

# THE CURRENT STATE OF THE UNLAWFUL INTERNET GAMBLING ENFORCEMENT ACT AND RECENTLY ADOPTED PROHIBITION ON FUNDING OF UNLAWFUL INTERNET GAMBLING

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## I. INTRODUCTION

In 2006, the United States Congress passed the Security and Accountability For Every Port Act (hereinafter “SAFE Port Act”).<sup>1</sup> Controversy surrounded the quick passage of this law at the end of the 109th Congressional session because it included a provision now known as the Unlawful Internet Gambling Enforcement Act (hereinafter “UIGEA” or “the Act”).<sup>2</sup> Many Congressmen and women had not read this seemingly unrelated provision prior to voting on the SAFE Port Act, but nonetheless, it was passed. Since then, the passage of UIGEA the Act has been heavily criticized and challenged several times in federal court. This update discusses the procedural history of UIGEA, issues with the current Act, federal case law dealing with UIGEA, and the recently adopted federal regulations regarding enforcement of UIGEA.

## II. UNLAWFUL INTERNET GAMBLING ENFORCEMENT ACT

In 2005, two bills were introduced in the House of Representatives; the Internet Gambling Prohibition and Enforcement Act sponsored by former Congressman Jim Leach of Iowa<sup>3</sup> and the Internet Gambling Prohibition Act by Congressman Bob Goodlatte of Virginia.<sup>4</sup> These two bills created the foundation of what would become UIGEA. The bills were introduced in response to the unresolved dispute before the World Trade Organization between the United States and Antigua concerning “the development of the off-shore gambling and betting industry in Antigua.”<sup>5</sup> With the passage of UIGEA it became “a criminal offense for those ‘engaged in the business of betting or wagering’ to

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<sup>1</sup> Security and Accountability For Every Port Act, 6 U.S.C.S. § 901 (2006).

<sup>2</sup> Unlawful Internet Gambling Enforcement Act, 31 U.S.C.S. § 5363 (2008).

<sup>3</sup> Internet Gambling Prohibition and Enforcement Act, H.R. 4411, 109th Cong. (2005).

<sup>4</sup> Internet Gambling Prohibition Act, H.R. 4777, 109th Cong. (2005).

<sup>5</sup> Tom Newnham, *WTO Case Study: United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, 7 ASPER REV. INT’L BUS & TRADE L. 77, 82 (2007).

'knowingly accept' any funds 'in connection with the participation of another person in unlawful Internet gambling.'<sup>6</sup> This law, which attempts to regulate Internet gambling, has the main effect of imposing restrictions on companies that operate "payment system instruments, credit cards, and wire transfers."<sup>7</sup> UIGEA requires federal regulators, namely the *Federal Reserve and the Department of the Treasury*, to impose rules and regulations on the financial institutions to prevent facilitation of monetary transactions related to unlawful Internet gambling.<sup>8</sup>

### III. RECENT ISSUES WITH UIGEA

Several issues surround UIGEA and the recently adopted regulations enforcing the Act. The most widely discussed by the panelists at the *Richmond Journal of Global Law & Business* Spring 2008 Symposium, Online Vice: Legal Issues in Online Gambling was the vague definition of the term "unlawful Internet gambling" in both the regulations and the Act. The current law leaves determining the definition of Internet gambling to federal and state laws, which at best provides a conflicting and broad definition of gambling.<sup>9</sup> Neither UIGEA nor its regulations specifically define the term, and even explicitly state that the term will not be defined for the purpose of enforcing UIGEA.<sup>10</sup>

One of the more peripheral issues, primarily addressed in this update, concerns the feasibility of enforcement of the regulations adopted jointly by the Federal Reserve and Department of the Treasury (hereinafter "Agencies") within the financial industry. Industry experts, members of Congress, and consumers have openly criticized the new regulations.<sup>11</sup> Industry experts and members of Congress in particular have specifically criticized the implementation of the regulations as being overly broad and difficult to obey. Officials representing the Agencies testified before the House of Representatives Financial Services Committee and stated that they found difficulty in

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<sup>6</sup> *Interactive Media Entm't & Gaming Ass'n., Inc. v. Gonzales*, 2008 U.S. Dist LEXIS 16903, \*2 (D.N.J. Mar. 4, 2008) (citing 31 U.S.C. § 5362(10)(A)).

