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Barriers to Financing Internet Gambling Under UIGEA

Edward A. Morse
Professor of Law
McGrath North Mullin & Kratz Chair in Business Law
Creighton University School of Law
2133 California Street
Omaha, Nebraska 68178
Phone: 402-280-3091; e-mail: morse@creighton.edu
Web: http://law.creighton.edu/morse

I. INTRODUCTION.

The Unlawful Internet Gambling Enforcement Act (UIGEA) was enacted on October 13, 2006.[1] This bill nearly died quietly after being passed by the House in July 2006 (H.R. 4411), but the Conference Committee inserted it as Title VIII of the SAFE Port Act,[2] which was destined for passage. Proponents thus achieved success on a matter that had previously been unable to develop the required traction to move through Congress.

Far from a comprehensive solution, UIGEA is a modest attempt to address deficiencies in laws applicable to Internet gambling transactions. Rather than adopting a new legal framework, UIGEA relies upon existing state and federal laws to define the scope of legal gambling. However, it adds a federal criminal sanction to deter gambling businesses that attempt to thwart those laws and it empowers law enforcement efforts. Significantly, UIGEA also aims to restrict illegal Internet gambling by imposing additional obligations on financial service providers, thereby constraining funding for Internet gambling.

This outline provides an overview of UIGEA and the Internet gambling context, followed by a discussion of final regulations affecting participants in designated payment systems that could be used to conduct unlawful Internet gambling. These regulations are effective on January 19, 2009, and nonexempt participants are expected to comply beginning December 1, 2009.

The regulations require affected firms to establish policies and procedures designed to inhibit the financing of Internet gambling, including blocking restricted transactions and other forms of due diligence in screening commercial customers likely to be engaged in unlawful Internet gambling. They do not target consumers, thus leaving considerable room for individuals to gamble illegally on the Internet if they choose. However, UIGEA and its implementing regulations are likely to deter firms from offering financial services in support of unlawful Internet gambling, thereby also probably imposing greater transaction costs upon consumers who persist in gambling via the Internet.

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[1] Pub.L. 109-347, Title VIII, Oct. 13, 2006, 120 Stat. 1952, codified at 31 U.S.C. §§ 5361-67.
[2] Security and Accountability for Every Port Act, Pub.L. 109-347, October 13, 2006, 120 Stat. 1884.

II. PURPOSES OF UIGEA: PROBLEMS ASSOCIATED WITH INTERNET GAMBLING.

A. *Generally*. Internet gambling presents a number of underlying social and fiscal problems. In addition to concerns about externalized social costs, which are also associated with other forms of legalized gambling, the Internet presents some unique problems due to a virtual operational environment.

1. UIGEA includes the following Congressional findings with regard to Internet gambling:
   "(1) Internet gambling is primarily funded through personal use of payment system instruments, credit cards, and wire transfers.
   (2) The National Gambling Impact Study Commission in 1999 recommended the passage of legislation to prohibit wire transfers to Internet gambling sites or the banks which represent such sites.
   (3) Internet gambling is a growing cause of debt collection problems for insured depository institutions and the consumer credit industry.
   (4) New mechanisms for enforcing gambling laws on the Internet are necessary because traditional law enforcement mechanisms are often inadequate for enforcing gambling prohibitions or regulations on the Internet, especially where such gambling crosses State or national borders." 31 U.S.C.A. § 5361.

2. Other concerns about Internet gambling include:
   a. Lost tax revenue that may otherwise be imposed on state or tribal-run gambling operations that are subject to state regulation.
   b. Underage gaming, a problem exacerbated by the absence of robust methods for personal identification in an online environment.
   c. Potential association with money laundering or funding criminal or even terrorist enterprises.

3. Some believe that these concerns can be addressed through legalization and regulation, but Congress has not taken this approach.
   a. Efforts to repeal UIGEA or prevent the implementation of regulations, including a bill sponsored by Rep. Barney Frank (H.R. 5767) have not been successful.
   b. A litigation challenge to UIGEA and implementing regulations was also unsuccessful. See *Interactive Media Entertainment & Gaming Ass'n v. Gonzales*, 2008 WL 5586713 (D. N.J. 2008) (March 4, 2008).

