

Unlawful Internet Gambling Enforcement Act (UIGEA) and Its Implementing Regulations

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Summary

The Unlawful Internet Gambling Enforcement Act (UIGEA) seeks to cut off the flow of revenue to unlawful Internet gambling businesses. It outlaws receipt of checks, credit card charges, electronic funds transfers, and the like by such businesses. It also enlists the assistance of banks, credit card issuers and other payment system participants to help stem the flow of funds to unlawful Internet gambling businesses. To that end, it authorizes the Treasury Department and the Federal Reserve System (the Agencies), in consultation with the Justice Department, to promulgate implementing regulations. The Agencies adopted a final rule implementing the provisions of the UIGEA, 73 *Federal Register* 69382 (November 18, 2008); the rule was effective January 19, 2009, with a compliance date of June 1, 2010.

The final rule addresses the feasibility of identifying and interdicting the flow of illicit Internet gambling proceeds in five payment systems: card systems, money transmission systems, wire transfer systems, check collection systems, and the Automated Clearing House (ACH) system. It suggests that, except for financial institutions that deal directly with illegal Internet gambling operators, tracking the flow of revenue within the wire transfer, check collection, and ACH systems is not feasible at this point. It therefore exempts them from the regulations' requirements. It charges those with whom illegal Internet gambling operators may deal directly within those three systems, and participants in the card and money transmission systems, to adopt policies and procedures to enable them to identify the nature of their customers' business, to employ customer agreements barring tainted transactions, and to establish and maintain remedial steps to deal with tainted transactions when they are identified. The final rule provides non-exclusive examples of reasonably designed policies and procedures to prevent restricted transactions. The Agencies argued that flexible, risk-based due diligence procedures conducted by participants in the payment systems, in establishing and maintaining commercial customer relationships, is the most effective method to prevent or prohibit the restricted transactions.

Some Members of Congress have criticized the current Internet gambling restrictions for being, in their view, ineffective at stopping Internet gambling, an infringement on individual liberty, and a lost opportunity to collect tax revenue, among other things. The 112th Congress has held several hearings concerning Internet gambling and related issues, and several bills have been introduced that would allow for lawful, government-regulated Internet gambling activities. The legislation includes H.R. 1174 (Internet Gambling Regulation, Consumer Protection, and Enforcement Act), which would establish a licensing program administered by the U.S. Treasury Secretary under which Internet gambling companies may legitimately operate and accept bets or wagers from individuals located in the United States; H.R. 2230 (Internet Gambling Regulation and Tax Enforcement Act of 2011), which would establish a licensing fee regime within the Internal Revenue Code for Internet gambling operators; and H.R. 2366 (Internet Gambling Prohibition, Poker Consumer Protection, and Strengthening UIGEA Act of 2011), which would create an office within the U.S. Department of Commerce responsible for overseeing qualified state agencies that issue licenses to persons seeking to operate an Internet poker facility.

Several state legislatures are also considering measures that would legalize, license, and tax Internet gambling within their borders, taking advantage of a UIGEA provision that exempts intrastate Internet gambling from its applicable scope. A recent change in the U.S. Department of Justice's position regarding the federal Wire Act that now interprets that statute as prohibiting sports betting only (and not interstate transmission of other types of gambling) has also helped encourage state initiatives to legalize intrastate, and possibly even interstate, online gambling.

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Background

Passage of the Unlawful Internet Gambling Enforcement Act (UIGEA) in 2006 as Title VIII of the SAFE Port Act[1] represented the culmination of legislative consideration that began with the recommendations of the National Gambling Commission published in a 1999 report.[2] The legislative history of UIGEA indicates that Congress wanted the law, in part, to address the perceived problem of foreign Internet gambling operations that made their services available to U.S. customers.[3]

UIGEA prohibits anyone "engaged in the business of betting or wagering" from knowingly accepting checks, credit card charges, electronic transfers, and similar payments in connection with unlawful Internet gambling.[4] UIGEA expressly excludes from the definition of the term "business of betting or wagering" the services of financial institutions as well as communications and Internet service providers that may be used in connection with the unlawful bet;[5] however, such entities may nonetheless incur liability under UIGEA if they are directly engaged in the operation of an Internet gambling site.[6] A violation of UIGEA is subject to a criminal fine of up to $250,000 (or $500,000 if the defendant is an organization), imprisonment of up to five years, or both.[7] In addition, upon conviction of the defendant, the court may enter a permanent injunction enjoining the defendant from making bets or wagers "or sending, receiving, or inviting information assisting in the placing of bets or wagers."[8]

Any person or entity that violates UIGEA and its implementing regulations may also be subject to civil and regulatory enforcement actions.[9] For example, the Attorney General of the United States or a state attorney general may bring civil proceedings to enjoin a transaction that is prohibited under UIGEA.[10] However, UIGEA expressly limits the instances when the attorneys general may bring a civil suit against financial institutions and Internet service providers, as follows: they may only bring a civil proceeding against financial institutions to block transactions involving unlawful Internet gambling (unless the institution is directly involved in an unlawful Internet

[1] P.L. 109-347, 120 Stat. 1952 (31 U.S.C. 5361-5367) (2006).

[2] National Gambling Impact Study Commission, *Final Report* at 5-12 (1999). Earlier related CRS Reports include CRS Report RS22418, *Internet Gambling: Two Approaches in the 109th Congress*, from which some of this report is drawn, and CRS Report RS21487, *Internet Gambling: A Sketch of Legislative Proposals in the 108th and 109th Congresses*, which includes a more extensive discussion of the legislation's evolution. For a comprehensive report analyzing all forms of gambling and issues regarding gambling addiction and industry statistics, *see* CRS Report R41614, *Remote Gaming and the Gambling Industry*, by Suzanne M. Kirchhoff.

[3] *See, e.g.,* H.Rept. 109-412 (Pt.1), at 8 (2006)("[The Act's] primary purpose is to give U.S. law enforcement new, more effective tools for combating offshore Internet gambling sites that illegally extend their services to U.S. residents via the Internet"); H.Rept. 109-412 (Pt.2), at 8 (2006)("The booming industry of offshore websites accepting bets and wagers from persons located in the United States raises a number of social and criminal concerns related to Internet gambling").