<sup>7</sup> 31 U.S.C. § 5361(a)(1).

<sup>8</sup> 31 U.S.C. § 5365.

<sup>9</sup> 31 U.S.C. § 5362(10)(A).

<sup>10</sup> Prohibition on Funding of Unlawful Internet Gambling, 73 Fed. Reg. 69,382, 69,384 (Nov. 18, 2008) (to be codified at 12 C.F.R. pt. 233 and 31 C.F.R. pt. 132). For consistency in citation, all references to the Prohibition on Funding of Unlawful Internet Gambling will be cited to the regulation implemented by the Federal Reserve as §§233.1-233.7, referring to the seven sections of the regulation that will appear identically at 12 C.F.R. §§ 233.1-233.7 and 31 C.F.R. §§ 132.1-132.7.

<sup>11</sup> *Id.* at 69,383.

writing the regulation due to the vagueness of UIGEA.<sup>12</sup> Despite this difficulty the Agencies adopted the new regulations, against requests from members of Congress to cease adoption until the Obama Administration had taken office.<sup>13</sup> However, not all members of Congress opposed the new regulations. Representative Spencer Bachus of Alabama welcomed the new regulations as a way to stop offshore gambling interests from turning personal computers into casinos at any time of the day.<sup>14</sup>

#### IV. DISTRICT COURT INTERPRETATIONS OF UIGEA

In 2008 the constitutionality of UIGEA was challenged in a federal district court.<sup>15</sup> In *Interactive Media Entertainment & Gaming Ass'n, Inc. v. Gonzales* (hereinafter "*Interactive*") the plaintiff, a non-profit advocacy group, filed suit in the United States District Court for the District of New Jersey against the United States Attorney General, the Federal Trade Commission, and the Federal Reserve. Interactive claimed that UIGEA was unlawful and facially unconstitutional.<sup>16</sup>

Interactive asserted claims based on six causes of action; (1) the First Amendment right to expressive association, (2) the right to privacy, (3) the First Amendment right to commercial speech, (4) UIGEA's contradiction to the WTO ruling in the U.S.-Antigua dispute, (5) the ex post facto nature of UIGEA, and (6) the Tenth Amendment.<sup>17</sup> The defendants filed a cross motion to dismiss the complaint for lack of subject matter jurisdiction under Federal Rule of Civil Procedure 12(b)(1) and/or failure to state a claim under Rule 12(b)(6).<sup>18</sup> In an unpublished opinion, the district court analyzed the merits of each motion, ultimately granting the motion to dismiss, but did not determine whether Interactive lacked standing or failed to state a claim. Rather, the court reasoned that it was not in a position to "pass" judgment on the actions of Congress when they do not "impermissibly intrude on the Constitution's guarantees."<sup>19</sup>

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<sup>12</sup> *Bush Moves to Finalize Internet Gambling Regulations*, USA TODAY, Nov. 12, 2008, available at [http://www.usatoday.com/news/washington/2008-11-12-internet-gambling\\_N.htm](http://www.usatoday.com/news/washington/2008-11-12-internet-gambling_N.htm).

<sup>13</sup> *U.S. Issues Internet Gambling Rule, Ignoring Lawmaker*, REUTERS, Nov. 12, 2008, available at <http://www.reuters.com/article/internetNews/idUSTRE4A97TB20081111>).

<sup>14</sup> *Id.*

<sup>15</sup> See *Interactive Media Entm't & Gaming Ass'n, Inc. v. Gonzales*, 2008 U.S. Dist. LEXIS 16903 (D.N.J. Mar. 4, 2008).

<sup>16</sup> *Id.* at \*2-\*3.

<sup>17</sup> *Id.* at \*3.

<sup>18</sup> *Id.* at \*1.

<sup>19</sup> *Id.* at \*37.

