ANALYSIS OF THE ILLEGAL GAMBLING BUSINESSES ACT

Does It Apply to Funds Seized from Those Who Play in
Virtual Online Poker Cardrooms Conducted on Remote Gaming Servers?

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The IGBA was a component of the Organized Crime Control Act ("OCCA") which was enacted in 1970 to deal with organized crime. The OCCA was a wide-ranging act dealing with a variety of Organized Crime and Racketeering ("OCR") issues, such as limiting witnesses ability to claim Fifth Amendment rights, permitting witnesses to be jailed if they refused to comply with grand jury subpoenas, creating the witness protection program and probably most notably, creating the Racketeering Influenced and Corrupt Organizations ("RICO") Act.

The IGBA prohibits persons from operating illegal gambling businesses, and although it was enacted to combat organized crime, the courts have consistently held that it extends to all illegal gambling businesses, regardless of whether there is OCR involvement.[1] However, in addressing the issue of what constitutes an illegal gambling business, the courts have been circumspect and have limited application of the Act to businesses which clearly meet all the elements of the statute. The statute reads as follows:

> (a) Whoever conducts, finances, manages, supervises, directs, or owns all or part of an illegal gambling business shall be fined under this title or imprisoned not more than five years or both.
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> (b) As used in this section --
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> (1) "illegal gambling business" means a gambling business which --
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> (i) is a violation of the law of a State or political subdivision in which it is conducted;
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> (ii) involves five or more persons who conduct, finance, manage, supervise, direct, or own all or part of such business; and
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> (iii) has been or remains in substantially continuous operation for a period in excess of thirty days or has a gross revenue of $2,000 in any single day.[2]

[1] *United States v. Farris*, 624 F.2d 890 (9th Cir 1980), c*ert. denied* 101 S.Ct. 919, 449 U.S. 1111, 66 L.Ed.2d 839, *cert. denied* 101 S.Ct. 920, 449 U.S. 1111, 66 L.Ed.2d 839.

[2] 18 U.S.C. § 1955.

(2) “gambling” includes but is not limited to pool-selling, bookmaking, maintaining slot machines, roulette wheels or dice tables, and conducting lotteries, policy, bolita or numbers games, or selling chances therein.

(3) “State” means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

(c) If five or more persons conduct, finance, manage, supervise, direct, or own all or part of a gambling business and such business operates for two or more successive days, then, for the purpose of obtaining warrants for arrests, interceptions, and other searches and seizures, probable cause that the business receives gross revenue in excess of $2,000 in any single day shall be deemed to have been established.

(d) Any property, including money, used in violation of the provisions of this section may be seized and forfeited to the United States. All provisions of law relating to the seizures, summary, and judicial forfeiture procedures, and condemnation of vessels, vehicles, merchandise, and baggage for violation of the customs laws; the disposition of such vessels, vehicles, merchandise, and baggage or the proceeds from such sale; the remission or mitigation of such forfeitures; and the compromise of claims and the award of compensation to informers in respect of such forfeitures shall apply to seizures and forfeitures incurred or alleged to have been incurred under the provisions of this section, insofar as applicable and not inconsistent with such provisions. Such duties as are imposed upon the collector of customs or any other person in respect to the seizure and forfeiture of vessels, vehicles, merchandise, and baggage under the customs laws shall be performed with respect to seizures and forfeitures of property used or intended for use in violation of this section by such officers, agents, or other persons as may be designated for that purpose by the Attorney General.

(e) This section shall not apply to any bingo game, lottery, or similar game of chance conducted by an organization exempt from tax under paragraph (3) of subsection (c) of section 501 of the Internal Revenue Code of 1986, as amended, if no part of the gross receipts derived from such activity inures to the benefits of any private shareholder, member, or employee of such organization except as compensation for actual expenses incurred by him in the conduct of such activity.

In analyzing the statute, I will first discuss and dispense with the preliminary statutory sections requiring little or no analysis in the context of virtual online poker cardrooms conducted on remote gaming servers (as typically regulated by first-tier regulatory bodies and licensing jurisdictions outside of the US such as Alderney, Malta, the United Kingdom, France, Italy) and will then proceed to the issue at hand: what is an illegal gambling business under §§ (b)(1)(i) and (b)(2).

Resolved Issues

Section (a). Under §(a), the statute criminalizes conduct of anyone who "conducts, finances, manages, supervises, directs, or owns all or part of any illegal gambling business." It is interesting to note that only persons who conduct, finance, manage, supervise, direct or owns all or part of an illegal gambling business may be liable under the statute. The business itself is not liable. That does not appear significant now, but is worth noting as it may become significant in some way in the future.

Sections (b)(1)(ii), (b)(1)(iii) and (c). The business of the Internet poker site in question is conducted by five or more persons, has been in continuous operation for more than thirty days and received gross revenue in excess of $2,000 in a single day, so these sections require no analysis.

Section (e). The business is not conducted by a tax-exempt organization, so there is no need to analyze §(e) of the statute.