[4] 31 U.S.C. §5363.

[5] 31 U.S.C. §5362(2); *see* Interactive Media Entm't & Gaming Ass'n v. AG of the United States, 2009 U.S. App. LEXIS 19591, *2-3 n.1 (3d Cir. 2009).

[6] 31 U.S.C. §5367.

[7] 31 U.S.C. §5366(a).

[8] 31 U.S.C. §5366(b).

[9] 31 U.S.C. §§5364(e), 5365.

[10] 31 U.S.C. §5365.

gambling business, in which case criminal prosecution is available).[11] The attorneys general may also initiate civil proceedings against Internet service providers under UIGEA only to block access to unlawful Internet gambling sites or to hyperlinks to such sites under limited circumstances.[12]

UIGEA's definition of "unlawful Internet gambling" does not specify what gambling activity is illegal;[13] rather, the statute relies on underlying federal or state gambling laws to make that determination—that is, UIGEA applies to an Internet bet or wager that is illegal in the place where it is placed, received, or transmitted:

> The term "unlawful Internet gambling" means to place, receive, or otherwise knowingly transmit a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made.[14]

However, this statutory definition expressly *exempts* certain intrastate and intratribal Internet gambling operations, including state lotteries and Indian casinos that operate under state regulations or compacts. To qualify for the intrastate exception under UIGEA, a bet must (1) be made and received in the same state;[15] (2) comply with applicable state law that authorizes the gambling and the method of transmission including any age and location verification and security requirements;[16] and (3) not violate various federal gambling laws.[17] The intratribal exception is similar, but slightly different. Compliance with the various federal gambling laws remains a condition[18] and there are also similar security, age, and location verification requirements.[19] Intratribal gambling, however, may involve transmissions between the lands of two or more tribes and need not be within the same state.[20]

UIGEA further defines the term "bet or wager" to mean "the staking or risking by any person of something of value upon the outcome of a contest of others, a sporting event, or a game subject to chance, upon an agreement or understanding that the person or another person will receive something of value in the event of a certain outcome."[21] The statutory definition includes lottery participation, gambling on athletic events, and information relating to financing a gambling account, but a "bet or wager" does *not* include the following:

- securities transactions;
- commodities transactions;

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[11] 31 U.S.C. §5365(d).

[12] 31 U.S.C. §5365(c)(1).

[13] For an in-depth discussion of all federal criminal laws that may be implicated by illegal gambling using the Internet, *see* CRS Report 97-619, *Internet Gambling: An Overview of Federal Criminal Law*, by Charles Doyle.

[14] 31 U.S.C. §5362(10)(A).

[15] 31 U.S.C. §5362(10)(B)(i).

[16] 31 U.S.C. §5362(10)(B)(ii).

[17] 31 U.S.C. §5362(10)(B)(iii).

[18] 31 U.S.C. §5362(C)(iv).

[19] 31 U.S.C. §5362((10)(B)(iii).

[20] 31 U.S.C. §5362(10)(C)(i),(ii).

[21] 31 U.S.C. §5362(1)(A).

- over-the-counter derivative instruments;
- indemnity or guarantee contracts;
- insurance contracts;
- bank transactions (transactions with insured depository institutions);
- games or contests in which the participants do not risk anything but their efforts; or
- certain fantasy or simulation sports contests.[22]

UIGEA leaves in place questions as to the extent to which the Interstate Horseracing Act curtails the reach of other federal laws,[23] an issue that was at the center of World Trade Organization (WTO) litigation.[24] The statute instructs the Secretary of the Treasury and the Board of Governors of the Federal Reserve, in consultation with the Attorney General, to issue implementing regulations within 270 days of passage.[25]

On September 1, 2009, a federal appeals court ruled that UIGEA is not unconstitutionally vague.[26] The Interactive Media Entertainment & Gaming Association had filed a lawsuit alleging that UIGEA was facially unconstitutional, and sought to enjoin the enforcement of the act and its regulations. The U.S. Court of Appeals for the Third Circuit disagreed with Interactive's assertion that UIGEA was void for vagueness because of the lack of an "ascertainable and workable definition" of the statutory phrase "unlawful Internet gambling":

> The Supreme Court has explained that a statute is unconstitutionally vague if it "fails to provide a person of ordinary intelligence fair notice of what is prohibited, or is so standardless that it authorizes or encourages seriously discriminatory enforcement." United States v. Williams, 128 S. Ct. 1830, 1845, 170 L. Ed. 2d 650 (2008).... We reject Interactive's vagueness claim. The Act prohibits a gambling business from knowingly

[22] 31 U.S.C. §5362(1)(B)-(E).

[23] 31 U.S.C. §5362(10)(D)(iii). The Justice Department and certain members of the horse racing industry disagree over the extent to which the Horseracing Act amends the coverage of the Wire Act that outlaws the interstate transmission by wire of certain information related to gambling. UIGEA denies that its provisions are intended to resolve the dispute. In the 112th Congress, H.R. 2702 (Wire Clarification Act of 2011) would amend the federal criminal code to provide that provisions of federal law that establish criminal penalties for any activity involved in placing, receiving or otherwise transmitting a bet or wager will not apply to any bet or wager that is permissible under the Interstate Horseracing Act of 1978.

[24] *See e.g.*, *Don't Bet on the United States's Internet Gambling Laws: The Tension Between Internet Gambling Legislation and World Trade Organization Commitments*, 2007 COLUMBIA BUSINESS LAW REVIEW 439. In the WTO dispute, Caribbean nation Antigua and Barbuda ("Antigua") argued that the United States discriminates against foreign Internet gambling operators while permitting domestic, online gambling on horse racing, in violation of U.S. market access commitments under the General Agreement on Trade in Services treaty. Antigua won its case before the WTO, and on December 21, 2007, a WTO arbitration report determined that Antigua had suffered $21 million in damages annually. The WTO arbitrator ruled that Antigua may request authorization to suspend a maximum of $21 million annually in obligations owed to the United States under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights. (In other words, Antigua could infringe the rights of U.S. holders of copyrights, trademarks, and patents, up to $21 million a year.) Decision by the Arbitrator, Recourse to Arbitration by the United States for Arbitration under Article 22.6 of the DSU, United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services, WT/DS285/ARB (December 21, 2007). For more information on this case, *see* CRS Report RL32014, *WTO Dispute Settlement: Status of U.S. Compliance in Pending Cases*, by Jeanne J. Grimmett.