## V. RECENT REGULATIONS AND RULES

In October of 2007 the Board of Governors of the Federal Reserve System (hereinafter "Federal Reserve") and the Departmental Offices of the Treasury (hereinafter "Treasury") issued a proposed rule to implement UIGEA, the Prohibition on Funding of Unlawful Internet Gambling (hereinafter "Regulation").<sup>20</sup> The Regulation has several purposes. Primarily, the Regulation (a) sets out the necessary definitions of terms that appear in UIGEA, (b) designates payment systems subject to regulation by the Act, (c) exempts certain participants from having to comply with certain parts of the Regulation, and (d) provides a list of nonexclusive examples of policies and procedures designed to reasonably carry out the aims of UIGEA.<sup>21</sup>

Section 233.2 of the Regulation provides definitions of terms that appear in UIGEA.<sup>22</sup> The Regulation defines terms such as "actual knowledge," "automated clearing house system," "bet or wager," "Internet gambling business," and "unlawful Internet gambling," as well as many other terms commonly used by the financial services industry.<sup>23</sup> Several of these terms, such as "bet or wager," are very broad and may be interpreted to include actions not intended to be covered by UIGEA. According to the Regulation, a bet or wager is "the staking or risking by any person of something of value upon the outcome of a . . . game subject to chance . . ." <sup>24</sup> The Regulation uses the term "game subject to chance" in the definition of a "bet or wager," but does not go on to define the term itself.<sup>25</sup> Many commentators criticized this definition because neither the Regulation, nor the Act, distinguishes games subject to chance from skill games, such as poker.<sup>26</sup> Professor Charles Nesson, William F. Weld Professor of Law, Harvard Law School, and Founder of the Global Poker Strategic Thinking Society, simplified this distinction in his comments at the *Richmond Journal of Global Law & Business* Spring 2008 Symposium, Online Vice: Legal Issues in Online Gambling, by stating that "[t]he games of chance are played against the house and the games of skill are played against people around the table."<sup>27</sup> In a comment letter addressing

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<sup>20</sup> Prohibition on Funding of Unlawful Internet Gambling, 73 Fed. Reg. 69,382, 69,382 (Nov. 18, 2008) (to be codified at 12 C.F.R. pt. 233 and 31 C.F.R. pt. 132).

<sup>21</sup> 12 C.F.R. § 233.1(b) (2008).

<sup>22</sup> 12 C.F.R. § 233.2 (2008).

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at § 233.2(c)(1).

<sup>25</sup> *Id.*

<sup>26</sup> Prohibition on Funding of Unlawful Internet Gambling, 73 Fed. Reg. 69,382, 69,386 (Nov. 18, 2008) (to be codified at 12 C.F.R. pt. 233 and 31 C.F.R. pt. 132).

<sup>27</sup> Charles Nesson & Andrew Woods, *Commentary on the Law of Poker*, 8 RICH. J. GLOBAL L. & BUS. 11, 12 (2009).

this issue, the Poker Players Alliance suggested that a “dominant factor test” be adopted to determine whether the outcome of a game was predominantly determined by skill or by chance and that games of skill be specifically exempt from coverage by both the Act and the Regulation.<sup>28</sup> The Agencies addressed this concern by stating that the definition of such a term should be left up to applicable federal and state gambling laws.<sup>29</sup> One problem with this solution is that many federal and state gambling laws themselves are vague in defining a “game of chance.” The Agencies even seem to warn that a clear definition may be difficult to discern and recommend a “careful reading of the statutory language of the Act” to determine the intent.<sup>30</sup> The Agencies noted that the section in question uses both “game subject to chance” and “predominantly subject to chance” in defining a “bet or wager” and that if Congress intended to only restrict games *predominantly* subject to chance it would have exclusively used the term throughout the definition.<sup>31</sup>

Section 233.3 of the Regulation addresses designated payment systems subject to compliance.<sup>32</sup> The proposed Regulation included definitions of “money transmitting business” and “money transmitting service” that were eventually changed because they were overbroad.<sup>33</sup> Commenters urged the Agencies to make the change based on the possibility that businesses and services not intended to be covered by UIGEA, such as check cashers, currency exchangers and entities that issue and/or redeem money orders and travelers checks, would be affected.<sup>34</sup> Organizations such as the National Money Transmitters Association<sup>35</sup> argued that these types of entities should not be covered by a law or regulation aimed at restricting Internet gambling because “[s]uch activities could not be used for Internet gambling on an efficient basis.”<sup>36</sup>

