

# Center for Regulatory Effectiveness

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Charles Klingman  
Deputy Director,  
Office of Critical Infrastructure Protection  
and Compliance Policy  
US Department of the Treasury  
Room 1327, Main Treasury Building  
1500 Pennsylvania Avenue, NW.  
Washington, DC 20220

Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, NW  
Washington, DC 20551

**Re: Establishing A UIGEA Restricted Transaction List and Process for Resolving UIGEA Status of Other Transactions**

Dear Mr. Klingman and Ms. Johnson:

A list (or lists) of restricted transactions will need to be developed in response to the UIGEA. The question is whether a single list will be provided by the federal government or whether banks, credit unions, money transmitting businesses and other participants in designated payment systems will be tasked with developing their own lists interpreting complex federal, state and tribal gambling laws.

For reasons discussed below, the Center for Regulatory Effectiveness (“CRE”) is recommending adoption of the following list of UIGEA-restricted transactions:

<b>UIGEA Restricted Transactions</b>		
<u>Type of Transaction</u>	<u>Examples of Restricted Wagers</u>	<u>Examples of Non-Restricted Wagers</u>
Bets or wagers on any sporting event or contest not held at a state, tribal or locally licensed gambling facility.	Bets or wagers on any game or contest held by or under the auspices of Major League Baseball, the National Football League, National Basketball Association, National Hockey Association, and the National Collegiate Athletic Association.	Bets or wagers on horse races, greyhound races, jai-alai, fantasy sports teams.

### **Why A Restricted Transactions List Is Needed**

The Notice of Proposed Rulemaking (“NPRM”) emphasizes financial institutions using “reasonable due diligence” in identifying and blocking restricted transactions. As CRE previously explained,<sup>1</sup> however, due diligence cannot be effectively exercised, nor can restricted transactions be prohibited by commercial agreements or otherwise identified and blocked, without the parties knowing precisely what constitutes a restricted transaction.

The NPRM makes clear that private sector companies need to know which specific gambling transactions are lawful and which are not since the “safe harbor” provision for card systems includes “[e]stablishing transaction codes and merchant/business category codes...to enable the card system or the card issuer to identify and deny authorization for a restricted transaction.” Such codes could only be established if there is a list of restricted transactions.

Determining what precisely constitutes a restricted transaction is a complicated legal question that involves the interpretation of various federal, state and tribal gambling laws and the interplay between those laws. The agencies have recognized the difficulty in determining what is a restricted transaction as they have explained that the definition of some terms in the law could be: 1) geographically specific; and 2) transaction specific. As the NPRM states,

*application of some of the terms used in the Act may depend significantly on the facts of specific transactions and could vary according to the location of the particular parties to the transaction or based on other factors unique to an individual transaction.<sup>2</sup>*

The NPRM’s recognition that knowledge of facts unique to individual transactions is needed highlights the complex relationship between various federal and state laws and each individual transaction, not just each type of transaction. This complex relationship undermines the notion that “reference to the underlying substantive State and Federal gambling laws” is sufficient to allow parties determine whether a given transaction is restricted.

It is important to note that the agencies’ acknowledgment of the need for knowledge specific to individual transactions calls into serious doubt the practicality of any broad-based transaction identification/blocking scheme. CRE does agree with the agencies, however, that the issue of determining whether specific transactions are restricted is not well resolved through “a general regulatory definition.”<sup>3</sup>

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<sup>1</sup> [http://www.federalreserve.gov/SECRS/2007/November/20071120/R-1298/R-1298\\_33\\_1.pdf](http://www.federalreserve.gov/SECRS/2007/November/20071120/R-1298/R-1298_33_1.pdf).

<sup>2</sup> 72 Fed. Reg. 56682 (Oct. 4, 2007).

<sup>3</sup> Ibid.

### **Exemptions Undermine the Ability to Rely on Underlying Substantive Gambling Laws**

There are two contradictory goals expressed in the NPRM; the directives that participants in designated payment systems are to:

- 1) Resolve the scope of gambling-related terms “by reference to the underlying substantive State and Federal gambling laws;” and simultaneously
- 2) Ignore those same underlying substantive State and Federal gambling laws to create exemptions for certain favored gambling transactions even though the Act explicitly states that it should not be construed as “altering, limiting, or extending any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling....”

