

A CONSTITUTIONAL “INQUIRY” INTO THE TEXAS RACING ACT: THE PHYSICAL PRESENCE REQUIREMENT FOR WAGERING & THE DORMANT COMMERCE CLAUSE

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I. INTRODUCTION

With the advent of the commercial Internet, there came a fundamental transformation in the United States' economy.¹ In 2010, “e-commerce grew faster on a year-to-year percentage change basis than total economic activity.”² This growth in e-commerce also holds true in the horseracing industry. Advance deposit wagering (ADW) is the fastest growing segment of pari-mutuel wagering.³ ADW is a mechanism for betting on horse races where individuals place funds into an account and “wager via telephone, mobile device, or through the Internet.”⁴ With ADW comprising a larger portion of the betting industry, companies are more aware of the importance of offering their ADW systems to as many potential customers as possible.

Despite its market share, not everyone is willing to accept the ascendance of ADW so easily. Companies operating ADW systems must navigate inconsistent state regulations. These regulations vary - with different state regulations banning online gambling completely, permitting all forms of online gambling, banning online gambling with exceptions for pari-mutuel wagering, banning online pari-mutuel wagering and permitting only bets placed at an actual racetrack, and having unclear regulations requiring ADW operators to roll the dice.⁵ The convergence of complex legal analyses further complicates this growing market. Challenges to a

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¹ ROBERT D. ATKINSON ET AL., THE INFO. TECH. & INNOVATION FOUND., THE INTERNET ECONOMY 25 YEARS AFTER .COM: TRANSFORMING COMMERCE AND LIFE (2010), available at <http://www.itif.org/files/2010-25-years.pdf>.

² U.S. CENSUS BUREAU, U.S. CENSUS BUREAU E-STATS (2012), available at <http://www.census.gov/econ/estats/2010/2010reportfinal.pdf>.

³ CHURCHILL DOWNS, INC., ANNUAL REPORT (FORM 10-K) 6, (2008).

⁴ *Id.*

⁵ ERIC SINDLER, HARNESS TRACKS OF AM., RULES AND REGULATIONS: ADVANCE DEPOSIT WAGERING IN THE UNITED STATES AND CANADA (2010), available at http://ua-rtip.org/sites/ua-rtip.org/files/adw_rules_and_regulations.pdf

state law that regulates gambling on the Internet can culminate in a multitude of potential legal quandaries, including: constitutional issues; the perplexity of applying legal doctrines to the Internet; and federalism concerns. Legal scholars have often said that the Dormant Commerce Clause, when combined with state laws that regulate the Internet, is “a nuclear bomb of legal theory.”⁶ This statement is particularly true when the Dormant Commerce Clause, the Internet, and the traditional state police power to regulate gambling converge.

There is an industry-wide trend of decreasing track attendance.⁷ Churchill Downs, Inc. suggested in 2007 that “over 80% of pari-mutuel handles bet at off-track locations,” including ADW channels.⁸ This industry shift signals the growing importance of off-track handles. On September 21, 2012, Churchill Downs Inc., doing business as Twinspires.com, filed a lawsuit in federal court against the Executive Director and other members of the Texas Racing Commission seeking declaratory and injunctive relief from the in-person wagering requirement of the Texas Racing Act, arguing it is an unconstitutional violation of the Commerce Clause.⁹

Part I of this note discusses the various federal laws which relate to online pari-mutuel wagering. Part II outlines the Commerce Clause and its dormant application. Parts III and IV provide an in-depth examination of the dormant Commerce Clause doctrine and its application in cases involving the Internet and gambling. Part V demonstrates the convergence of these complex legal analyses in *Churchill Downs Inc. v. Trout*. Finally, Part VI recommends a proper resolution to the *Churchill Downs* case and proposes a course for future regulation of the horseracing industry and pari-mutuel wagering.

II. APPLICABLE FEDERAL LAW

There are three major federal laws that directly relate to Internet pari-mutuel gambling. These laws include the Interstate Wire Act of 1961, the Interstate Horseracing Act of 1978, and the Unlawful Internet Gambling Enforcement Act of 2006. Although the industry has long called for clarification of these laws, and despite several attempts by Congress to amend legislation, uncertainty continues.¹⁰

⁶ Declan McCullagh, *Brick by Brick*, NETLY NEWS NETWORK (Jan. 31, 1997), <https://groups.google.com/forum/?fromgroups=#!topic/alt.cyberspace/0x0cUPuK0SA>.

⁷ *Racetrack Attendance Plummeting*, NPR (May 2, 2008), <http://www.npr.org/templates/story/story.php?storyId=90142692>.

⁸ CHURCHILL DOWNS, INC., *supra* note 3, at 15.

⁹ Complaint for Declaratory and Injunctive Relief, *Churchill Downs Inc. v. Trout*, et al., No. 12CV00880 (W.D. Tex. Sept. 21, 2012), 2012 WL 4485999, at 11.

¹⁰ See H.R. Res. 5599, 111th Cong. (2010); H.R. Res. 2702, 112th Cong. (2011).

A. The Interstate Wire Act of 1961

The first of these federal laws, the Interstate Wire Act of 1961 (Wire Act) could prove disastrous for ADW operators. Congress intended the Wire Act to assist states with “the enforcement of their laws pertaining to gambling, bookmaking, and like offenses and to aid in the suppression of organized gambling activities.”¹¹ The Wire Act provides:

Whoever being engaged in the business of betting or wagering knowingly uses 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, or for the transmission of a wire communication which entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers, shall be fined under this title or imprisoned not more than two years, or both.¹²

On September 20, 2011 the Department of Justice released a Memorandum Opinion that concluded “interstate transmissions of wire communications that do not relate to a ‘sporting event or contest’ fall outside the reach of the Wire Act.”¹³ Despite the Department’s intention to clarify the issues surrounding the Wire Act as it relates to lotteries, the Department further complicated the legal issues surrounding other forms of online gambling, including pari-mutuel wagering. The horseracing industry interprets the Wire Act as inapplicable to pari-mutuel betting.¹⁴ However, the Department of Justice disagrees.¹⁵ Throughout the memorandum, off-track betting on horseracing is referred to as Congress’ principal focus in enacting the Wire Act.¹⁶ These references suggest the Department of Justice would find the transmission of wire communications for the purpose of betting on a horse race illegal under the Wire Act. Nevertheless, the Wire

¹¹ H.R. Rep. No. 87-967, at 2631 (1961).

¹² 18 U.S.C. § 1084(a) (1961).

¹³ VIRGINIA A. SEITZ, MEMORANDUM OPINION FOR THE ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION 1 (2011), available at <http://www.justice.gov/olc/2011/state-lotteries-opinion.pdf>.

¹⁴ Ron Mitchell, *Opinion Opens Door to More Internet Gambling*, BLOODHORSE (Dec. 28, 2011, 6:00 PM), <http://www.bloodhorse.com/horse-racing/articles/66721/opinion-opens-door-to-more-internet-gambling>.

¹⁵ *Wire Act – IHA Clarification Introduced*, AM. HORSE COUNCIL (Feb. 3, 2012), <http://www.horsecouncil.org/legislation/wire-act---iha-clarification-introduced>.

¹⁶ SEITZ, *supra* note 13, at 8.

Act contains a provision excluding legal pari-mutuel wagering from the purview of the Act.¹⁷ 18 USC § 1084(b) provides:

Nothing in this section shall be construed to prevent the transmission in interstate or foreign commerce of information ... for the transmission of information assisting in the placing of bets or wagers on a sporting event or contest from a State or foreign country where betting on that sporting event or contest is legal into a State or foreign country in which such betting is legal.¹⁸

Therefore, the Wire Act should not be an obstacle for ADW operators or persons who wish to wager on horse races, as long as the interstate wager both originates and is received in states that permit such activity.