Section 233.4 provides several exemptions to UIGEA and the Regulations.<sup>37</sup> This section lists several types of entities that are exempt from the requirement of “establishing written policies and procedures reasonably designed to prevent or prohibit restricted transactions . . . .”<sup>38</sup> The Regulation exempts automated clearing

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<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> 12 C.F.R. § 233.3 (2008).

<sup>33</sup> Prohibition on Funding of Unlawful Internet Gambling, 73 Fed. Reg. at 69,388.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at 69,388 n.41.

<sup>36</sup> *Id.* at 69,388.

<sup>37</sup> 12 C.F.R. § 233.4 (2008).

<sup>38</sup> *Id.*

house systems, check collecting systems, money transmitting systems, and wire transfer systems, with certain exceptions.<sup>39</sup> Essentially, all entities involved in the type of transactions targeted by the Regulation are exempt, except for those entities that maintain a relationship with Internet gambling companies.<sup>40</sup> The burden of developing and maintaining written policies and procedures falls upon the entities involved in these relationships.<sup>41</sup> The Agencies reasoned that such a broad exemption is necessary and that implementing more narrow exemptions would create future problems as payment systems evolve.<sup>42</sup> This, however, puts all entities in the difficult position of attempting to determine whether any clients fall under the vague definition of an Internet gambling company or provide services considered to be unlawful Internet gambling. “One commenter acknowledged that a bank could perhaps identify customers engaged in illegal Internet gambling by conducting enhanced due diligence at account opening, but stated that having to conduct enhanced due diligence at each account opening would be a significant burden on banks and customers alike.”<sup>43</sup> This compounds the broader concern that “the proposed regulation would be unduly burdensome and would result in compliance costs greater than any offsetting societal benefit.”<sup>44</sup>

Section 233.5 provides the requirements for written policies and procedures that must be developed by all non-exempt entities.<sup>45</sup> These policies must be designed to “identify and block or otherwise prohibit restricted transactions.”<sup>46</sup> This section allows entities, such as those that operate card systems, to rely on existing policies and procedures if they comply with the requirements of UIGEA and the Regulations.<sup>47</sup> Commenters expressed concern over the significant burden imposed on entities in determining whether newly adopted policies and procedures actually comply with Regulation requirements.<sup>48</sup> Rather than require non-exempt entities to prove compliance through practice in implementing these newly adopted policies and procedures, the Regulation permits entities to issue written statements or notices in compliance. These written statements or notices will serve as a

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<sup>39</sup> *Id.*

<sup>40</sup> Prohibition on Funding of Unlawful Internet Gambling, 73 Fed. Reg. 69,382, 69,388 (Nov. 18, 2008) (to be codified at 12 C.F.R. pt. 233 and 31 C.F.R. pt. 132).

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.* at 69,389 n.46.

<sup>44</sup> *Id.* at 69,383.

<sup>45</sup> 12 C.F.R. § 233.5 (2008).

<sup>46</sup> *Id.* at § 233.5(a).

<sup>47</sup> Prohibition on Funding of Unlawful Internet Gambling, 73 Fed. Reg. 69,382, 69,390 (Nov. 18, 2008) (to be codified at 12 C.F.R. pt. 233 and 31 C.F.R. pt. 132).

<sup>48</sup> *Id.*

commitment to comply with the Regulation through newly adopted policies and procedures, unless the Agencies find otherwise through investigation.<sup>49</sup>

Section 233.6 provides a list of non-exclusive examples of the types of policies and procedures that can be implemented by non-exempt entities.<sup>50</sup> This section includes examples of policies and procedures regarding due diligence and specific examples for automated clearing house systems, card systems, check collection systems, money transmitting systems and wire transfer systems.<sup>51</sup> Criticism of this section included requests for clarification and greater detail in the examples provided.<sup>52</sup>

Section 233.7 establishes the regulatory enforcement power of the Agencies in compliance with other federal laws.<sup>53</sup>

#### A. *Reactions to the Recently Adopted Regulations*

Several general concerns with the adoption of the regulation include the undue influence of outside parties and the implications the Regulation will have on the incoming Administration of President Obama.