Specifically, the NPRM states that “interstate horseracing transactions” are exempted from the definition of “unlawful internet gambling” by the Act even though the “Department of Justice has consistently taken the position that the interstate transmission of bets and wagers, including bets and wagers on horse races, violates Federal law....”<sup>4</sup> Thus, **private sector companies are being asked to interpret criminal statutes in a manner that directly contradicts the Department of Justice’s understanding of those laws.**

#### ***The Internet Horseracing Gambling Exemption***

The Justice Department has made clear that they believe that interstate horseracing bets violate federal law. It should also be noted that some interstate horseracing wagers may also violate state laws, thus triggering violation of additional Federal statute(s).<sup>5</sup>

An example of a “legal” internet gambling company is XpressBet which describes itself as a “a legal, licensed, U.S.-based account wagering provider that offers...wagering...either online or by telephone.”<sup>6</sup> The betting service, which is owned by a company that operates or manages a number of race tracks, including Pimlico in Baltimore, MD, accepts funds via payment systems including ACH, credit/debit cards, check/money order, and wire transfer.<sup>7</sup> Of note, the company uses the motto “Anytime...from Anywhere.®”

The “from Anywhere” aspect of XpressBet’s operations is of particular concern with respect to state and federal gambling laws. Although XpressBet states that residents of certain states may not apply for accounts, they do not appear to have any restrictions on states from which account holders may place bets.

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<sup>4</sup> Ibid., p. 56681.

<sup>5</sup> 18 U.S.C. §§ 1952 and 1955 require an underlying violation of state law.

<sup>6</sup> <http://www.xpressbet.com/whatisxb.aspx>.

<sup>7</sup> <http://www.xpressbet.com/faq.aspx>.

Thus, for example, an XpressBet account holder visiting a state such as Utah that bans all gambling<sup>8</sup> could still use the telephone or internet to place a wager through XpressBet on horseraces across the country and overseas. It should be noted that similar services are also offered by other licensed internet betting companies such as TwinSpires which offers wagering on races around the country and overseas via telephone, computer and handheld wireless devices.

Since the NPRM states that interstate wagers on horseracing are exempt from the scope of the regulation, the agencies are requiring that participants in designated payments systems ignore certain potential violations of federal and state gambling laws.

### ***The Fantasy Sports Gambling Exemption***

The proposed rule exempts “any fantasy or simulation sports game.” While fantasy sports operators often provide the ability to play for free, many also offer pay-for-play options, some with significant payouts. For example, CBS’ fantasy football offers a “Double Diamond” level which requires participants to stake \$499.95 for the first team and \$449.95 for additional teams in order to possibly win \$3,500.<sup>9</sup> Lower stakes play for lower payouts is also available. CBS notes that residents of certain states are excluded from the higher stakes levels of playing.

Fantasy football with even higher stakes play is available from operators not affiliated with the NFL. For example, GridIron Fantasy Sports LLC offers a first prize of \$300,000 and requires “a minimum of \$1,750” be staked in order to play.<sup>10</sup>

In that fantasy sports games can involve participants staking non-trivial sums of money for the possibility of winning larger sums based on the performance of professional athletes in sporting events, it is reasonable to conclude that accepting funds for participation in such contests across state lines constitutes illegal gambling as understood by the Department of Justice.

While it may well be true that a participant’s knowledge and skill significantly enhance their chance of winning, the same is true for horseracing and, as discussed above, Justice considers interstate horseracing wagers to be unlawful. Although fantasy sports meeting certain criteria are exempt under the Act, operators of such sports may still potentially be prosecuted under federal and state laws. It should be noted the Justice Department did not weigh in on *Humphrey v. Viacom, Inc.* and the District Court’s decision did not impinge on the Department’s prosecutorial authority.

From a social perspective, fantasy sports is one of the most pernicious forms of wagering since it is a gateway gambling game; attracting fans to begin playing for free and, in the case of CBS, offering a stepladder of betting options beginning at a nominal amount (\$15 for the chance to win \$50) that escalates to wagering levels that require putting hundreds of dollars at risk, all conducted under the auspices of family-friendly entertainment companies.