4. Despite options for legal gambling in many states, individuals have shown a preference for Internet gambling. Some believe that the Internet may provide higher payouts than their domestic counterparts, and there is some empirical evidence for this phenomenon. See Edward A. Morse, *Extraterritorial Internet Gambling: Legal Challenges and Policy Options*, 1 INT. J. OF INTERCULTURAL INFO. MGT. 33 (2007), available online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=891851.

B. *Enforcement mechanisms.* Prior to UIGEA, Internet gambling firms knew that accepting wagers from U.S. residents was probably illegal, but they exploited the market anyway based on jurisdictional limits for enforcement.

1. *United States v. Betonsports PLC,* 2006 WL 3257797 (E.D. Mo. 2006), illustrates one segment of exploitation of U.S. gambling markets prior to UIGEA.
   a. Betonsports, a publicly-traded company incorporated in the U.K., with Internet gambling operations in other countries all located outside the U.S., took in over $1.2 billion (U.S.) in wagers, the vast majority of which (98%) came from U.S. residents.
   b. Websites and support equipment were located in Antigua and Costa Rica, but the firm advertised in U.S. markets.
   c. A 2004 prospectus for Betonsports included the following language, which indicates that the company knew they were engaged in illegal activities under U.S. law, but they chose to continue based on jurisdictional barriers to enforcing U.S. laws: "The Group has received legal advice that, notwithstanding that the Group's activities may be deemed illegal under U.S. law, there are jurisdictional issues regarding the imposition, adjudication and enforcement of U.S. law against the Group and the Directors, since the Group's relevant operating subsidiaries are not incorporated in the U.S. and do not have any physical presence in the U.S. The Directors have been advised that, for jurisdictional reasons, it would be difficult for any Group company to be prosecuted on a criminal charge in the U.S. or for a Director to be prosecuted on a criminal charge on his own behalf or on behalf of the company of which he was a Director if he were not physically present in the U.S."

2. Arrests of executives physically present in the United States, including those of Betonsports, indeed occurred.

3. Advertising was critical for promoting the Betonsports Internet business, as was financing through wire transfers and other means. Advertising here included print, radio, and television media that promoted the wagering as "legal and licensed" for U.S. operations. As the District Court noted, "This advertising is fraudulent." *Id.* U.S. firms were involved in advertising, as well as in providing telecommunications services to Betonsports in facilitating orders.

4. Fund transmitting services, including Western Union, were also part of the Betonsports business model. These services facilitated transfers of funds from U.S. customers to its off-shore betting operations.

5. The district court imposed a permanent injunction against Betonsports, which effectively shut down its business operations in the United States. Injunctive relief included:
   - Barring the company from operating websites, telephone services, or otherwise transmitting funds from U.S. patrons for gambling purposes;
   - Returning funds obtained from U.S. patrons and informing advertisers and telecommunications providers that it will cease illegal operations within the U.S.
   - Ensuring that domain names are transferred from U.S.-based registrars to the U.K., and further preventing access to U.S. jurisdictions, or in the event of access, displaying a message to the effect that they do not accept wagers from U.S. patrons.
   - Placing advertisements in national newspapers indicating that it is no longer accepting wagers from U.S. patrons, and providing a telephone number in which patrons can call for refunds.

6. A status report filed with the court on February 1, 2007, indicated the extent of compliance with these obligations, including problems concerning refunds of patron accounts due to fund availability.

C. *UIGEA Impact.* How does UIGEA affect a situation like that in Betonsports?

1. It does not resolve all jurisdictional limitations. Absent international agreement, jurisdictional constraints upon the imposition of U.S. laws on those outside of the United States persist. However, it may resolve some jurisdictional problems through clarifying federal jurisdiction and permitting certain forms of relief through federal courts.
   a. UIGEA grants "original and exclusive" jurisdiction to prevent and restrain restricted transactions to federal district courts. *See* 31 U.S.C. § 5365(a). Only injunctive relief is allowed. *See id.* § 5365(b).
   b. The U.S. Attorney General, state attorneys general, or other appropriate state officials are also empowered to institute proceedings to have an unlawful Internet gambling website removed by an interactive computer service, to the extent that service provides access to the website. *See* 31 U.S.C. § 5365(c).
      i. However, that assumes that the website is subject to U.S. jurisdiction.
      ii. Compare *Interactive Media Entertainment and Gaming Ass'n v. Wingate*, 2009 WL 142995 (Ky. App. 2009) (issuing a writ of prohibition against the enforcement of trial court order with regard to seizure and forfeiture of domain names of alleged illegal Internet gambling sites).
   c. An interactive computer service is exempt from liability unless it has actual knowledge and control of bets and wagers. *See id.*
   d. Regulated financial transaction providers are not subject to injunctive relief under this provision. *See* 31 U.S.C. § 5365(d). Presumably, regulatory agencies will exercise their authority in these situations.