Representative Steve Cohen of Tennessee raised concerns with the “appearance of a conflict of interest” regarding the involvement of William Wichterman, a former lobbyist for the National Football League (hereinafter “NFL”) who was appointed by President George W. Bush as Special Assistant to the President and Deputy Director of Public Liaison in April of 2008.<sup>54</sup> Wichterman was involved in the development of the regulation, which incidentally is supported by the NFL.<sup>55</sup> Fantasy sports betting, arguably a competitor to Internet gambling, is not prohibited by UIGEA or any other federal gambling law despite the fact that it seems to fit the definition of a bet or wager in that betting on fantasy sports involves the “staking or risking by any person of something of value upon the outcome of a contest of others.”<sup>56</sup>

Commenters have also criticized the vague definitions of other terms used in the Regulation. Wells Fargo & Company submitted a

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<sup>49</sup> *Id.*

<sup>50</sup> 12 C.F.R. § 233.6 (2008).

<sup>51</sup> *Id.*

<sup>52</sup> Prohibition on Funding of Unlawful Internet Gambling, 73 Fed. Reg. at 69,391.

<sup>53</sup> 12 C.F.R. § 233.7 (2008).

<sup>54</sup> Letter from Steve Cohen, Member of Cong., 9th District, Tenn., to Fred Fielding, White House Counsel (Nov. 7, 2008), *available at* <http://www.theagitator.com/uigea.pdf>.

<sup>55</sup> *Id.*

<sup>56</sup> 12 C.F.R. § 233.2(c)(1) (2008).

comment letter addressing the Regulation, noting that several terms were “too vague to provide a basis for compliance programs and suggested that they should be replaced with more precise terms that could be implemented by compliance personnel and examined by regulators.”<sup>57</sup>

Members of Congress issued more broad criticisms. Representative Barney Frank of Massachusetts stated that “[t]his midnight rulemaking will tie the hands of the new administration, burden the financial services industry at a time of economic crisis and contradict the stated intent of the Financial Services Committee.”<sup>58</sup>

## VI. FORECAST FOR UIGEA AND ACCOMPANYING REGULATIONS

The immediate impact of the adoption of the Prohibition on Funding of Unlawful Internet Gambling will be slight.<sup>59</sup> The Regulation went into effect January 19, 2009, but non-exempt entities are not required to comply until December 1, 2009.<sup>60</sup> Even after the Regulation is in full effect, experts such as Professor I. Nelson Rose believe that consumers of Internet gambling service will eventually be able to circumvent the procedures put in place by financial institutions seeking to comply with UIGEA.<sup>61</sup> These Regulations, while on one hand seen as a way to safeguard Americans from a dangerous vice, may eventually become one of a growing number of burdens on a fragile financial industry.

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<sup>57</sup> Prohibition on Funding of Unlawful Internet Gambling, 73 Fed. Reg. at 69,385, 69,385, n.19. (Nov. 18, 2008) (to be codified at 12 C.F.R. pt. 233 and 31 C.F.R. pt. 132).

<sup>58</sup> *Bush Moves to Finalize Internet Gambling Regulations*, USA TODAY, Nov. 12, 2008, available at [http://www.usatoday.com/news/washington/2008-11-12-internet-gambling\\_N.htm](http://www.usatoday.com/news/washington/2008-11-12-internet-gambling_N.htm).

<sup>59</sup> See I. Nelson Rose, *What Proposed UIGEA Regulations Mean For Poker Players*, POKER PLAYER, Jan. 7, 2008, <http://www.pokerplayernewspaper.com/viewarticle.php?id=2406>.

<sup>60</sup> Prohibition on Funding of Unlawful Internet Gambling, 73 Fed. Reg. at 69,382.

<sup>61</sup> Rose, *supra* note 59.