

EDWARDS ANGELL PALMER & DODGE LLP

2800 Financial Plaza Providence, RI 02903 401.274.9200 fax 401.276.6611 eapdlaw.com

The Menendez Bill Does More – and Less – than the Frank Bill Summary of the Internet Poker and Games of Skill Regulation, Consumer Protection and Enforcement Act of 2009, introduced by Senator Robert Menendez (D-NJ)

by Mark Hichar¹

On August 6, 2009, U.S. Senator Robert Menendez (D-NJ) introduced the latest bill (S. 1597)² that would allow – but regulate – some forms of interstate and cross-border Internet wagering. Titled the “Internet Poker and Games of Skill Regulation, Consumer Protection and Enforcement Act of 2009,” the 91-page Bill is considerably more detailed than the Bill introduced by Representative Barney Frank (D-MA) in May.³ However, unlike the Frank Bill, which would regulate and allow Internet gambling on games of chance as well as games of skill, the Menendez Bill would apply only to Internet-based games “in which success is predominately determined by the skill of the players, including poker, chess, bridge, mahjong and backgammon.”⁴ This reduction in scope may increase its likelihood of success, as advocates of Internet poker are more focused and seem to be stronger politically, than advocates of Internet gambling generally.⁵ Like the Frank Bill, the Menendez Bill excludes from its scope gambling on professional and amateur sports events. Such Internet wagering would remain illegal.

The following is a summary of the salient provisions of the Menendez Bill.

Licenses to operate “Internet game-of-skill facilities”

Under the Menendez Bill, operators of websites through which bets are initiated or received with respect to games of skill – “Internet game-of-skill facilities” – would be licensed by the U.S. Secretary of the Treasury (the “Treasury”). Licenses would be issued for five-year terms, and be renewable in accordance with Treasury-prescribed requirements. Without a license, it would be unlawful for a person to operate an Internet game-of-skill facility in interstate or foreign commerce in which bets are made by or received from persons located in the United States.

¹ Mark Hichar is a partner in the law firm Edwards Angell Palmer & Dodge L.L.P., and heads the firm’s Gaming Practice Group. He practices out of their offices in Boston and Providence.

² As of the date of this paper, the official version of the Bill was not posted on Thomas.gov because the text had not yet been received from the Government Printing Office.

³ The Internet Gambling Regulation, Consumer Protection and Enforcement Act (H.R. 2267).

⁴ “Poker” is the only one of the specifically-included games of skill that is defined, and even then it is defined imprecisely. It is defined as “any of the several card games that are commonly referred to as ‘poker’; that are played by 2 or more people who bet or wager on the cards dealt to them; in which players compete against each other and not against the person operating the game; and in which the person operating the game may assess a commission fee or any other type of fee.”

⁵ For example, the Poker Players Alliance, a poker advocacy group chaired by former Senator Alphonse D’Amato, claims to have over one million members nationwide.

EDWARDS ANGELL PALMER & DODGE LLP

States and Tribes can “Opt-Out”

Like the Frank Bill, the Menendez Bill would permit states and tribes to “opt out” of the covered Internet gambling by providing notice to the Treasury. No licensee could knowingly accept a bet or wager initiated by a person located in any state or on any tribal lands of any tribe that “opted out” – *i.e.*, elected to prohibit such bets or wagers.

In this regard, the Bill provides that “No provision of State law enacted prior to the [Menendez Bill] shall be construed to require a state to provide [an “opt-out” notice].” This presumably means that state anti-gambling laws enacted prior to the Menendez Bill are superseded by the Menendez Bill. Thus, if a particular state’s existing laws prohibit persons from initiating Internet poker wagers from within the state or prohibit the acceptance of Internet poker wagers from persons located in the state, then if such state does not “opt-out” as contemplated by the Menendez Bill, those theretofore prohibited activities would be permitted in the state. This would compel states wishing to continue in effect their existing anti-poker laws to “opt out” quickly, since the initial “opt out” period would run for only 90 days after enactment of the Bill. This aspect of the Bill likely will be objectionable to those who assert that whether and what types of gambling to permit should be the prerogative of the states. An “opt-in” process, rather than the current “opt-out” process might be needed to address those anticipated objections.