[25] 31 U.S.C. §5364.

[26] Interactive Media Entm't & Gaming Ass'n v. AG of the United States, 2009 U.S. App. LEXIS 19591 (3d Cir. 2009).

> accepting certain financial instruments from an individual who places a bet over the Internet if such gambling is illegal at the location in which the business is located or from which the individual initiates the bet. 31 U.S.C. §§ 5362(10)(A), 5363. Thus, the Act clearly provides a person of ordinary intelligence with adequate notice of the conduct that it prohibits.[27]

The appellate court noted that UIGEA "itself does not make any gambling activity illegal," but rather, the definition of "unlawful Internet gambling" references federal and state laws related to gambling.[28] Therefore, the court suggested that "to the extent that [there is] a vagueness problem, it is not with the Act, but rather with the underlying state law."[29]

Regulations Implementing UIGEA

UIGEA calls for regulations that require "each designated payment system, and all participants therein, to identify and block or otherwise prevent or prohibit restricted transactions through the establishment of policies and procedures" reasonably calculated to have that result.[30] On October 4, 2007, the Board of Governors of the Federal Reserve System and the Treasury Department (the Agencies) issued proposed regulations implementing UIGEA.[31] The proposal invited commentators to suggest alternatives and critiques before the close of the comment period on December 12, 2007. The proposal offered to exempt substantial activities in those payment systems in which tracking is not possible now and in which it may ultimately not be feasible. It also noted that the two Agencies felt that they have no authority to compel payment system participants to serve lawful Internet gambling operators.[32] After taking into consideration the public comments on the proposed rule and consulting with the Department of Justice (as required by the UIGEA), the Agencies adopted a final rule implementing the provisions of the UIGEA;[33] the rule was effective January 19, 2009, with a compliance date of June 1, 2010 (originally December 1, 2009).[34]

Designated Payment Systems & Due Diligence

The final rule identifies five relevant payment systems that could be used in connection with, or to facilitate, the "restricted transactions" used for Internet gambling: Automated Clearing House System (ACH), card systems, check collection systems, money transmitting business, and wire

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[27] *Id.* at *7.

[28] *Id.* at *11-12.

[29] *Id.* at *11.

[30] 31 U.S.C. §5364(a).

[31] 72 *Federal Register* 56680.

[32] "Some payment system operators have indicated that, for business reasons, they have decided to avoid processing any gambling transactions, even if lawful, because among other things, they believe that these transactions are not sufficiently profitable to warrant the higher risk they believe these transactions pose." The Agencies do not believe UIGEA authorizes them to countermand such a decision, 72 *Federal Register* 56688 (October 4, 2007).

[33] 73 *Federal Register* 69382 (November 18, 2008); U.S. Department of the Treasury, 31 C.F.R. Part 132, *Prohibition on Funding of Unlawful Internet Gambling*.

[34] The original compliance date of December 1, 2009, was extended by six months by order of the Department of the Treasury and the Federal Reserve Board, in response to a petition submitted by three gambling industry associations that were concerned that many small regulated entities did not have the resources necessary to develop and implement appropriate policies and procedures by the compliance date, 74 *Federal Register* 65687 (December 1, 2009).

transfer systems.[35] The rule defines a "restricted transaction" to mean any transactions or transmittals involving any credit, funds, instrument, or proceeds that the UIGEA prohibits any person engaged in the business of betting or wagering from knowingly accepting, in connection with the participation of another person in unlawful Internet gambling.[36] However, the rule does *not* provide a more specific definition of the term "unlawful Internet gambling;" instead, it restates the UIGEA's definition.[37]

While the Agencies expect that card systems will find that using a merchant and transaction coding system is "the method of choice" to identify and block restricted transactions, the Agencies felt that the most efficient way for other designated payment systems to comply with the UIGEA is through "adequate due diligence by participants when opening accounts for commercial customers to reduce the risk that a commercial customer will introduce restricted transactions into the payment system in the first place."[38]

The rule directs participants in the designated systems, unless exempted, to "establish and implement written policies and procedures reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions,"[39] and then provides non-exclusive examples of reasonably compliant policies and procedures for each system.[40] Participants may comply by adopting the policies and procedures of their payments system or by adopting their own.[41] Participants that establish and implement procedures for due diligence of their commercial customer accounts or commercial customer relationships will be considered in compliance with the regulation if the procedures include the following steps:[42]

1. At the establishment of the account or relationship, the participant conducts due diligence of a commercial customer and its activities commensurate with the participant's judgment of the risk of restricted transactions presented by the customer's business.
2. Based on its due diligence, the participant makes a determination regarding the risk the commercial customer presents of engaging in an Internet gambling business. Such a determination may take one of the two courses set forth below:
    a. The participant determines that the commercial customer presents a minimal risk of engaging in an Internet gambling business (such as commercial customers that are directly supervised by a federal functional regulator,[43] or an agency, department, or division of the federal government or a state government), or

[35] 31 C.F.R. §132.3.

[36] 31 C.F.R. §132.2(y).

[37] 31 C.F.R. §132.2(bb).

[38] 73 *Federal Register* 69394 (November 18, 2008).

[39] 31 C.F.R. §132.5(a).

[40] 31 C.F.R. §132.6.

[41] 31 C.F.R. §§132.5(b), 132.6(a).

[42] 31 C.F.R. §132.6(b).

[43] The term "federal functional regulator" means—the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Board of Directors of the Federal Deposit Insurance Corporation; the Director of the Office of Thrift Supervision; the National Credit Union Administration Board; and the Securities and Exchange Commission. 15 U.S.C. §6809.

b. The participant cannot determine that the commercial customer presents a minimal risk of engaging in an Internet gambling business, in which case it must obtain a certification from the commercial customer that it does not engage in an Internet gambling business. If the commercial customer does engage in an Internet gambling business, the participant must obtain: (1) documentation that provides evidence of the customer's legal authority to engage in the Internet gambling business and a written commitment by the commercial customer to notify the participant of any changes in its legal authority to engage in its Internet gambling business, and (2) a third-party certification that the commercial customer's systems for engaging in the Internet gambling business are reasonably designed to ensure that the commercial customer's Internet gambling business will remain within the licensed or otherwise lawful limits, including with respect to age and location verification.