2. UIGEA does not expand the definition of illegal gambling, but instead leaves this matter to extant federal and state laws governing gambling transactions.
   a. "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." 31 U.S.C. § 5362(10). Merely routing internet packets is not relevant in assessing the legality of a transaction, though the place where the wager is initiated, received, or made is relevant.
   b. No new federal restrictions on gambling are imposed under UIGEA. The Act states in part: "No provision of this subchapter shall be construed as altering, limiting, or extending any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States." *Id.*
   c. The Act recognizes the possibility that Internet gambling may become legal within the U.S., and it specifically excludes from its scope bets placed under the Interstate Horseracing Act of 1978. *Id.* This appears to flout a WTO ruling against the U.S. in a trade dispute with Antigua. However, as one court has explained, "UIGEA--which was enacted in 2006--would trump any obligations arising under the 1994 Uruguay Round Agreements. *See* 19 U.S.C. § 3512(a)(1) ("[n]o provision of any of the Uruguay Round Agreements ... that is inconsistent with any law of the United States shall have effect"); *see, e.g., Tag v. Rogers*, 267 F.2d 664, 667 (D.C.Cir.1959) ("has long been established that treaties and statutes are on the same level and, accordingly, that the latest action expresses the controlling law"). *Interactive Media Entertainment & Gaming Ass'n, v. Gonzales*, 2008 WL 5586713, 10 (D.N.J.) (D.N.J.,2008)

3. UIGEA clarifies that activities constituting unlawful Internet gambling are subject to federal criminal sanctions, and not merely state-based sanctions. Thus, it does expand and empower federal authorities in their efforts to enforce the law in this area, which might otherwise be left to the states, which are constrained not only by resources, but also by their own jurisdictional constraints. (See also point 1, above).
   a. Following the passage of UIGEA, publicly traded Internet gambling firms experienced significant declines in their stock price, thus reflecting the judgment of the marketplace that U.S. markets would indeed be affected by this legislation. *See* Edward A. Morse, *The Internet Gambling Conundrum: Extraterritorial Impacts of Domestic Regulation*, available online at http://hq.ssrn.com/submissions/MyPapers.cfm?partid=228554.
   b. These firms also changed their policies about accepting wagers from U.S.-based customers. *See id.* Potential criminal sanctions against officers, directors, and employees of such firms presumably play some part in these market changes.

4. UIGEA also clarifies that those who knowingly assist the gambling enterprise in conducting unlawful Internet gambling may also face criminal sanctions, though liability was also possible through aiding and abetting theory. See 18 U.S.C. § 2. For expanded discussion of aiding and abetting theory in this context, see Edward A. Morse & Ernest P. Goss, GOVERNING FORTUNE: CASINO GAMBLING IN AMERICA 197-202 (U. MICH. PRESS 2007). For a recent California case, holding that Yahoo! and Google were not liable for Internet gambling advertisements under 47 U.S.C. § 230 based on aiding and abetting theory, see *Cisneros v. Yahoo!, Inc.*, Cal. Super. Ct., No. 04-433518 (November 7, 2008).

III. REGULATING FINANCIAL INSTITUTIONS UNDER UIGEA.

The Act contemplates that regulations will affect business practices of participants in designated payment systems, thereby affecting a vital source of revenues transmitted from the U.S. Proposed regulations were issued in October 2007, and final regulations were issued in November 2008, effective January 19, 2009. *See* 73 FR 68382-01, 2008 WL 4915226 (F.R.). The regulations provide that compliance by nonexempt entities (a term described below) in designated payment systems is not required until December 1, 2009. Parallel regulations were promulgated by the Federal Reserve (12 CFR Part 233) and the Treasury (31 CFR Part 132). For convenience, citations will focus on 12 CFR Part 233. Highlights are discussed below.

A. *Restricted Transactions – Generally.*

The regulations are designed to constrain restricted transactions, which involve credit, funds, instruments, or proceeds which are knowingly accepted by a person engaged in the business of betting or wagering in connection with the participation of another person in unlawful Internet gambling. *See* 12 CFR § 233.2(v).