Note, however, that many state constitutions prohibit the expansion of gambling absent amendment or a specified vote of the electorate. Presumably such constitutional provisions would not be superseded by the new federal law.⁶

Licensee Fees and Taxation

Under the proposed law, each licensee would be required to pay a monthly fee equal to 10% of the funds deposited with the licensee during the month by persons located within the United States to be used to place bets on Internet games-of-skill. Half of this fee would go to the federal government and the other half would be divided among the “qualified” states and “qualified” tribes (*i.e.*, those not “opting out” of the receipt of such funds) from which the customers making such deposits were located, to each state and tribe pro rata according to the deposits attributable to persons located within that state or on the lands of that tribe. Qualified states and tribes would be prohibited from taxing (1) income of a licensee relating to customer deposits or wagers, unless the licensee maintains a permanent physical presence in the jurisdiction; or (2) deposits or bets placed with a licensee. States and tribes that are not “qualified” (*i.e.*, that have elected not to receive a pro rata share of the State or Indian tribal government gaming license fee) would be

⁶ For example, the Rhode Island Constitution prohibits “[a]ll lotteries . . . in the state except lotteries operated by the state and except those previously permitted by the general assembly prior to the adoption of [R.I. Const. Art. VI, § 15], and all shall be subject to the prescription and regulation of the general assembly.” R.I. Const. Art. VI, § 15 In Rhode Island, poker is considered a “lottery” – *i.e.*, a game in which contestants give consideration to compete for a prize, and in which chance predominates over skill in determining the outcome. See In re Advisory Opinion to the Governor (Casino I), 856 A.2d 320, 328 (R.I. 2004)) Thus, this provision of the Rhode Island Constitution would operate to compel the State to “opt-out” under the Menendez Bill.

EDWARDS ANGELL PALMER & DODGE LLP

able to impose taxes on (A) income of a licensee with respect to deposits or bets, but only if the licensee maintains a permanent physical presence in such jurisdiction; and (B) deposits or bets, provided that they were initiated or otherwise made by a person located within the jurisdiction of that state or tribe at the time of the deposit or bet.

Record Keeping

Under the Menendez Bill, each licensee would be required to keep daily records showing all deposits and the location of each person making a deposit. In addition, each licensee would have to report for each calendar year: (1) the name, address and taxpayer identification number of each bettor; (2) the gross winnings, gross wagers, and gross losses of each bettor; (3) the net Internet gaming winnings of each bettor; (4) the amount of tax withheld by the licensee, if any, with respect to each bettor; (5) the balance of any account maintained by the licensee for each bettor at the beginning and the end of the calendar year; and (6) the amounts of all deposits and withdrawals from each account. In addition, each licensee would be required to furnish to each bettor a written statement showing the information required to be shown on the aforementioned licensee report to the extent such information relates specifically to him or her.

Amendments to the UIGEA and Provisions Regarding Financial Transaction Providers

The Menendez Bill would amend the Unlawful Gambling Enforcement Act of 2006 (the “UIGEA”)⁷ by explicitly excluding from the term “unlawful Internet gambling” activities carried out by an Internet game-of-skill facility operated by a person licensed under the new law. Thus, the UIGEA essentially would be inapplicable to gambling authorized under the Menendez Bill.

The proposed law also provides that no financial transaction provider shall be held liable for engaging in financial activities or transactions, including payment processing activities, in connection with bets permitted by the proposed law or by the Interstate Horseracing Act of 1978 (15 U.S.C. §§ 3001 *et seq.*) unless such financial transaction provider had knowledge or reason to know that the specific activities or transactions are unlawful under the proposed law or the aforementioned Interstate Horseracing Act.

Finally, as requested by many financial transaction providers in connection with the UIGEA and its subsequent regulations, the proposed law would amend the UIGEA by requiring the creation of a list of Internet gambling website operators involved in illegal activity – *i.e.*, “Unlawful Internet Gambling Enterprises.” The proposed law defines an “Unlawful Internet Gambling Enterprise” as, generally: (1) an Internet gambling business that knowingly accepts funds, credit, transfers, checks or similar financial instruments in connection with the participation of another in unlawful Internet gambling; (2) a person who knowingly receives or transmits funds intended primarily for a person described in (1); or (3) a person who knowingly assists a person described in (1) or (2). Within 120 days after the enactment of the Bill, the Director of the Financial Crimes Enforcement Network would be required to submit to the Treasury a list of Unlawful