3. The participant notifies all of its commercial customers that restricted transactions are prohibited from being processed through the account or relationship, "through a term in the commercial customer agreement, a simple notice sent to the customer, or through some other method."[44]

Non-exclusive Examples of Compliant Policies and Procedures

Card Systems

Of the five payment systems, a "card system" as understood by the regulations is one that settles transactions involving credit card, debit card, pre-paid card, or stored value product and in which the cards "are issued or authorized by the operator of the system and used to purchase goods or services or to obtain a cash advance."[45] Merchant codes are a standard feature of the system which permits the system to identify particular types of businesses.[46] There are no card system exemptions from the regulations' requirements. Examples of reasonably compliant policies and procedures feature due diligence and prophylactic procedural components. The standards involve screening merchants to determine the nature of their business, a clause prohibiting restricted transactions within the merchant agreement, as well as maintaining and monitoring a business coding system to identify and block restricted transactions.[47]

Money Transmitting Businesses

"Money transmitting businesses" are entities such as Western Union and PayPal that are in the business of transmitting funds.[48] They too are without exemption from the UIGEA implementing regulations. Examples of acceptable policies and procedures for money transmitting businesses feature procedures to identify the nature of a subscriber's business, subscriber agreements to avoid restricted transactions, procedures to check for suspicious payment patterns, and an outline

[44] 73 *Federal Register* 69393 (November 18, 2008).

[45] 31 C.F.R. §132.2(f).

[46] 71 *Federal Register* 56684 (October 4, 2007).

[47] 31 C.F.R. §132.6(d).

[48] 31 C.F.R. §132.2(u), referring to the statutory definition provided in 31 U.S.C. §5330(d)(1).

of remedial actions (access denial, account termination)[49] to be taken when restricted transactions are found.[50]

The regulations contain exemptions in varying degrees for the other payment systems. In essence, because of the difficulties of identifying tainted transactions, they limit requirements to those who may deal directly with the unlawful Internet gambling businesses. In the case of "check collection systems," the coded information available to the system with respect to a particular check is limited to information identifying the bank and account upon which the check is drawn, and the number and amount of the check.[51] Information identifying the payee is not coded and a "requirement to analyze each check with respect to the payee would substantially ... reduce the efficiency of the check collection system."[52] Consequently, the final rule exempts all participants in a particular check collection through a check collection system except for "the first U.S. institution to which a check is transferred, in this case the institution receiving the check deposit from the gambling business"[53]—namely, the depository bank.[54]

Banks in which a payee deposits a check are covered by the regulations as are banks which receive a check for collection from a foreign bank. The rule offers examples for both circumstances. In the case of a check received from a foreign bank, examples of a depositary bank's reasonably compliant policies and procedures are procedures to inform the foreign banking office after the depositary bank has actual knowledge[55] that the checks are restricted transactions (such actual knowledge being obtained through notification by a government entity such as law enforcement or a regulatory agency).[56] In the purely domestic cases, examples of reasonably compliant policies and procedures would include (1) due diligence in establishing and maintaining customer relations sufficient to identify the nature of a customer's business, and to provide for a prohibition on tainted transactions in the customer agreement, and (2) remedial action (refuse to deposit a check; close an account) should a tainted transaction be unearthed.[57]

Wire Transfer Systems

"Wire transfer systems" come in two forms. One involves large volume transactions between banks; the second, customer-initiated transfers from one bank to another.[58] Like the check collection systems, under current practices only the recipient bank is in a realistic position to determine the nature of the payee's business. The Agencies sought public comments on whether

[49] However, "[a]s the examples in the rule are non-exclusive, a system or participant may choose to include fines in its policies and procedures where appropriate." 73 *Federal Register* 69393 (November 18, 2008).

[50] 31 C.F.R. §132.6(f).

[51] 72 *Federal Register* 56687 (October 4, 2007).

[52] 72 *Federal Register* 56687 (October 4, 2007).

[53] 72 *Federal Register* 56687 (October 4, 2007).

[54] 31 C.F.R. §132.4(b).

[55] "Actual knowledge" is defined by the regulation to mean, with respect to a transaction or commercial customer, "when a particular fact with respect to that transaction or commercial customer is known by or brought to the attention of (1) an individual in the organization responsible for the organization's compliance function with respect to that transaction or commercial customer, or (2) an officer of the organization." 31 C.F.R. §132.2(a).

[56] 31 C.F.R. §132.6(e)(2).

[57] 31 C.F.R. §132.6(e)(1).

[58] 72 *Federal Register* 56685 (October 4, 2007).

additional safeguards should be required of the initiating bank in such cases but ultimately decided to exempt all but the bank receiving the transfer.[59]

Banks that receive a wire transfer (the beneficiary's bank) are covered by the regulations, and examples of reasonably compliant policies and practices resemble those provided for check collection system participants: know your customer, have a no-tainted transaction customer agreement clause, and have a remedial procedure (transfer denied; account closed) when tainted transactions surface.[60]

Automated Clearing House System

The "Automated Clearing House System" (ACH) is a system for settling batched electronic entries for financial institutions. The entries may be recurring credit transfers such as payroll direct deposit payments or recurring debit transfers such as mortgage payments.[61] The entries may also include one time individual credit or debit transfers. Banks periodically package credit and debit transfers and send them to a ACH system operator who sorts them out and assigns them to the banks in which the accounts to be credited or debited are found. Participants are identified not according to whether they are transferring credits or debits but according to which institution initiated the transfer, i.e., originating depository financial institutions (ODFI) and receiving depository financial institutions (RDFI).[62]

The final rule exempts all participants processing a particular transaction through an ACH system, except for the RFDI in an ACH credit transaction, the ODFI in an ACH debit transaction, and the receiving gateway operator that receives instructions for an ACH debit transaction directly from a foreign sender.[63] These entities are not exempt under the theory that in any tainted transaction they will be in the best position to assess the nature of the business of the beneficiary of the transfer and to identify and block transfers to unlawful Internet gambling operators.[64] The ACH system operator, ODFIs in a credit transaction and RDFIs in a debit transaction are exempt from the regulations, however.[65]