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<sup>8</sup> See Utah Code, Title 76, Chapter 10, Section 1102.

<sup>9</sup> <http://football.sportsline.com/splash/football/spln/single>.

<sup>10</sup> <http://www.wcoff.com/Rules/tabid/57/Default.aspx>.

It is important to note that, as long as the fantasy sports games comply with the criteria specified in the Act, the transmission of “fees” and “prizes” associated with those games are UIGEA-permitted transactions, even if the games are offered by overseas companies/websites that also offer restricted sports bets. The agencies acknowledged the possibility of the complicating situation where an internet business offers both lawful and unlawful transactions when they recognized that “a business that engages in unlawful Internet gambling might also engage in lawful activities that are not prohibited by the Act.” The possibility of dual-status businesses again underscores that “reasonable due diligence” and/or knowing the nature of a customer’s business is insufficient for determining whether a given transaction is restricted.

The relevance of these internet gambling exceptions for fantasy sports and horseracing is that they demonstrate that:

1. Financial institution reliance on just the underlying substantive gambling laws is insufficient for determining whether a transaction should be identified and blocked under the Act; and
2. Any list of restricted transactions will be a subset of all gambling transactions that are potentially subject to federal and/or state prosecution.

### **Options for Establishing A List of Restricted Transactions**

There are two options developing lists of restricted transactions:

1. The federal government promulgates a list of restricted gambling transactions; or
2. Banks, credit card system operators, and other participants in designated payment systems consult with competent legal counsels who are expert in federal gambling laws *and* the gambling laws of each state in which the company does business, and develop lists based on the legal advice.

There are three primary problems associated with the private sector determining which internet gambling transactions are and are not lawful:

1. The economic burden on the private sector of conducting the necessary legal research would be substantial, as CRE has already explained;<sup>11</sup>
2. Different financial institutions may well develop different restricted transactions lists, thus exacerbating the problem highlighted in a recent House Judiciary Committee hearing of inconsistent enforcement policies for online wagering; and
3. It would be deeply inappropriate for the federal government to outsource the interpretation of criminal law.

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<sup>11</sup> [http://www.federalreserve.gov/SECRS/2007/November/20071106/R-1298/R-1298\\_25\\_1.pdf](http://www.federalreserve.gov/SECRS/2007/November/20071106/R-1298/R-1298_25_1.pdf).

## **Recommended Restricted Transactions List and Mechanism for Resolving the UIGEA Status of Other Gambling Transactions**

Footnote 1 in the NPRM states that although the Justice Department believes that interstate transmission of bets, including bets on horse races is illegal, “[t]he horse racing industry disagrees with this position.” Since the legal status of many interstate gambling transactions are either disputed or complex (dependent on location-specific or other transaction specific information), CRE recommends that:

1. Gambling transactions which are undisputedly unlawful be immediately placed on a restricted transactions list; and
2. The status of all other internet gambling transactions would be placed before an administrative law judge (“ALJ”) or other qualified federal official who, following an open, transparent proceeding, would make recommendations to the agencies as to which additional transactions, if any, should be added to the restricted transactions list.

Since the restricted transactions list would apply only to the transaction identification/blocking actions private sector organizations are obligated to take under the UIGEA, the list would not limit the authority of federal and state law enforcement agencies with respect to any gambling transaction.

### ***UIGEA Restricted Transactions***

According to the Justice Department, the sections of the United States Code most relevant to internet gambling are 18 U.S.C. §§ 1084, 1952, and 1955.<sup>12</sup> The Wire Act, § 1084, is of particular note since it: 1) specifically prohibits “the transmission in interstate or foreign commerce of bets or wagers...on any sporting event or contest...”; and 2) does not require an underlying violation of state law or other federal law. Section 1952 defines “unlawful activity” in interstate commerce to include “any business enterprise involving gambling...in violation of the laws of the State in which they are committed or of the United States” but does not contain any additional information as to what activities constitute gambling. Section 1955 prohibits “illegal gambling businesses” and includes an expansive definition of gambling but also requires an underlying violation of state or local law.

