congress (1) appears to have recognised that regulation of remote gambling is feasible and (2) affirmatively decided to retain any ambiguity regarding the IHA rather than "clarifying" it in the way the US had argued.

This latest decision had three major implications:

- The US remains out of compliance with an adverse WTO decision;
- As a result, Antigua is entitled to impose trade sanctions against the US to "encourage" the US to meet its international trade obligations to Antigua; and
- It is now impossible for the US to continue to maintain the pretense that it had somehow "won" the dispute or that the WTO had ruled that the US was entitled to prohibit the provision of remote gambling services from Antigua.

THE FIFTH ROUND

In the face of this clear and comprehensive victory for Antigua, rather than deciding to come into compliance with the rulings or to settle with Antigua, the US took the unprecedented step of declaring that it was going to withdraw the original commitment to allow the cross-border provision of gambling and betting services that had resulted in the adverse rulings in the first place. While there is a provision of the GATS that allows the withdrawal of a commitment, it has never before been used as a means of settling an adverse WTO ruling, and in fact has only been resorted to once before, by the European Union to balance out commitments as the result of the accession of new member-states to the EU.

Under the applicable WTO provision, before the US can withdraw the commitment, it must find means of compensating "any affected" WTO members as a result of the withdrawal of the commitment. If the parties cannot agree on the "compensation", then there is a procedure for arbitration of any dispute in that context. As this provision has never been used before, and never taken to arbitration, immense uncertainty exists as to what kind of "compensation" or "compensatory adjustments" complaining members are entitled to.

As a result of the US announcement, in addition to Antigua, the EU, Costa Rica, Canada, Macau, Canada and Australia filed claims for compensation with the US. As of the date of this writing, all of these parties, including Antigua, continue negotiating with the US over this issue. It must be said that the considerable uncertainty surrounding the proposed withdrawal continues and it is virtually impossible to predict how this will play out in the coming months. The EU itself has made rumblings about expecting a very high level of compensation, causing many to speculate that the US might have to reverse its hasty and unsound decision to withdraw the commitment, and come to a more rational assessment of and solution to the entire remote gambling and "free trade" issue.

THE SIXTH ROUND

Compounding this uncertainty is that under yet another WTO rule, Antigua is entitled to "the suspension of concessions or other obligations" of Antigua with or to the US in order to "induce compliance" by the US with the rulings. We have accordingly submitted authorisation to level concessions against the US in the amount of US \$3.4 billion a year – which is what our independent economists have determined to be the economic effect of the continuing failure of the US to comply with the rulings and to allow our providers with access to American consumers.

Although the concepts are complicated, in general under the applicable provision, the country being harmed can impose higher tariffs on services and goods from the offending country, block certain of its products altogether or otherwise put in suspension the harmed party's trade agreements until such time as the offender complies with the adverse WTO rulings. As a voluntary trade organisation, the WTO has no army, no police force and no right to levy fines or penalties on its members. Thus, its only "enforcement mechanism" against recalcitrant members is to allow the member in the right to impose these concessions.

In determining what concessions to impose, we are entitled to ensure that they be a "practical and effective" way

of inducing US compliance. We have requested approval to achieve our concessions by suspending intellectual property rights with respect to American copyrighted and trademarked products under the WTO's intellectual property rights agreement, or "TRIPS". Our reason for this is that putting higher tariffs on or prohibiting various American goods and services would have a very small impact, if any at all, on the US because the small volume of trade could easily be redirected by American businesses elsewhere and would in most cases drive the cost of replacement services, if they could be acquired at all, to Antiguan consumers.

The WTO rules acknowledge this, and directly provide for what is called "cross-agreement retaliation". It is a rare right and has been authorised only once before, in a dispute between Ecuador and the EU. Under the principles elaborated in that decision, we are pretty confident that Antigua will be given authority to do this "cross-retaliation" under the TRIPS, with the primary question being what the annual level of concessions will be.

True to form, the US complained not only about the level of concessions Antigua demanded, but also that we are not entitled to pursue them under the TRIPS. So, once again the dispute has headed before another panel of the WTO, this time to finally resolve those issues. This proceeding was commenced in August 2007, and we remain in the thick of it. A decision by the Arbitrators is anticipated by the end of November 2007. Arbitrations such as this are notoriously unpredictable, but we remain guardedly optimistic that Antigua will be authorised by the WTO to suspend concessions in *some* substantial amount under the TRIPS until the US complies with the Rulings.

This issue remains how to square the attempt by the US to withdraw its commitment for gambling and betting services with the adverse decision in the Antigua case. From our perspective, even if the US can withdraw the commitment, it will only affect its obligations to other members and not to Antigua—we have a final ruling in our favour and under general international legal principles, you cannot simply "change the rules" to comply with an adverse decision. The US, predictably, has stated that if it withdraws the commitment, it will then be in compliance. Unless the United States finally complies with the rulings or can bring itself to come to some kind of negotiated settlement with Antigua – which is what we have been pleading for to no avail from the very beginning – expect this astounding battle to continue into yet a seventh round! **CGI**

MARK MENDEL



Mark Mendel has been pursuing legal cases and causes for more than 25 years, primarily in the area of securities and finance. In late 2002, his El Paso, Texas-based law firm of Mendel Blumenfeld LLP developed Antigua's Internet gambling position, and was

hired by the Government to represent the country in early 2003. Mark has since spearheaded Antiguan representation at the World Trade Organisation. He lives in County Cork, Ireland.