⁷ 31 U.S.C. §§ 5361 *et seq.*

EDWARDS ANGELL PALMER & DODGE LLP

Internet Gambling Enterprises, and thereafter the list would be kept current. Such list would be required to include certain specified information pertaining to each Unlawful Internet Gambling Enterprise, including all of its known website addresses, owners, operators, financial agents and account numbers. A financial transaction provider would be deemed to have actual knowledge that a person is an Unlawful Internet Gambling Enterprise “to the extent such person is identified on the list available to the public, or on a non-public list made available to such financial transaction provider, . . . provided that the list shall not be deemed to be the sole source of such actual knowledge.”⁸

Suspension of the UIGEA Regulations and Promulgation of New Superseding Regulations

The Menendez Bill provides that, within 180 days after its enactment, the Treasury shall prescribe and publish regulations to carry it out. Further, from the date of its enactment until June 1, 2010, the regulations promulgated under the UIGEA are suspended – *i.e.*, they shall have no force or effect.⁹ During this period, the Treasury, in consultation with the Attorney General, shall revise the suspended UIGEA regulations in accordance with the amendments made to the UIGEA by the Menendez Bill.

Cheating and other Fraud Made Criminal

The proposed law makes it a crime punishable by fine, imprisonment or both, for anyone who makes a bet with a licensee, or who sends, receives or requests information assisting with such a bet, to knowingly use, or assist another to use, any electronic, electrical or mechanical device designed or programmed to obtain an improper advantage in any game authorized by the law. Similarly prohibited and punishable is the knowing use of any “cheating device”¹⁰ to cheat or defraud a licensee or other bettors, by any person making a bet with a licensee, or sending information assisting such a bet.

Regulations to Address Compulsive Gaming, Responsible Gaming and Self-Exclusion

The Bill would require the Treasury and state and tribal regulatory bodies that have been qualified to perform licensing investigatory functions (as discussed below) to prescribe regulations for the development of compulsive gaming, responsible gaming, and self-exclusion programs. The minimum requirements for such programs are set forth in the Bill.

⁸ It is not clear what this clause means. More specifically, it is not clear whether, to be deemed to have actual knowledge that a person is an Unlawful Internet Gambling Enterprise, a financial transaction provider must have some additional actual knowledge of a website operator’s illegal gambling activities in addition to such operator’s appearance on the list, or whether, if a website operator appears on the list, a financial transaction provider shall be deemed to have additional actual knowledge of the website operator’s illegal gambling activity.

⁹ However, the current UIGEA regulations would remain effective as to any violation of the UIGEA regulations that occurred before the enactment of the Menendez Bill.

¹⁰ This term is not defined, and its meaning is unclear.

EDWARDS ANGELL PALMER & DODGE LLP

Effective Date of the Proposed Law

The provisions of the Menendez Bill authorizing wagering on Internet games-of-skill through Internet game-of-skill facilities, and the regulations promulgated by the Treasury related thereto, would take effect on that date that is 90 days after the date on which the Treasury publishes the relevant regulations. Thus, these provisions would likely not become effective until approximately 270 days after enactment of the Bill – 90 days after the 180 days during which regulations are drafted, commented on, revised and ultimately published.

Sports Betting is not Authorized

As stated above, the Menendez Bill would not authorize Internet wagering on sporting events. More specifically, it prohibits licensees from knowingly accepting bets from persons located in the United States on sporting events, where such betting would violate the Professional and Amateur Sports Protection Act.¹¹

Bricks and Mortar Internet Poker Houses are Not Authorized

The proposed law would not authorize the establishment of public places, private clubs or associations, or similar physical facilities for the primary purpose of allowing the public or members access to Internet bets or wagers.

The Wire Wager Act is Addressed and Made Inapplicable

The Menendez Bill explicitly addresses the Wire Wager Act¹² which, generally, prohibits a gambling business from using a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers, or information assisting in placing bets or wagers.¹³ The

¹¹ 28 U.S.C. § 3702. That law prohibits sports wagering in the United States by providing that: “it shall be unlawful for a government entity to sponsor, operate, advertise, promote, license or authorize by law or compact, or a person to sponsor, operate, advertise, or promote . . . a lottery, sweepstakes, or other betting, gambling, or wagering scheme based, directly or indirectly . . . on one or more competitive games in which amateur or professional athletes participate, or are intended to participate, or on one or more performances of such athletes in such games.”