Case law clearly demonstrates that the broad-scope of the prohibition on sports bets. For example, in *U.S. v. Kaczowski*, 114 F.Supp.2d 143 (W.D.N.Y., 2000), which concerned bets from New York being placed in a country where they were legal, the judge’s discussion of the Wire Act noted that “a plain reading of which demonstrates the criminality of the placing of bets or wagers on any sporting event or contest, through interstate and foreign communication...” Moreover, the applicability of the Wire Act beyond the traditional “bookmaking” function was made clear in *U.S. v. Cohen*, 260 F.3d 68 (2nd Cir.2001). In a discussion of the case, Judge Carnes in *U.S. v. Corrar*, 512 F.Supp.2d 1280 (N.D. Ga.,2007) explained,

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<sup>12</sup> Statement of Catherine L. Hanaway, United States Attorney Eastern District of Missouri, United States Department of Justice, Before the United States House of Representatives Committee of the Judiciary, November 14, 2007.

“Cohen was not a ‘bookie’ in the sense that defendant has used the term, because he did not personally accept bets or wagers from his customers. Within two years of founding his company, World Sports Exchange was receiving over 60,000 calls per month. ...Cohen was a manager and promoter of his business, farming out the actual receipt of bets to others.”

Since sports bets are the only type of prohibited wager that is explicitly discussed in statute without reference to state or local laws and that is undisputedly unlawful irrespective of location, CRE recommends the following initial restricted transactions list:

<b>UIGEA Restricted Transactions</b>		
<u>Type of Transaction</u>	<u>Examples of Restricted Wagers</u>	<u>Examples of Non-Restricted Wagers</u>
Bets or wagers on any sporting event or contest not held at a state, tribal or locally licensed gambling facility.	Bets or wagers on any game or contest held by or under the auspices of Major League Baseball, the National Football League, National Basketball Association, National Hockey Association, and the National Collegiate Athletic Association.	Bets or wagers on horse races, greyhound races, jai-alai, fantasy sports teams.

***Adjudicative Proceeding***

After promulgation of the above initial restricted transactions list, the Secretary and the Board of Governors of the Federal Reserve System, or delegated officials, would appoint an ALJ or other qualified federal official to consider what other types of transactions, entered into in what locations, if any, should be added to the list.

The ALJ or other designated official would review federal and State laws applicable to gambling and gaming, and types of betting or wagering that appear to be potentially subject to such laws, and on the basis of such review develop nominations for any additions to the list. The federal official would announce any such preliminary determinations for additions to the restricted transactions list through notice in the *Federal Register* and direct notice to any known organizations or companies sponsoring or supporting such transactions and State governmental entities having jurisdiction over such matters. Such organizations or companies or State agencies would then have the opportunity to submit materials pertinent to such preliminary determinations and to request a formal public hearing on the matter. The adjudicative official could also consider additional materials at his/her discretion and conduct discovery, so long as all materials are entered into the record.

At the conclusion of any such opportunity for submission of relevant materials and a hearing, the ALJ or other qualified federal official would prepare a recommendation for any addition to the list, along with

supporting findings and conclusions, and submit it to the Secretary and the Board of Governors of the Federal Reserve System.

Upon submission to the Secretary and the Board, the Secretary and the Board would publish notice of the adjudicative official's recommendation and their proposed decision on the recommendation in the *Federal Register* and directly to any party that had submitted materials or participated in a hearing. Such notice would provide interested parties sixty (60) days within which to submit materials or views supporting or opposing the preliminary determination to the Secretary and the Board of Governors, following which the Secretary and the Board would issue a final decision on any changes in the restricted transactions list through notice in the *Federal Register*.

### **Conclusion**

The agencies should:

1. Promulgate a restricted transactions list requiring designated payment systems to identify and block sports bets on events not held at a state, tribal or locally licensed gambling venue; and
2. Charge an ALJ or other qualified federal official to hold an open, transparent proceeding with respect to other internet gambling transactions and to make recommendations to the agencies as to any additional specific types of wagers that should be placed on the restricted transactions list.

Sincerely,

/s/

Jim Tozzi

Member, Board of Advisors