B. Unlawful Internet Gambling Enforcement Act of 2006

It has been suggested that the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) makes Internet pari-mutuel wagering illegal.¹⁹ However, it is clear from the statutory text, which provides “the term ‘unlawful internet gambling’ shall not include any activity that is allowed under the Interstate Horseracing Act of 1978,” that Congress did not intend for the UIGEA to have any effect upon pari-mutuel wagering.²⁰

C. The Interstate Horseracing Act of 1978

The Interstate Horseracing Act of 1978 (IHA) was enacted in order to “regulate interstate commerce with respect to wagering on horseracing,” with the express intention to “further the horseracing & legal off-track betting industries in the United States.”²¹ The IHA requires the consent of the host racing commission, host racing association, and off-track racing commission, and further requires compliance with a state’s laws in order for the acceptance of an interstate off-track wager to be legal.²² As long as ADW operators comply with these requirements, the IHA explicitly permits interstate pari-mutuel wagers via telephone or other electronic media.

¹⁷ United States v. Bala, 489 F.3d 334 (8th Cir. 2007) (using 18 U.S.C. § 1084(b) as an exception to criminal liability for participating in pari-mutuel wagering under the Wire Act).

¹⁸ 18 U.S.C. § 1084(b) (1961).

¹⁹ Alex Waldrop, *Working For Players in Washington*, BLOODHORSE (June 27, 2010, 12:09 PM), <http://cs.bloodhorse.com/blogs/ntra-alex-waldrop-straight-up/archive/2010/06/27/working-for-players-in-washington.aspx>.

²⁰ 31 U.S.C. § 5362(D)(i) (2006).

²¹ 15 U.S.C. § 3001(b) (1978).

²² 15 U.S.C. § 3004(a) (1978).

III. THE COMMERCE CLAUSE

A. Commerce Power Generally

Article 1, § 8, cl. 3 of the Constitution grants Congress the power to “regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.”²³ The Commerce Clause has long been one of Congress’ main sources of power, allowing it to regulate many activities and create federal crimes. The Supreme Court has held that the Commerce Clause “not only bestows powers upon Congress to regulate interstate commerce, but also limits the powers of the states to erect barriers against interstate trade.”²⁴

Although Congress’ Commerce power is plenary, the item or activity to be regulated must actually be “commerce” in order to be subject to Congress’ power.²⁵ In the Supreme Court’s first major case examining the Commerce Clause, *Gibbons v. Ogden*, the Court defined “commerce” as “intercourse”²⁶ and found the power “is complete in itself, may be exercised to its utmost extent, and acknowledges no limitations, other than are prescribed in the Constitution.”²⁷ In *Champion v. Ames*, the Court held Congress’ commerce power included the ability to prohibit the interstate transportation of lottery tickets.²⁸ Additionally, courts have extended the Court’s reasoning to find Congress has the ability to “prohibit all interstate transmission of wagers.”²⁹ The Supreme Court has also held state and local actions are “within the domain of the Commerce Clause if they burden interstate commerce or impede its free flow.”³⁰

B. Dormant Commerce Clause

The Supreme Court has construed the Commerce Clause to prohibit state laws and regulations which burden interstate commerce, even in the absence of congressional action. The Court has interpreted the dormant Commerce Clause as serving the Commerce Clause’s “purpose of preventing a state from retreating into economic isolation or jeopardizing the welfare of the Nation as a whole, as it would do if it were free to place burdens on the flow of commerce across its borders that commerce wholly

²³ U.S. Const. art. I, § 8, cl. 3.

²⁴ *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 35 (1980).

²⁵ *Gibbons v. Ogden*, 22 U.S. 1, 1 (1824).

²⁶ *Id.* at 4.

²⁷ *Champion v. Ames*, 188 U.S. 321, 347 (1903) (quoting *Gibbons v. Ogden*, 22 U.S. 1 (1824)).

²⁸ *Id.* at 328.

²⁹ *E.g.*, *Martin v. United States*, 389 F.2d 895, 899 (5th Cir. 1968).

³⁰ *C & A Carbone v. Clarkstown*, 511 U.S. 383, 389 (1994).

within those borders would not bear.”³¹ Further, the Supreme Court has found the construction of the Commerce Clause to create a “dormant” doctrine reflecting the Framers’ “conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued the relations among the Colonies and later among the states under the Articles of Confederation.”³²

After establishing an item or activity is subject to Congress’ commerce power, it is subject to two threshold inquiries. First, is whether federal law has made permissible the state or local law’s discriminatory impact on interstate commerce.³³ The state or local government has a high burden in proving its law is exempt from Commerce Clause scrutiny.³⁴ Courts require that “Congress must manifest its unambiguous intent before a federal statute will be read to permit or to approve such a violation of the Commerce Clause.”³⁵ A mere reference to the states’ ability to regulate, without something in the “statute or legislative history evincing a congressional intent to alter the limits of state power otherwise imposed by the Commerce Clause,” would likely be insufficient to meet this burden.³⁶ The Supreme Court has stated, “absent a ‘clear expression of approval by Congress, any relaxation in the restrictions on state power otherwise imposed by the Commerce Clause unacceptably increases ‘the risk that unrepresented interests will be adversely affected by restraints on commerce.’”³⁷

The second threshold inquiry is whether in-state and out-of-state interests are “similarly situated for constitutional purposes.”³⁸ The Supreme Court has stated, “any notion of discrimination assumes a comparison of substantially similar entities.”³⁹ If the in-state and out-of-state entities “provide different products” there may be a lack of competition between the entities.⁴⁰ Thus, there “can be no local preference, whether by express discrimination against interstate commerce, or undue burden upon it, to which the dormant Commerce Clause may apply.”⁴¹ Therefore, if the legal distinction is based on different types of “business forms” and not on domicile, the dormant Commerce Clause does not apply.⁴²

³¹ *Okla. Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179-80 (1995).

³² *Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979).

³³ *Wyoming v. Oklahoma*, 502 U.S. 437, 457 (1992).

³⁴ See *Id.* at 456 (describing the burden on the state to show the unavailability of nondiscriminatory alternatives).

³⁵ *Id.* at 458.

³⁶ *Id.*

³⁷ *Maine v. Taylor*, 477 U.S. 131, 139 (1986) (quoting *South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 92 (1984)).

³⁸ *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 299 (1997).

³⁹ *Id.* at 298.

⁴⁰ *Id.* at 300.

⁴¹ *Id.*

⁴² *Allstate Ins. Co. v. Abbott*, 495 F.3d 151, 162 (5th Cir. 2007).

The main inquiry under the dormant Commerce Clause analysis is whether the state or local law is discriminatory. If the law is discriminatory, it will be subjected to the “strictest scrutiny.”⁴³ If the court finds the law non-discriminatory, the law is subject to a lesser scrutiny focused on whether the “burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”⁴⁴

A local or state law is unconstitutional under the dormant Commerce Clause “where it discriminates against interstate commerce either facially, by purpose or by effect.”⁴⁵ State or local laws that discriminate against interstate commerce face a “virtually *per se* rule of invalidity.”⁴⁶ When a statute affirmatively discriminates, a state must “demonstrate both that the statute serves a legitimate local purpose and that this purpose could not be served as well by available nondiscriminatory means.”⁴⁷ This is a high burden for state and local governments to overcome because “in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.”⁴⁸

The burden of establishing that a law is discriminatory falls on the party challenging the statute.⁴⁹ For a statute to be discriminatory on its face, the text must “facially benefit in-state interests over out-of-state interests or give some benefit to intrastate companies that it does not give to interstate companies.”⁵⁰ However, even a facially neutral statute can be discriminatory in its purpose or effect.⁵¹

A law enacted with the intent to discriminate against out-of-state interests is discriminatory.⁵² The Supreme Court directs courts to perform “an independent assessment of the asserted purpose” behind legislation in their analyses.⁵³ Most courts will look to both “direct and indirect evidence to determine whether a state adopted a statute with a discriminatory purpose.”⁵⁴ Several circuit courts have adopted the equal protection analysis from *Village of Arlington Heights v. Metropolitan Housing Development*

⁴³ *Hughes v. Oklahoma*, 441 U.S. 332, 337 (1979).