¹² 18 U.S.C. § 1084.

¹³ Whereas most commentators (as do I) maintain that the Wire Wager Act applies only to wagering on sporting events, the Department of Justice (“DOJ”) asserts that the Wire Wager Act applies to all types of Internet gambling. See for example the letter dated January 2, 2004, from David M. Nissman, United States Attorney, District of the Virgin Islands, to Judge Eileen R. Petersen, Chair of the U.S. Virgin Islands Casino Control Commission. In addition, while a 2002 5th Circuit U.S. Court of Appeals decision held that the Wire Act applied only to sports wagering (In re MasterCard Int’l Inc., 313 F.3d 257 (5th Cir. 2002)), the DOJ has never agreed with this decision and the decision is binding only on U.S. District Courts in Louisiana, Mississippi and Texas. Moreover, a 2007 U.S. District Court opinion from Utah and a 2008 opinion from a Magistrate Judge in the U.S. District Court for the Eastern District of Missouri have held that the Wire Act applies to all forms of gambling. (United States v. Lombardo, 2007 WL 4404641 (D. Utah 2007) and U.S. v. Gary Kaplan, et al., (U.S.D.C. E.D.Mo. March 20, 2008), No. 4:06CR0037 CEJ/MLM, “Report and Recommendation of United States Magistrate Judge Regarding Gary Kaplan’s Motion to Dismiss Counts 3 – 12.”)

EDWARDS ANGELL PALMER & DODGE LLP

Wire Wager Act would be inapplicable to any wagering occurring pursuant to the proposed law or under the Interstate Horseracing Act of 1978¹⁴ -- the latter exception likely indicating the continued political power of the horse-racing industry.

Required Licensee Qualifications

Under the proposed law, persons seeking a license to operate an Internet game-of-skill facility in interstate or foreign commerce must apply to the Treasury. To be licensed, an applicant must demonstrate to the Treasury by “clear and convincing evidence” that the applicant and individuals associated with the applicant are of good character, honesty, and integrity and are persons “whose prior activities, reputation, habits, and associations do not pose a threat to the public interest or to the effective regulation and control of Internet game-of-skill facilities, or create or enhance the dangers of unsuitable, unfair, or illegal practices, methods and activities in the conduct of Internet game-of-skill facilities . . .”

In my view, the foregoing would compel companies seeking licensure under the new law that have admitted wrongdoing as part of a settlement with the Department of Justice (“DOJ”), to separate themselves from any individuals materially involved in such past wrongdoing. In this regard moreover, the proposed law states that the Treasury “may not” determine an applicant to be suitable for licensing if, among other things: it “is delinquent in filing any applicable Federal or State tax return” or in the payment of any applicable tax or related amount, or it knowingly accepted bets or wagers on sporting events from persons located in the United States in violation of applicable federal or state law.¹⁵ This would obligate applicants to file all outstanding tax returns and pay all outstanding taxes in connection with any license application, and would seemingly preclude from licensure any applicant that had previously entered into an agreement with the DOJ in which it acknowledged accepting unlawful sports wagers from persons located in the United States. Note in this regard also, that under the proposed law a license may not be denied to an applicant who submits an application during the first 90 days that the Treasury accepts applications solely because the applicant previously operated an Internet game-of-skill facility in which wagers were knowingly initiated or received from persons located in the United States.

In addition, each applicant for a license must present a comprehensive plan reasonably calculated:

- (1) to verify the identity and age of each customer and ensure that no one under the age of 21 may place any bets;

¹⁴ 15 U.S.C. §§ 3001 *et seq.*

¹⁵ It is not clear whether the words “may not” in this provision mean that the Treasury would be prohibited from finding an applicant suitable for licensing if it was delinquent in filing a tax return or paying a tax, or knowingly accepted unlawful sports wagers from persons in the United States, or whether “may not” means merely that the applicant is in danger of being found unsuitable (*i.e.*, “may not” be found suitable). I believe the former interpretation is more likely to be correct.