1. These transactions include not only credit cards or electronic fund transfers, but also checks, drafts, or similar instruments.

2. Such funds must be accepted or received by an Internet gambling business, which for this purpose, means "the business of placing, receiving or otherwise knowingly transmitting a bet or wager by any means which involves the use, at least in part, of the Internet, but does not include the performance of the customary activities of a financial transaction provider, or any interactive computer service or telecommunications service." 12 CFR § 233.2(r).
   a. Significantly, financial transaction providers, including credit card issuers, financial institutions, money transmitting businesses, or payment networks, are not necessarily engaged in an Internet gambling business merely by virtue of providing services.

b. Interactive computer services similarly enjoy an exemption from this definition of being an internet gambling business, as do telecommunications firms.
c. Nevertheless, aiding and abetting liability may attach to such firms when they knowingly assist an Internet gambling firm in flouting legal restrictions on Internet gambling, but such law is apart from the focus of UIGEA.
d. Also significant: a restricted transaction must involve funds going to an Internet gambling business, not vice versa. *See* 12 CFR § 233.2(y); Final Regulation Comments at 23 ("Under the final rule, the term 'restricted transaction' would not include funds going to a gambler, and would only include funds going to an Internet gambling business.") (hereinafter "Comments").

3. "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." 12 CFR § 233.2(bb).
   a. The legal status depends on existing law, and the Act does not expand upon extant authorities on the matter of illegal gambling.
   b. The regulations contemplate that legal opinions may be appropriate for the purpose of determining whether a domestic entity is in compliance with the regulations. See 12 CFR § 233.6(b)(2)(ii)(B)(1).

4. "Bet or wager" is defined to include "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." 12 CFR § 233.2(c).
   a. The degree of "chance" contemplated by the term "game subject to chance" is interpreted to encompass games where chance is a significant factor, but it need not be the predominant factor in the outcome. (See Comments page 19). Advocates for poker as a game of skill are unlikely to be satisfied by the scope of this definition.
   b. To the extent one is uncertain as to whether a "game subject to chance" is involved, due diligence procedures allow reliance upon a "reasoned legal opinion" on such matters as legality, as discussed further below.
   c. The regulations also contain numerous exceptions designed to preclude restrictions on securities or commodities trading, as well as insurance or other contracts of indemnity or guarantee. *See* 12 CFR § 233.2(c).
   d. Exemptions also exist for contests where the participants do not risk anything of value other than their efforts in accessing the internet or playing the game, and for certain kinds of fantasy sports leagues. See id. Sports leagues or contests where prizes and awards are established beforehand and are not determined by the number of participants or

amount of fees paid may be exempt. However, the team may not coincide with an existing real-world team. *See id.*

5. "Designated payment systems" which could be used by participants in connection with, or to facilitate a restricted transaction include: Automated clearing house (ACH) systems, card systems, check collection systems, and wire transfer systems. *See* 12 CFR § 233.3.

6. "Money transmitting businesses" may also be included as "designated payment systems" but only to the extent they:
   a. Engage in transmission of funds (a term which excludes "check cashing, currency exchange, or the issuance or redemption of money orders, travelers' checks, and other similar instruments") and
   b. "Permit customers to initiate transmission of funds transactions remotely from a location other than a physical office of the money transmitting business." 12 CFR § 233.3(d).
      i. This definitional exclusion for money transmitters is a significant change from the proposed regulations. It focuses exclusively on remote access transactions, rather than those conducted in person, for pragmatic reasons. Comments to the final regulations state: "[T]he Agencies' view is that money transmitting businesses that do not permit their customers to initiate remote fund transfers, such as through a website, could not reasonably be used for Internet gambling because of the lack of broad public accessibility."
      ii. This change restricted the estimated number of affected businesses from 253,208 under the proposed regulations to only 16 firms.
      iii. Another exemption, discussed below, also ensures that "send" agents are effectively exempt unless they are also operators of the money transmitting system. *See* 12 CFR § 233.4(c).

B. *Obligations: Policies and Procedures.* Non-exempt participants in designated payment systems are required to establish written policies and procedures that are "reasonably designed to identify and block or otherwise prevent or prohibit restricted transactions." 12 CFR 233.5(a). (Part III.E., below, covers exemptions).