⁴⁴ *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

⁴⁵ *Allstate Ins. Co.*, 495 F.2d 160; *see also Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984).

⁴⁶ *City of Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978).

⁴⁷ *Maine v. Taylor*, 477 U.S. 131, 138 (1986).

⁴⁸ *Granholm v. Heald*, 544 U.S. 460, 472 (2005).

⁴⁹ *See Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979).

⁵⁰ *Transcon. Gas Pipeline Corp. v. La. Tax Comm’n*, 32 So.3d 199, 209 (La. 2010).

⁵¹ *See Allstate Ins. Co. v. Abbott*, 495 F.3d 151, 160 (5th Cir. 2007).

⁵² *See id.*

⁵³ *Exxon Corp. v. Governor of Md.*, 437 U.S. 117, 137 (1978).

⁵⁴ *E.g., Jones v. Gale*, 470 F.3d 1261, 1269 (8th Cir. 2006).

Corp. to determine whether a state's legislature acted with discriminatory intent.⁵⁵ The four *Arlington Heights* factors are:

- (1) [W]hether a clear pattern of discrimination emerges from the effect of the state action,
- (2) the historical background of the decision, which may take into account any history of discrimination by the decision-making body,
- (3) the specific sequence of events leading up to the challenged decision, including departures from normal procedures, and
- (4) the legislative or administrative history of the state action, including contemporary statements by decision-makers.⁵⁶

Additionally, some courts require a party to show a "relationship between the proffered evidence and the challenged statute" where a party presents "circumstantial evidence of an allegedly discriminatory purpose."⁵⁷ The Fifth Circuit has held "stray protectionist remarks of certain legislators are insufficient" to demonstrate discriminatory intent.⁵⁸ Thus, to prove a law was enacted with discriminatory purpose in the Fifth Circuit, a party must present significant circumstantial evidence and show the effect of the evidence on the challenged law.

A statute can also be discriminatory if it has the practical effect of "favoring in-state interests over out-of-state interests."⁵⁹ Courts require the challenging party to make a "substantial showing" to prove discriminatory effect.⁶⁰ In addition, the Sixth Circuit has held that to prove a law has a discriminatory effect, the party "must show both how local economic actors are favored by the legislation and how out-of-state actors are burdened by the legislation."⁶¹ To satisfy this "substantial showing" the Ninth Circuit found neither the "mere fact that a statutory regime has a discriminatory potential" nor "a de minimis benefit to in-state companies" would be sufficient to subject a law to strict scrutiny.⁶² The Supreme Court has held, "the fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against

⁵⁵ *Allstate Ins. Co.*, 495 F.3d 160; see *Waste Mgmt. Holdings, Inc. v. Gilmore*, 252 F.3d 316, 336 (4th Cir. 2001).

⁵⁶ *Allstate Ins. Co.*, 495 F.3d 160.

⁵⁷ *Alliance of Auto. Mfrs. v. Gwadosky*, 430 F.3d 30, 39 (2005); *E. Ky. Res. v. Fiscal Court of Magoffin Cnty.*, 127 F.3d 532, 543 (6th Cir. 1997).

⁵⁸ *Allstate Ins. Co.*, 495 F.3d 161.

⁵⁹ *Granholt v. Heald*, 544 U.S. 460, 487 (2005).

⁶⁰ *E.g., Black Star Farms v. Oliver*, 600 F.3d 1225, 1232-33 (9th Cir. 2010).

⁶¹ *Cherry Hill Vineyards, L.L.C. v. Lilly*, 553 F.3d 423 (6th Cir. 2008) (internal quotation marks omitted).

⁶² *Black Star Farms, L.L.C.*, 600 F.3d 1235.

interstate commerce.”⁶³ Although, if the “effect of a state regulation is to cause local goods to constitute a larger share and goods with an out-of-state source to constitute a smaller share” of the market, there may be a discriminatory effect.⁶⁴

However, the Supreme Court has held that “where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”⁶⁵ If a law is not discriminatory and still indirectly burdens interstate commerce, a state or local government is still required to justify the law, but is subject to lesser scrutiny.⁶⁶

In *Pike v. Bruce Church* the Supreme Court held that a state or local government must advance a “legitimate local purpose” to justify a statute that burdens interstate commerce.⁶⁷ A state or local government could advance any one of a multitude of legitimate reasons for passing a law. The Supreme Court has adopted a general reluctance to challenge the discretion of lawmakers to determine the usefulness of legislation.⁶⁸ Therefore, a court should give due regard to the “local benefit” lawmakers advance “so long as an examination of the evidence before or available to the lawmaker indicates that the regulation is not wholly irrational in light of its purposes.”⁶⁹

After a legitimate local purpose is found, “the question becomes one of degree.”⁷⁰ Such analysis requires a case-by-case balancing of the benefits of unimpeded interstate commerce against the legitimate purpose advanced by the state or local government.⁷¹ The Supreme Court has held the “extent of the burden that will be tolerated will ... depend on the nature of the local interest involved.”⁷² Thus, this lesser degree of scrutiny requires the state or local government to show the “local benefits [are] ample to support” the legislature’s decision and there is “no approach with a lesser impact on interstate activities.”⁷³ If the law satisfies the two requirements of the *Pike v. Bruce Church* test, it will be upheld despite its incidental burdens on interstate commerce.⁷⁴

⁶³ *Exxon Corp. v. Governor of Md.*, 437 U.S.117, 126 (1978).

⁶⁴ *Id.* at n. 16.

⁶⁵ *Pike v. Bruce Church, Inc.*, 397 U.S. 137,142 (1970).

⁶⁶ *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 306 (1997).

⁶⁷ *Pike*, 397 U.S. 142.

⁶⁸ *See CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 92 (1987) (quoting *Kassel v. Consolidated Freightways Corp. of Del.*, 450 U.S. 662, 670 (1981)).

⁶⁹ *Kassel v. Consolidated Freightways Corp. of Del.*, 450 U.S. 662, 680-81 (1981) (Brennan, J., concurring).

⁷⁰ *Pike*, 397 U.S. 142.

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 473 (1981).

⁷⁴ *See Pike*, 397 U.S. 137.