The examples of ACH system reasonably compliant policies and procedures are comparable to those for check collection and wire transfer systems: in purely domestic cases, know your customer, have a no-tainted transaction customer agreement clause, have a remedial procedure (disallow origination of ACH debit transactions; account closed) when tainted transactions surface; in the case of receiving transfers from overseas, know your foreign gateway operator, have a no-tainted transaction agreement, have a remedial procedure (ACH services denied; termination of cross-border relationship) when tainted transactions surface.[66] The Agencies explained that U.S. participants processing *outbound* cross-border credit transactions (ACH credits and wire transfers) are exempted "because there are no reasonably practical steps that a

[59] 31 C.F.R. §132.4(d).

[60] 31 C.F.R. §132.6(g).

[61] 72 *Federal Register* 56683 (October 4, 2007).

[62] *Id.*

[63] 31 C.F.R. §132.4(a).

[64] 72 *Federal Register* 56686 (October 4, 2007).

[65] *Id.*

[66] 31 C.F.R. §132.6(c).

U.S. participant could take to prevent their consumer customers from sending restricted transactions cross-border."[67] The Agencies explained that there is insufficient information to allow U.S. participants to identify and block restricted transactions in cross-border ACH credit transactions and sending wire transfers abroad.[68]

Regulatory Enforcement of UIGEA

Good faith compliance with UIGEA and its regulations insulates U.S. financial firms that participate in designated payment systems from both regulatory[69] and civil liability.[70] Regulatory enforcement is the responsibility of the Federal Trade Commission and the "federal functional regulators" within their areas of jurisdiction, that is, the Governors of the Federal Reserve, the Comptroller of the Currency, the Federal Deposit Insurance Commission, the Office of Thrift Supervision, the National Credit Union Administration, and the Securities and Exchange Commission.[71]

Federal Enforcement Actions Under UIGEA

The enactment of UIGEA had an immediate impact on Internet gambling activities. For example, NETeller, a payment processing company based in the Isle of Man that reportedly processed more than $10 billion in gambling proceeds between U.S. customers and offshore Internet gambling business from 1999 to 2007, entered into a deferred prosecution agreement with the U.S. Department of Justice under which it agreed to discontinue U.S. operations, cooperate with investigators, and to pay the U.S. $136 million in sanctions and to return an additional $96 million to U.S. customers.[72] Several offshore Internet gambling companies sought similar agreements after the enactment of UIGEA.[73] A number of large banking institutions, which underwrote the initial public offers for offshore Internet gambling companies on the London stock exchange, were the targets of grand jury subpoenas as well.[74]

Some Internet gambling companies, however, were undeterred by the new federal law and attempted to rely on fraudulent methods to circumvent UIGEA's prohibitions. Yet despite their efforts to evade UIGEA, several of these companies have faced prosecution and been forced to shut down their operations. For example, on April 15, 2011, the U.S. Attorney for the Southern

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[67] 73 *Federal Register* 69389 (November 18, 2008).

[68] *Id.*

[69] 31 U.S.C. §5364(c).

[70] 31 U.S.C. §5364(d).

[71] 31 U.S.C. §5364(e).

[72] "Neteller to Pay Dollars 136m Gambling Penalty," *Financial Times USA* at 16 (July 19, 2007).

[73] *Id*.; "Sportingbet Cuts Deal," *Express on Sunday* at 7 (August 5, 2007) ("Sportingbet is now following the lead of rivals PartyGaming and 888 Holdings which started talks with the United States Attorney's Office ... in a bid to remove the threat of any criminal proceedings."); Eric Pfanner, "A New Chance for Online Gambling in the U.S.," *New York Times* (April 27, 2009) ("This month, PartyGaming agreed to a $105 million settlement with the U.S. attorney's office in New York, involving the period before 2006, when it acknowledged that its activities had been 'contrary to certain U.S. laws.' In turn, the U.S. authorities agreed not to prosecute the company, which is listed on the London Stock Exchange, or its executives.").

[74] Andrew Ross Sorkin and Stephanie Saul, "Gambling Subpoenas on Wall St," *New York Times,* at C1 (January 22, 2007).

District of New York announced the unsealing of an indictment of 11 defendants, including the founders of the three largest Internet poker websites (Poker Stars, Full Tilt Poker, and Absolute Poker), that charged them with a variety of federal offenses including bank fraud, conspiracy, violating UIGEA, money laundering, and operating an illegal gambling business.[75] For example, the offshore Internet poker companies allegedly "arranged for the money received from U.S. gamblers to be disguised as payments to hundreds of non-existent online merchants purporting to sell merchandise such as jewelry and golf balls,"[76] thereby tricking U.S. banks and credit card issuers to process their payments. In addition, the indictment also accused the Internet poker companies of "persuad[ing] the principals of a few small, local banks facing financial difficulties to engage in [payment] processing in return for multi-million dollar investments in the banks."[77] As part of this enforcement action, the Federal Bureau of Investigation seized five Internet domain names that were used by the poker companies to host their illegal poker games;[78] such domain name seizure "effectively shuttered their doors."[79]

Legislation in the 112th Congress

Since passage of UIGEA in 2006, there have been several attempts to repeal the law or loosen its restrictions, although no such legislation has been enacted. Several bills have been introduced in the 112th Congress that would allow for lawful, government-regulated Internet gambling activities. Such legislative proposals have been supported by Members of Congress who have criticized the current Internet gambling restrictions for being, in their view, ineffective at stopping Internet gambling by millions of Americans,[80] an infringement on individual liberty,[81] and a lost opportunity to collect billions of dollars in tax revenue,[82] among other things. Some interest groups also endorse legislation that would regulate, rather than prohibit, Internet gambling because they believe it would help protect American consumers (adults and minors) from the risks of fraud and other financial and societal costs associated with online gambling.[83] What

[75] U.S. Department of Justice, "Manhattan U.S. Attorney Charges Principals of Three Largest Internet Poker Companies with Bank Fraud, Illegal Gambling Offenses and Laundering Billions in Illegal Gambling Proceeds," April 15, 2011, *available at* http://www.justice.gov/usao/nys/pressreleases/April11/scheinbergetalindictmentpr.pdf.