1. Compliance with this regulation presents an epistemological challenge: how can one know if one's systems are compliant, *i.e.*, "reasonably designed"?

2. Comments to the final regulations recognize: "The Act does not indicate how a participant is to determine whether a system's policies and procedures comply with the regulation and yet, makes such a determination a requirement for compliance …."

3. The regulations impose a different burden on operators of payment systems than on other participants. Non-operator participants are allowed to rely on a written statement or notice by the operator that they are in compliance.

4. The regulations provide only limited additional guidance, including some "non-exclusive examples". *See* 12 CFR § 233.6 (discussed below).

5. If regulators discover noncompliance, they are expected to "work with the operator" to correct any deficiency.

C. *Due Diligence: Establishing Commercial Customer Relationships.*

1. Due diligence is required when an account or relationship is established with a commercial customer. Inquiries are to be "commensurate with the participant's judgment of the risk of restricted transactions presented by the customer's business." 12 CFR § 233.6(b).

2. If after due diligence, the participant cannot determine that the commercial customer presents a "minimal risk of engaging in an Internet gambling business", the participant is required to obtain written assurance that the customer does not engage in an Internet gambling business. Minimal risks are assigned specifically to:
   a. Entities directly supervised by Federal functional regulators. See 12 CFR § 233.7(a).
   b. Agencies, departments, or divisions of Federal or State government. See 12 CFR § 233.6(b)(4).

3. If the participant determines that a customer engages in an Internet gambling business, the customer must provide:
   a. Evidence of legal authority, such as a license or legal opinion covering such authority, along with a written assurance to notify of any changes in that authority.
   b. 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."
      1. Query how age verification can be satisfied in this context.
      2. Query whether location-based restrictions would be sufficient if no-U.S.-based participants are involved.
   c. The customer must also receive notification that restricted transactions are prohibited. *See generally* 12 CFR § 233.6(b).

4. Given existing requirements under the Patriot Act for banks to guard against money laundering, *see* 31 U.S.C. § 5318(h), and to undertake due diligence for non-United States persons, *see* 31 U.S.C. § 5318(i), the UIGEA regulations appear to impose only modest additional burdens for commercial customer relationships. *See also* 31 CFR § 103.176 (due diligence programs for correspondent accounts for foreign financial institutions).

a. Significantly, comments to the final regulations indicate that regulatory agencies would not expect U.S. participants to conduct due diligence of a foreign respondent's commercial customers.
b. Similarly, if a U.S. bank has a commercial customer that is a money-transmitting business, the bank would not be responsible for assessing risks associated with commercial customers of that money-transmitting business.
c. However, if the U.S. participant had actual knowledge of restricted transactions, action would be required. For this purpose, actual knowledge requires facts to be known to "an individual in the organization responsible for the organizations' compliance function with respect to that transaction or commercial customer" or to "an officer of the organization." *See* 12 CFR § 233.2(a)).

D. *Payment Card Systems: Blocking Transactions*. Card system operators, merchant banks, processors, or issuing banks, may also satisfy the requirement for policies and procedures through implementing procedures that are reasonably designed to identify and block restricted transactions. *See* 12 CFR § 233.6(d).

1. Blocking, for this purpose, refers to denying authorization for the transaction, and does not require freezing funds. *See* 12 CFR § 233.2(d).

2. Due diligence requirements in establishing commercial customer accounts or relationships, as noted above, appear to provide an alternative means of compliance, as the regulations are stated disjunctively. *See* 12 CFR § 233.6(d)(1) (provide for "either [due diligence from customer accounts]or [i]mplementation of a code system…."). Keeping this approach optional may be important to the extent that significant numbers of customer agreements may be affected, thus presenting significant compliance costs.

3. Coding systems, which include transaction codes and merchant/business category codes, may also be designed to identify and deny authorization "for a transaction that the coding procedures indicates may be a restricted transaction." Such implementation includes:
   a. Codes accompanying an authorization request that provide the operator or issuer with the ability to identify and deny authorization to transactions coded as a restricted transaction.
   b. Operators should engage in ongoing monitoring or testing to ensure that authorization requests are coded correctly, and they should also monitor and analyze payment patterns to detect suspicious payment volumes from merchant customers.
   c. Operators, acquirers, and processers should also adopt procedures that outline circumstances in which access will be denied and accounts should be closed in the event of actual knowledge a merchant has processed restricted transactions through the system.