IV. THE INTERNET & THE DORMANT COMMERCE CLAUSE

The "borderless world" of the Internet has a peculiar way of complicating established legal doctrines, causing lawmakers and jurists to seek guidance in crafting legislation.⁷⁵ *American Libraries Association v. Pataki*, a district court opinion, has become the leading case on Internet and dormant Commerce Clause jurisprudence.⁷⁶ The Court in *American Libraries* determined that the Internet is subject to Congress' interstate commerce authority, qualifying as an area of "commerce that must be marked off as a national preserve to protect users from inconsistent legislation that, taken to its extreme, could paralyze development of the Internet altogether."⁷⁷ The New York law at issue in *American Libraries* prohibited a person from:

Knowing the character and content of the communication which, in whole or in part, depicts actual or simulated nudity, sexual conduct or sado-masochistic abuse and which is harmful to minors, to intentionally use any computer communication system allowing the input, output, examination or transfer, of computer data or computer programs from one computer to another, to initiate or engage in such communication with a person who is a minor.⁷⁸

The court enjoined enforcement of the law after finding it would be "impossible to restrict the effects of the New York Act to conduct occurring within New York" and thus found a per se violation of the Commerce Clause.⁷⁹ The court further stated "even if the Act were not a per se violation of the Commerce Clause . . . [it] would nonetheless be an invalid indirect regulation of interstate commerce, because the burdens it imposes on interstate commerce are excessive in relation to the local benefits it confers."⁸⁰ In finding the statute failed the *Pike v. Bruce Church* test, the court made a strong statement about the protection the Internet deserves as an instrumentality of commerce. Although the Court conceded protecting children from pedophilia is a "quintessentially legitimate" state interest, the court found the Act would result in an "extreme burden on interstate

⁷⁵ *Am. Libraries Ass. v. Pataki*, 969 F. Supp. 160, 168 (1997).

⁷⁶ Jack L. Goldsmith & Alan O. Sykes, *The Internet and the Dormant Commerce Clause*, 110 YALE L.J. 785, 786 (2001).

⁷⁷ *Am. Libraries Ass.*, 969 F. Supp. 160, 169.

⁷⁸ N.Y. PENAL LAW § 235.21 (McKinney 1967).

⁷⁹ *Am. Libraries Ass.*, 969 F. Supp. 160.

⁸⁰ *Id.*

commerce.”⁸¹ Furthermore, before concluding and granting the injunction, the court echoed concerns about the singular nature of the Internet, necessitating “uniform national treatment and bar[ring] the states from enacting inconsistent regulatory schemes.”⁸²

Since *American Libraries*, several jurisdictions elected to follow the court’s reasoning.⁸³ However, this trend has not been universal.⁸⁴ Although the opinion in *American Libraries* stressed that the Internet is “wholly insensitive to geographical distinctions,”⁸⁵ the maturation of geolocation technologies and the consequent reduction of burdens placed on interstate commerce from varying state Internet regulations mark a change in Internet commerce clause scholarship.⁸⁶ Despite this, courts have appeared relatively willing to strike down state laws that regulate the Internet as unconstitutional violations of the Commerce Clause.

V. GAMBLING & THE DORMANT COMMERCE CLAUSE

Despite their general distaste for state Internet regulations, courts have consistently supported the power of states to regulate interstate gambling via their police powers. When applying the dormant Commerce Clause to state police powers, courts have attempted to strike a proper balance with federalism concerns.⁸⁷ The Supreme Court stated the “limitation upon state power” through the dormant Commerce Clause is not absolute, and the “states retain authority under their general police powers to regulate matters of ‘legitimate local concern’ even though interstate commerce may be affected.”⁸⁸ Nevertheless, the Court was careful to note that “however important the state interest at hand, ‘it may not be accomplished by discriminating against articles of commerce coming from

⁸¹ *Id.* at 177-179.

⁸² *Id.* at 184.

⁸³ *E.g.*, *ACLU v. Johnson*, 194 F.3d 1149 (10th Cir. 1999) (invalidating under the dormant Commerce Clause a New Mexico statute criminalizing dissemination by computer of materials harmful to minors); *Cyberspace Commc’ns, Inc. v. Engler*, 55 F. Supp. 2d 737 (E.D. Mich. 1999) (invalidating under the dormant Commerce Clause a Michigan statute criminalizing the use of computers to distribute sexually explicit materials to minors); *PSINet, Inc. v. Chapman*, 108 F. Supp. 2d 611 (W.D. Va. 2000) (enjoining enforcement of a Virginia pornographic communication law at the preliminary injunction stage, in part on dormant Commerce Clause grounds).

⁸⁴ *PSINet, Inc. v. Chapman*, 362 F.3d 227 (4th Cir. 2004); *American Booksellers Foundation v. Dean*, 342 F.2d 96 (2d Cir. 2003); *ACLU v. Johnson*, 194 F.3d 1149 (10th Cir. 1999).

⁸⁵ *Am. Libraries Assoc.*, 969 F. Supp. 170.

⁸⁶ See Kevin F. King, *Geolocation and Federalism on the Internet: Cutting Internet Gambling’s Gordian Knot*, 11 COLUM. SCI. & TECH. L. REV. 41, 63 (2010).

⁸⁷ See, e.g., *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Me.*, 520 U.S. 564, 596 (1997) (Scalia, J., dissenting) (explaining the Court’s cases have “struggled (to put it nicely) to develop a set of rules by which [the court] may preserve a national market without necessarily intruding upon the States’ police powers, each exercise of which no doubt has some effect on the commerce of the Nation.”)

⁸⁸ *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 36 (1980).

outside the State unless there is some reason, apart from their origin, to treat them differently.”⁸⁹

States can use their police powers to protect their citizens’ health, welfare, safety, and morals.⁹⁰ This power is broad and “the regulation of gambling enterprises lies at the heart of the state’s police power.”⁹¹ In *Posadas de Puerto Rico Assoc. v. Tourism Co. of Puerto Rico*, the Supreme Court recognized Puerto Rico’s “interest in restricting advertising to reduce the demand for casino gambling by Puerto Rico’s residents and thus protect their health, safety, and welfare” as a “substantial governmental interest.”⁹² Thus, in a dormant Commerce Clause analysis, the finding that a legitimate local interest is within the state’s police power weighs heavily in favor of the constitutionality of the regulation. However, as many cases demonstrate, a finding that a regulation legitimately concerns a state’s protection of its citizens’ health safety, welfare, and morals is not always enough to survive a dormant Commerce Clause challenge.⁹³

Neither the courts of appeals nor the Supreme Court have entertained a case challenging a state gambling statute on dormant Commerce Clause grounds. However, these types of cases have appeared in state courts and federal district courts for some time. Recently, the Washington Supreme Court heard a challenge to a law that banned all Internet gambling, while allowing residents to enjoy “brick-and-mortar” gambling.⁹⁴ Rousso, an avid poker player, challenged Washington’s ban on Internet gambling alleging it violated the dormant Commerce Clause.⁹⁵ The Supreme Court of Washington disagreed and upheld the law.⁹⁶ In doing so, the court interpreted the statute as facially neutral because it “equally prohibits Internet gambling regardless of whether the person or entity hosting the game is located in Washington.”⁹⁷ The plaintiff argued the law,

⁸⁹ *Id.* (quoting *Philadelphia v. New Jersey*, 437 U.S. 617, 626-27 (1978)).

⁹⁰ *Police Powers*, LEGAL INFO. INST. (Aug. 19, 2010, 5:21 PM), http://www.law.cornell.edu/wex/police_powers.

⁹¹ *Johnson v. Collins Entm’t Co.*, 199 F.3d 710, 720 (4th Cir. 1999).

⁹² *Posadas De Puerto Rico v. Tourism Co. of Puerto Rico*, 478 U.S. 328, 329 (1986).

⁹³ *See, e.g., Granholm v. Heald*, 544 U.S. 460, 492 (2005) (invalidating a law concerning alcohol regulation); *American Libraries Assoc. v. Pataki*, 969 F. Supp.160, 178 (S.D.N.Y. 1997) (invalidating a law that was aimed at protecting minors from pedophiles).

⁹⁴ *Rousso v. Washington*, 239 P.3d 1084, 1086 (Wash. 2010) (holding the law at issue expressly permitted pari-mutuel wagering via the Internet despite the general Internet gambling ban).