[76] *Id.* at 2.

[77] *Id.* at 3.

[78] *Id.* at 1.

[79] Matt Richtel, "U.S. Cracks Down on Online Gambling," *New York Times,* at B1 (April 16, 2011).

[80] *Tax Proposals Related to Legislation to Legalize Internet Gambling: Hearing Before the House Comm. on Ways and Means,* 111th Cong., 2nd sess. (2010) (statement of Rep. McDermott) ("[E]very day millions of Americans gamble on the Internet. Prohibition hasn't prevented the millions of Americans who want to gamble online from doing it. It has forced internet gambling operators to work offshore, it has put consumers at risk, and it sends billions in dollars of revenue to other nations.").

[81] *H.R. 2267, Internet Gambling Regulation, Consumer Protection, and Enforcement Act: Hearing Before the House Comm. on Financial Services,* 111th Cong., 2nd sess. (2010) (statement of Rep. Paul) ("The ban on Internet gambling infringes upon two freedoms that are important to many Americans: the ability to do with their money as they see fit, and the freedom from government interference with the Internet.").

[82] *Tax Proposals Related to Legislation to Legalize Internet Gambling: Hearing Before the House Comm. on Ways and Means,* 111th Cong., 2nd sess. (2010) (statement of Rep. Frank) ("[B]illions of dollars in taxes … remain uncollected. Enacting these bills would bring this industry out of the shadows, benefit consumers and ensure that all of the revenue does not continue to exclusively benefit offshore operators.").

[83] *See, e.g., Internet Gaming: Is There a Safe Bet?: Hearing Before the House Comm. on Energy and Commerce, Subcomm. on Commerce, Manufacturing and Trade,* 112th Cong., 1st Sess. (2011) (statement of Parry Aftab, FairPlayUSA).

follows is a brief description of the bills in the 112th Congress that would authorize and regulate some forms of Internet gambling.

Internet Gambling Regulation, Consumer Protection, and Enforcement Act

The Internet Gambling Regulation, Consumer Protection, and Enforcement Act (H.R. 1174) is a bill introduced by Representative John Campbell. H.R. 1174 would establish a licensing regime under which Internet gambling operators may lawfully accept bets or wagers from individuals located in the United States. Under the bill, the Secretary of the Treasury would have full regulatory authority over the Internet gambling licensing program, including the power to approve, deny, renew, or revoke licenses to operate an Internet gambling facility.[84] In addition, the Secretary of the Treasury would have the power to delegate his authority to "qualified State and tribal regulatory bodies" for the purposes of regulating the operation of Internet gambling facilities by licensees and determining the suitability of applicants to obtain a license.[85] Qualified state or tribal authorities would also be allowed to enforce any requirement of the act that is within their jurisdiction.[86]

In addition, H.R. 1174 would establish specific standards and requirements for Internet gambling licensees to satisfy, including the following:[87]

1. Establishing safeguards to verify that the customer placing a bet or wager is of legal age as defined by the law of the state or tribal area in which the individual is located at the time the bet or wager is placed.
2. Requiring mechanisms that verify that the customer placing a bet or wager is physically located in a jurisdiction that permits Internet gambling.
3. Ensuring the collection of all taxes relating to Internet gambling from customers and from any licensee.
4. Maintaining safeguards to combat fraud, money laundering, and the financing of terrorism.
5. Maintaining safeguards to protect the customer's privacy and security.
6. Establishing safeguards to combat compulsive Internet gambling.
7. Maintaining facilities within the United States for processing of bets or wagers made or placed from the United States.[88]
8. Certifying that they have not committed an intentional felony in violation federal or state gambling laws.[89]
9. Verifying that their customers are not delinquent on their child support.[90]

[84] H.R. 1174, §2, adding new 31 U.S.C. §5383(a).

[85] H.R. 1174, §2, adding new 31 U.S.C. §5383(o).

[86] H.R. 1174, §2, adding new 31 U.S.C. §5383(o)(6).

[87] H.R. 1174, §2, adding new 31 U.S.C. §5383(g).

[88] H.R. 1174, §2, adding new 31 U.S.C. §5383(k)(1)(A)(vii).

[89] H.R. 1174, §2, adding new 31 U.S.C. §5383(d)(3)(I).

Indian tribes and states may opt out of the Internet gambling regime if they provide notice to the Secretary of the Treasury; Indian tribes must give notice within 90 days after enactment of the Internet Gambling Regulation, Consumer Protection, and Enforcement Act,[91] while each state has a longer period of time to decide whether to opt-out—a period starting from the enactment of H.R. 1174 and ending on the date on which the state's legislation has conducted one full general legislative session.[92] Therefore, customers located within Indian tribes and states that elected to opt out would be prohibited from engaging in Internet gambling activities,[93] and licensees would be responsible for blocking access to those customers.

The Director of the Financial Crimes Enforcement Network, within 120 days after the bill's enactment, would be required to submit to the Treasury Secretary a list of "unlawful Internet gambling enterprises" that identifies any person who has violated UIGEA more than 10 days after the date of the bill's enactment; such a list is to be posted on the Department of the Treasury website for public access and also distributed to "all persons who are required to comply with" the regulations promulgated by the Federal Reserve and the Treasury Department.[94] Another provision of H.R. 1174 provides safe harbor from liability for financial institutions that process transactions for licensees, unless they had knowledge that the specific financial activities or transactions are conducted in violation of federal or state laws.[95]

H.R. 1174 prohibits licensees from accepting credit cards as a form of payment with respect to Internet gambling.[96] The bill also expressly states that no licensee may accept bets or wagers on sporting events, with the exception of pari-mutuel racing as permitted by law (such as horse racing and greyhound racing).[97] In addition, the bill would exempt from the new regulatory regime Internet gambling conducted by any state or tribal lottery authority.[98]

Internet Gambling Regulation and Tax Enforcement Act of 2011

Representative Jim McDermott introduced a companion bill to Representative Campbell's licensing legislation, the Internet Gambling Regulation and Tax Enforcement Act of 2011 (H.R. 2230). This bill would establish a licensing fee regime within the Internal Revenue Code for Internet gambling operators; it essentially creates a tax on online gambling deposits. H.R. 2230 would require each licensee to pay a monthly Internet gambling license fee in an amount equal to 2% of all funds deposited by customers during that month.[99] According to Representative

(...continued)

[90] H.R. 1174, §2, adding new 31 U.S.C. §5383(q).