   See generally 12 CFR § 233.6(d)(1)(ii).

4. Card systems possess an advantage over other payment systems in their ability to recognize transactions by codes, which are typically not possible under other designated payment systems, such as check or ACH systems.

5. Guidance for check collection systems, accordingly, does not suggest coding or blocking as an example. However, participants in check collection systems should adopt procedures to address the remedial actions taken when a bank has actual knowledge it is being used to process checks that are restricted transactions. *See* 12 CFR § 233.6(e).
   a. No particular remedy is required by these regulations.
   b. Comments state: "When restricted transactions are discovered, the Agencies expect that a participant's regulator will review the remedial actions taken by the participant and come to a judgment as to whether the participant took appropriate action under the circumstances."

E. *Exempt Entities*. Some entities are exempt from compliance with the requirement of establishing policies and procedures reasonably designed to prevent or prohibit restricted transactions with respect to particular transactions. These include:

1. Retailers that sell prepaid gift cards. Such retailers are not participants in a designated payment system, and thus are not covered by these rules. *See* Comments, note 50.

2. Intermediate ACH system participants. *See* 12 CFR § 233.4. Exemptions are granted for participants processing transactions through an ACH system, to the extent that they do not have a direct relationship with the originator or depositor. Thus, the following ACH participants are not exempt:
   a. The receiving depository financial institution and any third-party processor receiving the transaction in an ACH credit transaction;
   b. The originating depository financial institution and any third-party processor initiating the transaction in an ACH debit transaction;
   c. Receiving gateway operators and third-party processors that receive instructions for an ACH debit transaction directly from a foreign sender.
   d. In the above categories, third-party processors would be expected to have a direct relationship with a commercial customer initiating/receiving the transaction. *See* 12 CFR § 233.2(aa).

3. Participants in a check collection system, except for the depositary bank. *See* 12 CFR § 233.4(b).

4. Send agents in money transmitting businesses, unless they are also operators. *See* 12 CFR § 233.4(c).

   a. Send agents within the U.S. would not be expected to have direct relationships with commercial Internet gambling firms operating abroad,

while operators would be expected to conduct due diligence in establishing those commercial relationships.

b. As noted above, money transmitting businesses are not treated as designated payment systems unless they can be accessed remotely. *See* 12 CFR § 233.3(d)

5. Wire transfer participants, except for the beneficiary's bank. *See* 12 CFR § 233.4(d).

F. *Rejected Policies*. The following are notable policies that were rejected in designing the final regulations.

1. Monitoring the Internet. Proposed regulations suggested that financial institutions should monitor the Internet to ensure that their trademarks were not used in an unauthorized manner by Internet gambling websites to flout U.S. gambling restrictions.
   a. Final regulations eliminated this requirement, on the basis that the Act should not convert a right to protect trademarks into a legal obligation.
   b. Business decisions to police trademarks are thus independent of the Act, though one questions whether "actual knowledge" might emerge from public flouting in cyberspace.

2. Fines. Proposed regulations required fines to be imposed on members of ACH systems, card systems, and money transmitting businesses, to the extent their members processed restricted transactions. Fines were removed from the final regulations, leaving this matter to the discretion of agencies.

3. Agreements with foreign counterparties. Proposed regulations required U.S. firms to have agreements with foreign banks that they have policies and procedures reasonably designed to ensure that commercial relationships would not be used to process restricted transactions. This was problematic for many reasons, including the difficulty for the foreign institution to determine what was "unlawful Internet gambling" based on the multiplicity of U.S. laws. The foreign institution may also be in a correspondent relationship, thus providing an attenuated link to the ultimate commercial gambling firm.

4. Monitoring consumer transactions. Neither the proposed regulations nor the final regulations contemplate a requirement that firms obtain assurances from non-commercial customers that they are not engaging in unlawful Internet gambling. Proposed regulations rejected such a requirement, in part, on the ground that consumer representations in this context may be unreliable.

5. Lists of firms conducting unlawful Internet gambling. UIGEA does not require a list of firms engaged in unlawful gambling, and neither do the final regulations. Not only would it be difficult to compile such a list and keep it current, but it would also not necessarily be useful to the extent that many payment processing systems do not utilize payee names.