⁹⁵ *Id.* at 1087.

⁹⁶ The Supreme Court of Washington expressly addresses *American Libraries Assoc. v. Pataki* and suggests that regulations of Internet gambling, comparable to those imposed on “brick-and-mortar” gambling establishments would result in a major burden on commerce and distinguish the current case by contending the Washington law is not “useless to address legitimate state interests” like the NY law was in *American Libraries Assoc. v. Pataki*. However, it is unlikely regulations would have more of a burden on interstate commerce than an outright ban, which entirely precludes online gambling operators from the Washington market. And the NY law in *American Libraries* was not “useless,” rather the benefits did not outweigh the burden because of the low likelihood of accomplishing the statutory purpose. *Id.* at 1092, 1094.

⁹⁷ *Id.* at 1088.

although facially neutral, was discriminatory in effect.⁹⁸ The court rejected this argument for two reasons. They first found that “Internet gambling and brick-and-mortar gambling are two different activities.”⁹⁹ The court then reasoned that any alleged discriminatory impact is simply an indirect and “secondary effect” of the legislation, which is not sufficient to establish that the statute is discriminatory and subject the law to heightened scrutiny.¹⁰⁰

The court did concede that, even though the law is not discriminatory, it still resulted in a “considerable impact on interstate commerce” and proceeded with the more lenient test from *Pike v. Bruce Church*.¹⁰¹ The court relied heavily upon the state’s ability to regulate gambling under their police powers and found the burden imposed by the law is “comparable to the substantial state interest stemming from the State’s police power to protect the health, welfare, safety, and morals of its citizens.”¹⁰² Ultimately, the Washington Supreme Court found the less restrictive alternatives offered by the plaintiff would not allow Washington to “clearly... avoid threats to health, welfare, safety, and morals posed by Internet gambling equally as well in a manner that imposed less of a burden on interstate commerce.”¹⁰³ Thus the Washington ban on all Internet gambling was not “clearly excessive” and did not violate the dormant Commerce Clause.¹⁰⁴

VI. THE CASE: *CHURCHILL DOWNS INC. v. TROUT, ET AL.*

A. The Texas Racing Act

The Texas Racing Act was amended in September 2011 to specifically prohibit pari-mutuel wagering via the Internet.¹⁰⁵ The Act had required wagering to be conducted “by an association within its enclosure” since 1986, but did not specifically mention the Internet until amended in 2011.¹⁰⁶ The Texas Racing Act provides: “a person may not accept, in person, by telephone, or over the Internet, a wager for a horse race . . . conducted inside or outside this state from a person in this state unless the wager is authorized.”¹⁰⁷ More specifically, § 11.011(f) states “nothing in this Act is to be construed to allow wagering in Texas on simulcast races at

⁹⁸ *Id.* at 1089.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 1090.

¹⁰² *Id.*

¹⁰³ *Id.* at 1091.

¹⁰⁴ *Id.*

¹⁰⁵ 2011 Tex. Sess. Law Serv. Ch. 522, §17 (H.B. 2271) (West).

¹⁰⁶ See 1991 Tex. Sess. Law Serv. Ch. 386 (H.B. 2263) (West) (leaving “within its enclosure” language intact).

¹⁰⁷ Tex. Rev. Civ. Stat. Ann. art. 179e, § 11.01(a) (West 2013).

any location other than a racetrack licensed under this Act that has been granted live race dates by the commission.”¹⁰⁸ Therefore, if someone in Texas wishes to bet on a horse race, they must travel to a racetrack and make their wager in person.

B. The Complaint

On September 21, 2012, Churchill Downs, Inc. brought suit for declaratory and injunctive relief alleging the Texas Racing Act is unconstitutional because it violates the dormant Commerce Clause.¹⁰⁹ Churchill Downs, the owner and operator of one of the largest ADW websites, Twinspires.com, argues the Texas Racing Act is essentially an “in-person” requirement, which are “inherently discriminatory against out-of-state businesses.”¹¹⁰ Churchill Downs concedes the Texas Racing Act is facially neutral, but alleges the statute is discriminatory in its purpose and effect.¹¹¹ In support of their claim of discriminatory intent, Churchill Downs asserts that the primary purpose of the legislation was to raise revenue, citing statements made by legislators contained in the legislative history.¹¹² Churchill Downs also contends the Texas Racing Act has the discriminatory effect of increasing market share for in-state horse tracks while decreasing market-share for out-of-state tracks.¹¹³ In sum, Churchill Downs contends the Texas Racing Act and its physical presence requirement “is discriminatory as a matter of Supreme Court precedent, economic effect, and legislative intent.”¹¹⁴

C. The Answer

In response, the defendants claim the dormant Commerce Clause should not apply for two reasons. First, defendants allege the discriminatory impact of the Texas Racing Act, if any, is permissible because of federal legislation.¹¹⁵ Citing the Interstate Horseracing Act of 1978 and the Unlawful Internet Gambling Enforcement Act of 2006, defendants suggest the federal laws’ permissive attitude towards states “freely regulating” is sufficient to remove the state law from the purview of the dormant

¹⁰⁸ § 11.011(f).

¹⁰⁹ Complaint for Declaratory and Injunctive Relief at 1-4, Churchill Downs Inc. v. Trout, et al., No. 1:12-CV-00880, (W.D. Tex. 2012).

¹¹⁰ Brief for Plaintiffs at 5, Churchill Downs Inc. v. Trout, et al., No. 1:12-CV-00880 (W.D. Tex. 2012).

¹¹¹ Complaint for Declaratory and Injunctive Relief, *supra* note 109, at 4.

¹¹² *Id.* at 11-12.

¹¹³ *Id.*

¹¹⁴ Brief for Plaintiffs, *supra* note 110, at 22.

¹¹⁵ Defendants’ Response to Plaintiff’s Motion for Preliminary Injunction at 2-4, Churchill Downs Inc. v. Trout, et al., No. 1:12-CV-00880, (W.D. Tex. 2012).

Commerce Clause.¹¹⁶ Specifically, the defendants claim that the Interstate Horseracing Act “defers to every State involved to determine legality.”¹¹⁷ Defendants contend there are “two layers to IHA compliance with an interstate off-track bet: (1) the wager must be legal in every state that is involved and (2) the wager must comply with § 3004 ...”¹¹⁸ This statutory scheme begins with a “threshold inquiry” of “whether the interstate off-track wager is ‘lawful in each State involved’” and “if it is not, the IHA does not even proceed to the secondary question of whether the appropriate approvals and consents have been obtained.”¹¹⁹

Second, and in the alternative, the defendants argue the dormant Commerce Clause is inapplicable because Churchill Downs is not “similarly situated” with Texas tracks because they “serve different markets” and offer “different products.”¹²⁰

To counter Churchill Downs’ main argument, defendants argue the statute was not enacted with discriminatory purpose.¹²¹ Rather, they assert that the main impetus of the 2011 amendment was clarification of existing law.¹²² Defendants also claim the Texas Racing Act would survive the *Pike v. Bruce Church* test, arguing that in relation to the local benefit, the burden imposed is not clearly excessive.¹²³ The defendants contend that limiting gambling is a “substantial and legitimate state purpose” and the burden on Churchill Downs is not “clearly excessive” because it only forecloses ADW operators from the Texas market.¹²⁴ In addition, defendants claim that “the link between the in-person requirement and the State’s desire to protect the public interest is evident from the regulatory scheme” and “any burden is not significant in comparison to the benefits.”¹²⁵

VII. ANALYSIS

A. Suggested Resolution of the Case

Churchill Downs Inc. v. Trout, et al., is now before the Federal District Court for the Western District of Texas and presents a case of first impression. Although the facts of *Rousso v. Washington* are similar, the

¹¹⁶ *Id.* at 7-8.