[91] H.R. 1174, §2, adding new 31 U.S.C. §5387(b).

[92] H.R. 1174, §2, adding new 31 U.S.C. §5387(a).

[93] A state or tribe's decision to opt out does not necessarily mean that persons located within the state or tribal land are prohibited from all Internet gambling activities; rather, the state's governor or the tribal chief must clearly identify the "nature and extent" of the limitation on bets and wagers. H.R. 1174, §2, adding new 31 U.S.C. §5387.

[94] H.R. 1174, §2, adding new 31 U.S.C. §5386.

[95] H.R. 1174, §2, adding new 31 U.S.C. §5385(a).

[96] H.R. 1174, §2, adding new 31 U.S.C. §5389.

[97] H.R. 1174, §2, adding new 31 U.S.C. §5388.

[98] H.R. 1174, §2, adding new 31 U.S.C. §5390. The bill also provides clarification that the Wire Act (18 U.S.C. §1084) shall not apply to certain specified activities in connection with Internet gambling conducted by any state or tribal lottery authority. *Id.*

[99] H.R. 2230, adding new 26 U.S.C. §4491(a)(1).

McDermott, this fee "would never be imposed on a land-based casino. It would level the playing field between online operators and brick-and-mortar gambling operations which are more expensive to run."[100] In addition, the bill provides revenue incentives for states and Native American tribes, as states and tribal authorities have the option of accepting from licensees, on a monthly basis, an online gambling fee "equal to 6 percent of all deposited funds deposited by customers residing in each State or area subject to the jurisdiction of an Indian tribal government."[101] Acceptance of this fee by the state or tribal government relieves the licensee from any obligation to pay any other fee or tax to the state or tribal government relating to online gambling services.[102]

Internet Gambling Prohibition, Poker Consumer Protection, and Strengthening UIGEA Act of 2011

Introduced by Representative Joe Barton, the Internet Gambling Prohibition, Poker Consumer Protection, and Strengthening UIGEA Act of 2011 (H.R. 2366) would legalize and regulate interstate Internet poker only, as opposed to other forms of Internet gambling that would be permitted under Representative Campbell's bill. Under H.R. 2366, anyone wishing to operate an online poker website would need to obtain a license from "qualified" state or tribal gambling oversight commissions. Such state or tribal agencies would need to be approved by a new Office of Internet Poker Oversight that the bill establishes within the U.S. Department of Commerce.[103] The new federal Office of Internet Poker Oversight would be responsible for ensuring that qualified state or tribal agencies comply with the requirements under the act and would have the power to investigate and take appropriate remedial action against them.[104] H.R. 2366 specifies a range of minimum standards for state and tribal agencies to satisfy in order for them to be permitted to participate in the licensing program.[105] The bill also sets forth several standards that qualified state and tribal agencies must apply in determining whether a party should be issued an Internet poker facility license.[106] Like Representative Campbell's bill, H.R. 2366 allows states and Indian tribes to "opt out" of the license regime; in order to do so, the state's governor or the principal chief of the Indian tribe would need to inform the Secretary of Commerce of the "nature and extent" of the limitation on bets or wagers with respect to Internet poker that would apply to any person who resides in that state or who is located in the particular tribal land, respectively.[107]

H.R. 2366 also would require an Internet poker facility, in order to obtain a license, to demonstrate to the qualified state or tribal agency that it maintains certain safeguards and mechanisms that, among other things, (1) ensure that the person placing the bet or wager is at

[100] *Tax Proposals Related to Legislation to Legalize Internet Gambling: Hearing Before the House Comm. on Ways and Means,* 111th Cong., 2nd sess. (2010) (statement of Rep. McDermott).

[101] H.R. 2230, §2(a), adding new 26 U.S.C. §4493(b).

[102] H.R. 2230, §2(a), adding new 26 U.S.C. §4493(c).

[103] H.R. 2366, §103(b).

[104] H.R. 2366, §103(a).

[105] H.R. 2366, §103(c).

[106] H.R. 2366, §104(c).

[107] H.R. 2366, §104(a)(3).

least 21 years of age or older; (2) ensure that the person is physically located in a jurisdiction that allows such bets or wagers; and (3) prevent fraud, money laundering, and terrorist financing.[108]

U.S. Department of Justice Office of Legal Counsel's Recent Opinion on the Wire Act

The federal Wire Act, 18 U.S.C. 1084, prohibits the use of interstate telephone facilities by those in the gambling business to transmit bets or gambling-related information. Early federal prosecutions of Internet gambling generally charged violations of the Wire Act.[109] However, one federal appeals court concluded that the Wire Act applies only to sports gambling,[110] while a subsequent district court concluded that it applies to non-sports gambling as well.[111] The U.S. Department of Justice's Criminal Division has consistently maintained that the Wire Act applies not only to sports wagering but can also be applied to other forms of interstate gambling, including non-sports Internet gambling. Such an expansive view of the Wire Act by the Justice Department dissuaded state governments from expressly authorizing and implementing Internet gambling within their jurisdictions.[112] However, in late 2011, in response to a request by the states of Illinois and New York for an opinion regarding whether their proposed use of the Internet to sell lottery tickets to in-state adults would violate the Wire Act, the Justice Department's Office of Legal Counsel (OLC) reversed its interpretation of the Wire Act, opining that "interstate transmissions of wire communications that do not relate to a 'sporting event or contest,' 18 U.S.C. §1084(a), fall outside the reach of the Wire Act."[113] Some observers predict that this change in position will cause "an explosion of poker, instant lotteries and casino games on the Internet, run or licensed by the states."[114] In addition, because of the OLC's opinion, states may be able to enter into compacts with one another to operate online gambling across state lines.[115]

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[108] H.R. 2366, §104(d).