G. *Liability issues.*

1. The Act provides protection from liability based on blocking or refusing to honor a transaction:

   "(1) that is a restricted transaction;
   (2) that such person reasonably believes to be a restricted transaction; or
   (3) as a designated payment system or a member of a designated payment system in reliance on the policies and procedures of the payment system, in an effort to comply with regulations …." 31 U.S.C. § 5364(d).

2. The final regulations merely parrot the statutory language, providing no further clarification on the scope of liability protection. *See* 12 CFR § 233.5(e).
   a. Card payment systems routinely block transactions coded as Internet gambling transactions, without regard to whether those transactions are restricted transactions under the Act. Card payments are generally subject to contractual duties between the issuer and cardholder, creating a limited base for potential liability in this context.
   b. The regulations do not require firms to adopt more specific coding to permit lawful Internet gambling transactions to proceed. Business decisions about the kind of transactions a firm wishes to process are not constrained by UIGEA. *See* 12 CFR § 233.5(e); Comments at 35.
   c. Business decisions to block may be influenced by bankruptcy decisions like *In re Baum*, 386 B.R. 649, 659 (2008), which find debt incurred in violation of UIGEA to be unenforceable.

3. Financial service providers may face liability for wrongful dishonor of payment. *See* UCC §§ 4-402 (checks) and 4A-212 to -402 (wire transfers). Liability protection offered here appears adequate to address these concerns. Blocking is unlikely to occur absent actual knowledge, although "reasonable belief" may be tested in this context.

IV. SELECTED EXAMPLES FOR DISCUSSION.

The following hypothetical scenarios are offered for discussion and analysis of the scope and effectiveness of UIGEA and the final regulations. As can be seen, UIGEA does not provide a comprehensive solution; practical barriers to devising more effective solutions are considerable.

A. Retail customer of commercial bank seeks to wire funds to his own bank account in the U.K. for the purpose of facilitating further transfers to an Internet gambling firm located outside of the U.S.
   1. Activity here is generally outside the scope of UIGEA. Should banks inquire as to customer purposes? Regulations do not require this. Are there any practical steps that a bank could take to prevent consumer customers from cross-border restricted transactions in this context?

2. Note that a Report of Foreign Bank and Financial Accounts (FBAR) (Form TD F 90-22.1) would be required from this individual by June 30, to the extent that the individual has authority over accounts totaling $10,000 at any time during the year. (See http://www.irs.gov/pub/irs-pdf/f90221.pdf).
   a. Noncompliance can result in civil penalties of $10,000 for non-willful violation, and the greater of $100,000 or 50 percent of the amount in the account for willful violations. Criminal fines of up to $50,000 and imprisonment of up to 10 years may also be imposed in addition to these civil penalties. See IR-2008-79 (June 17, 2008).
   b. Tax return disclosure on Schedule B of Form 1040 is also required, without regard to the balance of the account.

B. Individual gambler visits office of money transmitter firm and orders funds transmitted to agent in foreign country for the purpose of placing bets on sporting events through legal Internet gambling firm operating in that country.

   1. Money transmitter office, without remote access, appears exempt as "send agent." Query what practical steps could be imposed here?

   2. Operator of system, and perhaps others, may nevertheless have due diligence obligations. Do these depend on how the transfer is routed? If transferee advertises on the web that it can be an agent for U.S. clients, does a new obligation arise?

   3. If bank is involved and money transmitter is a commercial customer, what due diligence is required for the bank? As a practical matter, would reasonable due diligence expose restricted transactions in this context?

C. In order to facilitate betting transactions from its customers, foreign Internet gambling firm forms an LLC in the U.S., which then seeks to open a bank account for the purpose of depositing customer wagers. The LLC also seeks to obtain a credit card account with an acquiring bank for the purpose of receiving payments from customers.

   1. Will due diligence obligations on bank prevent this account relationship?

   2. Will due diligence and/or blocking obligations prevent this merchant account relationship from being formed?

   3. If the merchant card account is opened, would ongoing monitoring and pattern analysis detect restricted transactions?

D. Foreign Internet gambling firm sends a wire transfer to the bank account of an individual customer in the U.S., representing the balance of his wagering account. The wire transfer goes through a foreign correspondent bank to a U.S. counterpart, and then through U.S. banking channels to the customer's local bank.

1. Note that this is not a restricted transaction, since it is not received by an Internet gambling business.

2. Will any due diligence obligations affect participants in this context, which involves inbound transfers? Will actual knowledge affect those obligations?

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03/03/2009