¹¹⁷ Brief for Defendants at 6, *Churchill Downs Inc. v. Trout, et al.*, No. 1:12-CV-00880 (W.D. Tex. 2012).

¹¹⁸ *Id.* at 7.

¹¹⁹ *Id.*

¹²⁰ Defendants’ Response to Plaintiff’s Motion for Preliminary Injunction, *supra* note 115, at 9.

¹²¹ *Id.* at 8-11.

¹²² *Id.* at 6.

¹²³ Brief for Defendants, *supra* note 117, at 19.

¹²⁴ Defendants’ Response to Plaintiff’s Motion for Preliminary Injunction, *supra* note 115, at 11.

¹²⁵ Brief for Defendants, *supra* note 117, at 20-21.

Washington case is not controlling law.¹²⁶ Additionally, Washington's statute banning Internet gambling expressly excluded pari-mutuel wagering from the ban and, thus, the Western District of Texas should find the Washington Supreme Court decision simply persuasive, at most.

Proceeding through established dormant Commerce Clause analyses, the first question is whether the item or activity being regulated is subject to Congress' commerce power. The Supreme Court's decision in *Champion v. Ames*, which held a lottery ticket was a subject of interstate commerce,¹²⁷ coupled with Congress' language in the Interstate Horseracing Act of 1978 stating their intention to "regulate interstate commerce with respect to wagering on horseracing,"¹²⁸ makes it difficult to argue that advance deposit wagering on horseracing is not subject to Congress' commerce power. State or local laws that regulate pari-mutuel wagers via the Internet are subject to Congress' plenary commerce power.¹²⁹ Therefore, the dormant Commerce Clause gives rise to a default presumption that states are prohibited from erecting statutory barriers against such economic activity.

The court must then consider what is likely the defendants' strongest argument - that federal law permits the discriminatory impact of Texas's law on interstate commerce. The Supreme Court has held that "Congress may redefine the distribution of power over interstate commerce by permitting the states to regulate the commerce in a manner which would otherwise not be permissible"¹³⁰ However, to allow such an effect, Congress must "manifest its unambiguous intent."¹³¹ The Unlawful Internet Gambling Enforcement Act of 2006 does not meet this highly specific requirement. The Unlawful Internet Gambling Enforcement Act of 2006 expressly states, "the term 'unlawful Internet gambling' shall not include any activity that is allowed under the Interstate Horseracing Act of 1978."¹³²

On the other hand, the defendants' argument regarding the Interstate Horseracing Act of 1978 is much stronger. In enacting the IHA, Congress specifically stated its intention to "further the horseracing and legal off-track betting industries in the United States" and to ensure that each state has the "primary responsibility for determining what forms of gambling may legally take place within their borders."¹³³ Recognizing that

¹²⁶ See *Rouso v. Washington*, 239 P.3d 1084 (Wash. 2010).

¹²⁷ *Champion v. Ames*, 188 U.S. 321, 363-64 (1903).

¹²⁸ 15 USC § 3001(b) (2011).

¹²⁹ See *Kentucky Div., Horsemen's Benevolent and Protective Ass'n, Inc. v. Turfway Park Racing Ass'n, Inc.*, 20 F.3d 1406 (6 Cir. 1994).

¹³⁰ *South Central Timber Development, Inc. v. Wunnicke*, 467 U.S. 82 (1984).

¹³¹ *Wyoming v. Oklahoma*, 502 U.S. 437, 458 (1992).

¹³² Unlawful Internet Gambling Enforcement Act of 2006 § 801, 31 U.S.C. § 5362(10)(D)(i) (2006).

¹³³ Interstate Horseracing Act of 1978, 15 USC § 3001(a)(1) (1978).

“unrestricted proliferation of off-track wagering would hurt the horseracing industry by decreasing attendance at tracks, which, in turn, would reduce the number of horses needed to compete and the number of individuals employed in the industry,” Congress “opted for the compromise found at 15 U.S.C. § 3004(a) which allows interstate off-track wagering if, and only if, the interested parties consent.”¹³⁴

The statutory scheme established by Congress provides for a “general federal prohibition of interstate off-track betting, set forth in 15 U.S.C. § 1303,” which provides: “No person may accept an interstate off-track wager except as provided in this chapter.”¹³⁵ Then, § 3004 serves as an elaborate exception to the general prohibition, requiring the consent of several parties as a “prerequisite to acceptance” of an interstate off-track wager.¹³⁶

The Supreme Court considered a similar statutory scheme in *Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System*, 472 U.S. 159 (1985), where a general federal prohibition existed but “the language of” § 3(d) of the Bank Holding Company Act of 1956, also known as the “Douglas Amendment,” “plainly permit[ed] the States to lift the federal ban entirely.”¹³⁷ In response to a Commerce Clause challenge, the Supreme Court determined that “the commerce power of Congress [was] not dormant, but [had] been exercised by that body when it enacted the Bank Holding Company Act and the Douglas Amendment to the Act.”¹³⁸ Consequently, the Supreme Court held that petitioners’ Commerce Clause attack failed because “the state actions which [Congress] plainly authorizes are invulnerable to constitutional attack under the Commerce Clause.”¹³⁹

However, the mere reference to the states’ “responsibility for determining what forms of gambling may legally take place within their borders” contained in § 3001 of the Interstate Horseracing Act may be insufficient to remove the law from the purview of the Commerce Clause. There is a strong argument that this language is not unambiguously clear that Congress intended the Interstate Horseracing Act to “plainly authorize” the states’ discrimination against interstate commerce.

Although it is true that if “Congress ordains that the states may freely regulate an aspect of interstate commerce,” their laws concerning that activity are “invulnerable to challenge” under the Commerce Clause; the

¹³⁴ Kentucky Div., Horsemen’s Benevolent and Protective Ass’n, Inc. v. Turfway Park Racing Ass’n, Inc., 20 F.3d at 1414-15.

¹³⁵ *Id.* at 1415.

¹³⁶ Interstate Horseracing Act of 1978, 15 USC § 3004(a) (1978).

¹³⁷ *Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System*, 472 U.S. 159, 169 (1985).

¹³⁸ *Id.* at 174.

¹³⁹ *Id.*

defendants' reliance on this principle is likely misplaced.¹⁴⁰ When Congress has intended to permit discrimination against interstate commerce in other contexts, it has manifested its "unambiguous intent." For instance, the McCarran-Ferguson Act, enacted in 1945, was examined in *Western and Southern Life Insurance Co. v. State Bd. of Equalization of California*. The McCarran-Ferguson Act provides:

Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.¹⁴¹

Unlike the clarity present in the McCarran-Ferguson Act, the Interstate Horseracing Act of 1978 does not "evinced a congressional intent to alter the limits of state power otherwise imposed by the Commerce Clause."¹⁴² Rather, the vague congressional finding in § 3001 of the IHA is more similar to those provisions which courts have found insufficient to grant states the authority to burden interstate commerce. For example, the Supreme Court held that § 201(b) of the Federal Power Act, which provides that the Act's provisions "shall not ... deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a state line," was "in no sense an affirmative grant of power to the states to burden interstate commerce in a manner which would otherwise not be permissible."¹⁴³ Further, the Supreme Court held the Twenty-First Amendment to the United States Constitution, which was enacted to "restore to the States" their police powers to regulate alcohol, to "not displace the rule that States may not give a discriminatory preference to their own producers."¹⁴⁴ Likewise, a court would likely find the broad reference to states' authority to regulate gambling in the IHA does not "confer upon the States an ability to restrict the flow of interstate commerce that they would otherwise not enjoy."¹⁴⁵

The second threshold issue that must be resolved is the defendants' suggestion that in-state brick-and-mortar racetracks are not "similarly situated" to online ADW operators because they serve different markets and

¹⁴⁰ *W. & S. Life Ins. Co. v. State Bd. of Equalization of Cal.*, 451 U.S. 648, 652-53 (1981).