[109] *See, e.g.,* United States v. Ross, 1999 WL 782749 (S.D.N.Y. September 16, 1999)(denying a motion to dismiss a four count indictment charging violations of 18 U.S.C. §1084 and 18 U.S.C. §371 (conspiracy) in connection with Internet gambling business operated out of Curacao in the Netherlands Antilles); *see also,* People ex rel. Vacco v. World Interactive Gaming Corporation, 185 Misc.2d 852, 861-62, 714 N.Y.S.2d 844, 852 (1999)(noting in dicta violations of the Wire Act in connection with an offshore Internet casino that accepted wagers from bettors in New York).

[110] In re MasterCard International Inc., 313 F.3d 257, 262 (5th Cir. 2002)("The district court concluded that the Wire Act concerns gambling on sporting events or contests and that the [RICO] plaintiffs had failed to allege that they had engaged in internet sports gambling. We agree ... ").

[111] United States v. Lombardo, 639 F.Supp.2d 1271 (D.Utah 2007).

[112] *Oversight Hearing on the U.S. Department of Justice Opinion on Internet Gaming: What's at Stake for Tribes: Hearing Before the Senate Comm. on Indian Affairs,* 112th Cong., 2d Sess. (statement of Patrick Fleming, the Poker Players Alliance), at 2.

[113] *Whether Proposals by Illinois and New York to Use the Internet and Out-of-State Transaction Processors to Sell Lottery Tickets to In-State Adults Violate the Wire Act*, 35 Op. O.L.C. __, ___ (September 20, 2011), *available at* http://www.justice.gov/olc/2011/state-lotteries-opinion.pdf.

[114] *Oversight Hearing on the U.S. Department of Justice Opinion on Internet Gaming: What's at Stake for Tribes: Hearing Before the Senate Comm. on Indian Affairs,* 112th Cong., 2d Sess. (statement of I. Nelson Rose, Professor of Law), at 1.

[115] *Id.*

State Internet Gambling Laws and Recent State Legislative Activity

Most states prohibit any gambling that they do not expressly permit. All states except Hawaii and Utah authorize some form of gambling by their residents, such as lotteries, bingo, card games, slot machines, or casinos. Seven states (Illinois, Indiana, Louisiana, Montana, Oregon, South Dakota, and Washington) expressly outlaw Internet gambling. However, in light of growing state budget deficits and state legislators' desire to find ways of raising revenue without increasing taxes, several states are considering measures that would legalize, license, and tax Internet gambling within their borders. Such legalization would take advantage of UIGEA's "intrastate exemption" provision; states also no longer need to be concerned about prosecution under the Wire Act for enacting such laws due to the recent Department of Justice OLC opinion.

In April 2011, the District of Columbia authorized the District's lottery commission to offer games of skill or chance including poker via the Internet in the District of Columbia, becoming the first jurisdiction in the nation to legalize intrastate Internet gambling.[116] However, after some D.C. lawmakers criticized the apparently covert manner in which online gambling was approved (it was a late-night amendment to a budget law that received no public debate or hearings before passage),[117] the Council of the District of Columbia voted to repeal the law in February 2012.[118]

In June 2011, Nevada amended its state law to allow certain gaming licensees to conduct Internet gambling operations, effective upon passage of federal authorizing legislation or United States Justice Department notification that federal law permits such activity.[119] In late December 2011, the Nevada Gaming Control Board approved regulations to allow Internet poker within its borders, becoming the first state to do so.[120]

On March 4, 2011, the governor of New Jersey vetoed a bill that would have permitted intrastate Internet gambling, based in part on concerns that the New Jersey constitution limits casino gambling to within the boundaries of Atlantic City and also the uncertainty regarding the applicability of the federal Wire Act.[121] A bill is currently progressing through the New Jersey legislature to permit Atlantic City casinos to take bets from gamblers via the Internet.[122]

The Utah legislature passed a bill, signed by the Utah governor on March 19, 2012, that specifically prohibits Internet gambling within its borders and also provides for the state to opt-

[116] Justin Jouvenal and Michael Laris, "'Hot Spots' Part of D.C. Officials' Plan to Allow Internet-based Gambling in City," *The Washington Post* (April 13, 2011).

[117] Mike DeBonis, "D.C.'s Internet Gambling Bid Questioned," *The Washington Post* (January 26, 2012).

[118] Theo Emery, "Disputes in Washington End Gambling Program," *The New York Times,* at A19 (February 16, 2012).

[119] AB 258, available at http://www.legis.stat.nv.us/Session/76th2011/Bills/AB/AB258-EN.pdf.

[120] Alexandra Berzon, "Nevada Sets Framework for Internet Poker," *The Wall Street Journal* (December 22, 2011).

[121] Lisa Fleisher and Alexandra Berzon, "Internet Gambling Vetoed in New Jersey," *The Wall Street Journal* (March 4, 2011).

[122] "NJ Internet Gambling Bill Approved By Senate Committee," *CBS Philly* (April 3, 2012), *available at* http://philadelphia.cbslocal.com/2012/04/03/nj-internet-gambling-bill-approved-by-senate-committee/.

out of the federal licensing regime that would be created by H.R. 1174, the Internet Gambling Regulation, Consumer Protection, and Enforcement Act, should Congress pass the law.[123]

Iowa directed its state racing commission to study and report on "the creation of a framework for the state regulation of intrastate Internet poker."[124] The report, issued in December 2011, concluded that intrastate online poker could be conducted safely and would raise revenue of $3 million to $13 million per year.[125] The Iowa senate in March 2012 approved a measure that allows the state's casinos and racetracks to offer Internet poker.[126]

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[123] Tripp Balts, "Utah Governor Signs Bill Opting State Out of Net Gambling If Feds Allow It," *BNA Electronic Commerce & Law Report* (March 22, 2012).

[124] *Available at* http://coolice.legis.state.ia.us/linc/84/external/SF526_Enrolled.pdf .

[125] Michael Cooper, "Mired in Debt, States Pursue Web Gambling," *New York Times,* at A1 (January 18, 2012).

[126] Rod Boshart, "Online Poker Clears Senate Hurdle in Iowa," *Quad-City Times* (March 13, 2012).