EDWARDS ANGELL PALMER & DODGE LLP

- (2) to verify the state or tribal land in which the customer is located at the time he or she attempts to place a bet, and to ensure that no customer who is located in a state or tribal land that has opted out pursuant to the proposed law can place a bet;
- (3) to make available individualized responsible gaming options that the customer may choose, such as loss limit, deposit limit and gambling time limits;
- (4) to prevent persons on the list of self-excluded persons from initiating any bets or wagers;
- (5) to protect the privacy and security of each customer;
- (6) to protect against fraud and money laundering; and
- (7) to ensure that all taxes (from players and operators) in connection with the play and operation of Internet games-of-skill are collected, reported and disbursed as required, and that adequate records are maintained to enable later auditing and verification.

The cost of administering the proposed law with respect to each licensee, including the cost of any review or examination of the licensee to ensure compliance, would be assessed against the licensees.

Outsourcing of Licensing Investigatory Functions to State and Tribal Bodies

Like the Frank Bill, state agencies and tribal bodies that regulate gambling¹⁶ could, upon application to the Treasury, be determined qualified to review prospective applicants for licenses and thus could be relied upon to certify whether any such applicant meets the licensing qualifications established under the proposed law. Like the Frank Bill, the Menendez Bill thus outsources to the states and tribes much of the licensing function contemplated by the Bill.

Early Commencement of Operations

Under certain circumstances, the proposed law would allow for the commencement of operations before a license is granted. Specifically, the proposed law provides that the provision of the law making unlawful the unlicensed operation of an Internet game-of-skill facility shall not apply to a person who, not later than 90 days after the enactment of the proposed law, notifies the Treasury of its intent to seek a license and who, not later than 90 days after the Treasury begins accepting applications for licenses, submits an application. Such a person may operate an Internet game-of-skill facility without a license from the date it submits its application until the

¹⁶ More specifically, state agencies and tribal bodies that regulate gambling that would be classified as class III gambling under the Indian Gaming Regulatory Act, 25 U.S.C. § 2703.

EDWARDS ANGELL PALMER & DODGE LLP

earlier of (1) the date the Treasury grants or denies its license application; or (2) the date that is two years after the date of its application submittal.¹⁷

Funds Authorized for the Study and Prevention of Problem and Pathological Gambling

Further, the Menendez Bill authorizes the following amounts to increase knowledge and awareness with respect to problem gambling, and to further problem gambling research and treatment:

- \$200,000 per year over five years for problem gambling awareness education;
- \$4 million per year over five years for problem gambling research; and
- \$10 million per year over five years for grants to help states, local governments and non-profit agencies to provide comprehensive education, prevention and treatment services to individuals with gambling problems.

Annual Reports

Finally, under the proposed law, beginning within the year after the Treasury prescribes regulations, and annually thereafter, the Treasury must submit to Congress a report on the licensing and regulation of Internet game-of-skill facilities, including a description of all opt out notices received, the amount of user fees collected, an estimate of the income tax revenue attributable to the operation of Internet game-of-skill facilities during the period covered by the report, a list of state and tribal regulatory bodies that the Treasury has determined suitable to review license applications and conduct similar activities, and information on regulatory and enforcement actions taken during the period to which the report relies.

Conclusion

The Menendez Bill appears to be more carefully considered and thorough than the Frank Bill, and thus more amenable to serious consideration. In addition, by including within its scope only gambling on skill games, it may have a greater likelihood of passage. The Menendez Bill also clarifies the relation of its provisions to existing state law better than does the Frank Bill, but it does so in a way that may offend states' rights advocates. At present, it is not known whether either Bill will move forward in its respective chamber, nor is it known what the Obama

¹⁷ The Bill language to which this discussion relates, on page 68 of the Bill, is garbled and requires correction. It provides: “[The Bill provision that requires operators of Internet game-of-skill facilities to be licensed by the Treasury] shall not apply to a person who [gives the stated notice within 90 days after enactment of the Bill and then, within the first 90 days that the Treasury accepts applications for licensees submits to the Treasury] an application for a license under such subchapter may operate an Internet game-of-skill facility in interstate and foreign commerce, in which bets or wagers are knowingly initiated, received, or otherwise made by individuals located in the United States, without a license issued to such person by the [Treasury] . . .”

EDWARDS ANGELL PALMER & DODGE LLP

administration's position is in regard to either Bill or, for that matter, in regard to Internet gambling generally.