¹⁴¹ McCarran-Ferguson Act of 1945, 15 U.S.C. § 1011 (2012); *see also W. & S. Life Ins.*, 451 U.S. at 653.

¹⁴² *Wyoming v. Oklahoma*, 502 U.S. at 458.

¹⁴³ *New England Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982).

¹⁴⁴ *Granholm v. Heald*, 544 U.S. 460, 484-87 (2005).

¹⁴⁵ *New England Power Co.*, 455 U.S. at 340 (citing *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27 (1980)).

offer different products.¹⁴⁶ The court should reject this argument. Whether the two conflicting entities are similarly situated depends on how the respective activities are framed. In-state tracks offer live entertainment, whereas online ADW operators do not. However, the activity at issue is the off-track betting service. When viewed in this light, many in-state tracks, which permit patrons to wager on races occurring elsewhere, offer the same service as online ADW operators that allow those who wish to wager on any horse race, to bet regardless of their geographic proximity to a specific track.¹⁴⁷ Although the language of the Texas Racing Act does not hinge on domicile, it should not be interpreted as simply regulating two dissimilar business forms.¹⁴⁸ Therefore, in-state racetracks and online ADW operators are competitors, and the Texas Racing Act should be scrutinized under the dormant Commerce Clause.

Since both threshold inquiries indicate the Commerce Clause applies, the court should reach the merits of Churchill Downs' dormant Commerce Clause argument. Whether or not the Texas Racing Act is found to be discriminatory, it cannot survive inspection. Although § 11.01 of the Texas Racing Act is not discriminatory on its face, there is a strong argument it was enacted with a discriminatory purpose or, in the alternative, has a discriminatory effect. Therefore, it should face the "virtually *per se* rule of invalidity."¹⁴⁹

If a law is enacted with the legislative intent to discriminate against out-of-state economic interests, the law is discriminatory.¹⁵⁰ Since the Fifth Circuit has adopted the four-factor equal protection analysis from *Arlington Heights v. Metropolitan Housing Development Corp.* to determine whether the state has adopted a statute with a discriminatory purpose, each of these factors should be considered with regard to the Texas Racing Act.¹⁵¹ Defendants contend the most recent amendment to the Texas Racing Act was aimed at simply clarifying the law, as evidenced by legislative history. However, the court should focus not on the purpose of the most recent amendment, which simply added the word "Internet," but instead focus on the underlying purpose of the statute's requirement that wagers be placed in-person at a racetrack.¹⁵²

¹⁴⁶ Gen. Motors Corp. v. Tracy, 519 U.S. 278, 300 (1997).

¹⁴⁷ E.g., *Simulcast*, SAM HOUSTON RACE PARK, <http://www.shrp.com/simulcast.html> (last visited Feb. 22, 2013).

¹⁴⁸ Allstate Ins. Co. v. Abbott, 495 F.3d 151, 161 (5th Cir. 2007).

¹⁴⁹ See *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978).

¹⁵⁰ See *Allstate Ins. Co.*, 495 F.3d at 160.

¹⁵¹ *Id.*

¹⁵² *House Transcript*, April 8, 2011, TEX. TRIBUNE, April 8, 2011, <http://www.texastribune.org/session/82R/transcripts/2011/4/8/house/> (quoting Representative Raphael Anchi, "... And, frankly, it has been the current Texas Racing Act has been silent on internet gaming. So while there are some rules promulgated, and it is suggested that internet gaming and taking bets from Texas residents over the internet on racing by non Texas licensed entities it is illegal. This makes it clear that it's illegal.").

Applying the *Arlington Heights* factors to Texas's "in-person requirement" indicates that the relevant section of the Texas Racing Act was enacted with the intent to discriminate against out-of-state interests. The first factor, whether a clear pattern of discrimination emerges from the effect of the state action,¹⁵³ establishes a discriminatory purpose. A clear pattern of discrimination emerges from the Texas Racing Act because the ban effectively eliminates the ability for all out-of-state companies to accept wagers from Texas residents. The second factor, the historical background of the decision,¹⁵⁴ also weighs in favor of finding discriminatory intent in the Texas Racing Act. The Texas Racing Commission suggested multiple times that the legislature adopt a law that legalized ADW, but the legislature continued to allow only in-person pari-mutuel wagering that took place at a racetrack.¹⁵⁵ The third factor, however, leans in favor of finding there was not a discriminatory purpose behind the Texas Racing Act. The specific sequence of events leading up to the legislative decision did not include any departures from normal procedures.¹⁵⁶ That is, there was nothing anomalous about the legislative process of this statute. The fourth factor, the legislative or administrative history¹⁵⁷ also suggests a discriminatory intent existed because contemporaneous statements by the Texas legislators reveal a desire to favor in-state tracks and strong concerns regarding the revenue of the Texas horseracing industry. In a short exchange, the word "revenue" is mentioned among legislators twelve times.¹⁵⁸ Although "stray protectionist remarks alone" are not sufficient to demonstrate there was a discriminatory intent in enacting the legislation, Churchill Downs' other circumstantial evidence of a discriminatory purpose results in a sufficient showing to "condemn" the law as discriminatory.¹⁵⁹

Churchill Downs' alternative argument concerning the discriminatory effect of the statute is also convincing. Churchill Downs must make a "substantial showing" to prove the Texas Racing Act results in discriminatory effects.¹⁶⁰ The Texas Racing Act prohibits wagering on horseracing unless the bet is placed in person at a facility that conducts live racing.¹⁶¹ Despite the neutral wording and broad scope of the ban, the statute's effect is to exclude all out-of-state companies from participating in

¹⁵³ See *Vill. of Arlington Heights v. Metro. Hous. Dev. Corp.*, 429 U.S. 252, 266–68, 97 (1977); see also *Waste Mgmt. Holdings, Inc. v. Gilmore*, 252 F.3d 316, 336 (4th Cir. 2001) (applying *Arlington Heights* factors to dormant Commerce Clause analysis).

¹⁵⁴ *Vill. of Arlington Heights*, 429 U.S. at 166–68.

¹⁵⁵ TEX. RACING COMM'N, STUDY OF THE CURRENT STATE OF HORSE AND GREYHOUND RACING IN TEXAS AND INDUSTRY RECOMMENDATIONS FOR IMPROVEMENT, at 14 (2011), available at <http://www.txrc.state.tx.us/agency/news/postings/Report-Current-State-of-Texas-Racing.pdf>.

¹⁵⁶ *Id.*

¹⁵⁷ *Vill. of Arlington Heights*, 429 U.S. at 166–68.

¹⁵⁸ E.g., *House Transcript*, April 8, 2011, *supra* note 135.

¹⁵⁹ See *Allstate Ins. Co. v. Abbott*, 495 F.3d 151, 161 (5th Cir. 2007).

¹⁶⁰ See *Black Star Farms LLC v. Oliver*, 600 F.3d 1225, 1232 (9th Cir. 2010).

¹⁶¹ TEX. REV. CIV. STAT. ANN. art. 179e, § 11.01(a) (West 2011).

the Texas wagering market. The effect of § 11 of the Texas Racing Act is to burden all out-of-state online ADW operators, who cannot legally accept wagers on Texas races. Likewise, in-state tracks benefit from the statute, requiring all persons wishing to wager to actually travel to a Texas racetrack. In addition, a report prepared by the Texas Racing Commission suggested that the amount of wagering that would occur if the state legalized ADW wagers would be approximately \$94 million, demonstrating the importance of the Texas market.¹⁶² Therefore, the Texas Racing Act's ban on Internet wagering will lead to an increased market share for in-state tracks at the expense of out-of state tracks. This inequitable impact is a sufficient showing to prove the Texas Racing Act is discriminatory in its effect.

Even if found non-discriminatory, the Texas Racing Act cannot pass the lenient test from *Pike v. Bruce Church*. The Texas Racing Act undeniably burdens interstate commerce, even if "incidentally." Therefore, it is subject to Commerce Clause scrutiny. Under the *Pike* test, the court must answer two questions: (1) whether there is a legitimate local purpose behind the statute; and (2) whether those local benefits are outweighed by the burden placed on interstate commerce.

Considering the extensive discussion of economic issues in the legislative history, it is conceivable the primary motivation for the Texas Racing Act is protectionism. Although a court is hesitant to second-guess the judgments of legislatures, the Supreme Court has specifically held "by itself . . . revenue generation is not a local interest that can justify discrimination against interstate commerce."¹⁶³ However, the defendants' contend the first part of this inquiry is satisfied because "limiting gambling" is a legitimate and substantial local purpose.¹⁶⁴ If proper regard is given to the local purpose advanced by the defendants, it cannot be found that the Texas Racing Act is "wholly irrational in light of its stated purposes."¹⁶⁵

Nevertheless, even the laudable goal of limiting gambling, which is supported by the states' police power, cannot justify the burden the Texas Racing Act places on interstate commerce. The nature of the interest at stake determines the "extent of the burden that will be tolerated."¹⁶⁶ Although a state's attempt to protect their citizens' health, safety, and morals is a substantial local interest, this fact alone is not dispositive. As illustrated in *American Libraries Assoc v. Pataki* and *Granholm v. Heald*, a legitimate local concern is necessary, but not sufficient under a dormant

¹⁶² TEX. RACING COMM'N, *supra* note 138, at 12.

¹⁶³ *C & A Carbone Inc. v. Clarkstown*, 511 U.S. 383, 393 (1994).

¹⁶⁴ Defendants' Response to Plaintiffs' Motion for Preliminary Injunction at 11, *Churchill Downs Inc. v. Trout*, No. 1:12-cv-00880-LY (W.D. Tex. 2012).

¹⁶⁵ *Kassel v. Consol. Freightways Corp. of Del.*, 450 U.S. 662, 680-81 (1981) (Brennan, J., concurring).

¹⁶⁶ *Pike v. Bruce Church Inc.*, 397 U.S. 137, 142 (1970).

Commerce Clause analysis.¹⁶⁷ The interests at stake in *American Libraries*, protecting children from pedophiles, and *Granholm v. Heald*, keeping alcohol out of minors' hands, are arguably more significant than Texas's interest in limiting gambling. Thus, Texas's legitimate local purpose does not outweigh the extreme burden on interstate commerce resulting from the ban on all Internet wagering. Furthermore, there are several less restrictive alternatives that would accomplish the state's goal of limiting gambling. For example, the Texas Racing Commission itself suggested the Texas legislature "pursue legislation that would allow ADWs in the state and set up fair revenue sharing between the horsemen, greyhound owners, breeders, Texas tracks and ADW operators."¹⁶⁸ Through cooperation, Texas and ADW operators could establish gambling limits or appropriate safeguards to ensure responsible wagering.

Ultimately, the provisions of the Texas Racing Act banning all online pari-mutuel wagering and requiring all bets to be placed in person at a racetrack cannot withstand Commerce Clause scrutiny, whether the law is found to be discriminatory or not. Therefore, the federal district court for the Western District of Texas should hold the Texas Racing Act unconstitutional as a violation of the dormant Commerce Clause.

B. Legislative Proposal

Much of the tension fueling the enactment of state laws banning Internet wagering stems from the inherent competition between brick-and-mortar racetracks and ADW operators. Racetracks rely on money wagered to operate and provide lucrative purses to attract competitive racing. However, handles have been decreasing industry-wide and are estimated to be 28.9% lower than they were in 2003 when "total wagering on U.S. races hit its high," at \$15.2 billion.¹⁶⁹

An understanding regarding Internet wagering laws must be reached within the horseracing industry if the industry is to remain both reputable and profitable. The most promising and viable option for compromise is for industry leaders to come together with the goal of drafting and proposing an interstate compact, complete with model wagering legislation that avoids unconstitutional barriers to commerce.¹⁷⁰ For example, the Racing Regulatory Compact, although it is not perfect,

¹⁶⁷ See *Am. Libraries Ass'n v. Pataki*, 969 F.Supp. 160, 178 (S.D.N.Y. 1997); see also *Graham v. Heald*, 544 U.S. 460, 472 (2005).

¹⁶⁸ TEX. RACING COMM'N, *supra* note 138, at 14.

¹⁶⁹ Matt Hegarty, *Handle on U.S. Races Soars 18% in December; 2011 Handle Down 5.65%*, DAILY RACING FORM (Jan. 5, 2012, 1:59 PM), <http://www.drj.com/news/handle-us-races-soars-18-december-2011-handle-down-565>.

¹⁷⁰ Tom LaMarra, *State Legislators Told Compact Viable Option*, BLOODHORSE (July 28, 2010, 9:36 AM), <http://www.bloodhorse.com/horse-racing/articles/58101/state-legislators-told-compact-viable-option>.

offers a strong starting point for progress.¹⁷¹ Although sacrifices must be made on both sides, the possibility of uniform legislation ensures that racetracks maintain the ability to operate and generate revenue, while also decreasing obstacles for ADW operators to offer their service to a larger market, providing stability to a struggling industry. There is much to be gained by strengthening the horseracing industry, which is a small, but important sector of the American economy, providing 460,000 full-time equivalent jobs and a direct annual economic effect of \$39 billion.¹⁷² Through compromise and cooperation, the industry can reform and revitalize.

VIII. CONCLUSION

As addressed above, the Texas Racing Act is unlikely to survive this dormant Commerce Clause challenge because it discriminates against out-of-state commerce in both its purpose and effect. This important case, pending before the United States District Court for the Western District of Texas, clearly illustrates the problems arising between these two competing factions of the horseracing industry. Despite their inherent competition for wagering revenue, one's success does not necessarily come at the expense of the other. In fact, online ADW operators' entire existence depends on live racing. Likewise, the mobility and simplicity of advance deposit wagering may attract new fans to horseracing. Therefore, a compromise that benefits both sections of the industry is ideal.

While litigation can cure an unconstitutional law, the adoption of an interstate compact, which could effectively deal with the issues created by the advent of advance deposit wagering, is the better alternative for an already-struggling industry. This small, yet distinct and important area of the American economy faces a choice; continue down a self-destructive path of state-by-state protectionism or unify to maximize revenues through an interstate network of live racing and Internet-based wagering. The free-flow of wagering revenue could increase purses, ensure the viability of racetracks, and ensure the popularity of horseracing for years to come.

¹⁷¹ See Ky. Rev. Stat. Ann. § 230.3761 (West 2011); Colo. Rev. Stat. § 12-60-202(5) (West 2010).

¹⁷² AM. HORSE COUNCIL, NATIONAL ECONOMIC IMPACT OF THE U.S. HORSE INDUSTRY, 2005, available at <http://www.horsecouncil.org/national-economic-impact-us-horse-industry>.