Section (d). Under Section (d), any property, including money, used in violation of the provisions of the statute section may be seized and forfeited to the United States. If the operation of an Internet poker site is determined to violate the statute, there should be little question that the money being paid or refunded to players was used in violation of the statute and would be subject to seizure.

However, poker players may well have a basis to contest the forfeiture as innocent third parties. In at least fourteen states Internet poker players are not committing any crime, in an additional fourteen states, poker tournament players are not committing any crime and only in the State of Washington might a player be committing a felony. Moreover, whether the gambling be legal or illegal, mere players are not violating the statute.[3]

[3] *United States v. Smaldone*, 583 F.2d 1129 (10 Cir. 1978), *cert. denied*, 99 S.Ct. 846, 439 U.S. 1073, 59 L.Ed.2d 40, *cert. denied* 99 S.Ct. 1029, 439 U.S. 1119, 59 L.Ed.2d 80; *U.S. v. George*, 568 F.2d 1064 (4th Cir. 1978); *U.S. Box*, 530 F.2d 1258 (5th Cir. 1976); *U.S. v. Schaefer*, 510 F.2d 1307 (8th Cir. 1975), *cert. denied* 95 S.Ct. 1975, 421 U.S. 975, 44 L.Ed.2d 466, *cert. denied* 95 S.Ct. 1980, 421 U.S. 978, 44 L.Ed.2d 470; *U.S. v. Ciamacco*, 362 F.Supp. 107 (W.D.Pa. 1973), *affirmed* 491 F.2d 748, *affirmed* 491 F.2d 751; *U.S. v.Kohne*, 358 F. Supp. 1053 (W.D.Pa. 1973), *affirmed* 485 F.2d 679, *cert.*

Even if grounds for forfeiture do exist, the statute only provides that the property "may" be seized and forfeited. This allows courts some discretion in ordering forfeiture and the court can refuse forfeiture if it imposes a disproportionate penalty in light of the specific facts of a particular case.[4] Consequently, a court could compel the Government to release the funds of many, and possibly all, the poker players who ever have funds seized under IGBA.

"Illegal Gambling Business" Issue

Under §(b)(1)(i), an "'illegal gambling business' means a gambling business which - is a violation of the law of a State or political subdivision in which it is conducted." And, under §(b)(2) "'gambling' includes but is not limited to pool-selling, bookmaking, maintaining slot machines, roulette wheels or dice tables, and conducting lotteries, policy, bolita or numbers games, or selling chances therein." Although card games are not specifically designated as gambling, they have been held to constitute gambling if prohibited under state law.[5]

Unlike the Wire Act, which only applies to sportsbooks, and unlike the Unlawful Internet Gambling Enforcement Act, which like Wire Act only applies to parties "engaged in the business of betting or wagering," the IGBA applies to all gambling businesses, sportsbooks, casinos and cardrooms alike, but only if the business "**is a violation of the law of a State or political subdivision in which it is conducted.**"

There have been four criminal prosecutions reported to date against offshore operators under the statute, three failed and one succeeded.

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denied 94 S.Ct. 2624, 417 U.S. 918, 41 L.Ed. 224, *affirmed* 485 F.2d 681, *affirmed* 485 F.2d 682, *affirmed* 487 F.2d 1394, *affirmed* 487 F.2d 1395, *affirmed* 487 F.2d 1396.

[4] *United States v. Premises Known as 318 South Third Street*, 988 F.3d 822 (8th Cir. 1993).

[5] *United States v. Trupiano*, 11 F.3d 769 (8th Cir. 1993) (a sophisticated "gin rummy" card playing operation as opposed to a "friendly poker game"; *United States v. Shursen*, 649 F.2d 1250 (8th Cir. 1981) (blackjack); *United States v. Graham* 534 F.2d 1357 (9th Cir. 1976) (blackjack).

In the first case, the United States Attorney's office in Texas charged that the gambling business was operating in violation of state law. The appeals court, however, held that, although much of the gaming-related activity was in Texas, the actual bookmaking prohibited by Texas law occurred in Jamaica, so there was no violation of Texas law, and therefore no violation of the Federal statute.[6]

In the second case, the United States Attorney's office in Pennsylvania filed charges against an offshore sportsbook which was conducting support activities, such as management and accounting within the state. The jury was not sure where the actual betting occurred, so it asked the judge. The judge said that it was up to the jury to decide. They returned a "not guilty" verdict within 15 minutes.[7]

These cases resulted in acquittals, not because the defendants were beyond the jurisdiction of the United States, or were licensed by foreign governments, or were using the Internet. The prosecutions in each case failed because the government could not prove that the actual activity occurring within the United States violated the laws of the state where it was occurring.

The third case involved a new defendant in a second prosecution of the Pennsylvania case. He was tried and convicted under the statute because the indictment charged that he was "promoting" gambling in violation of a state law prohibiting the promotion of illegal gambling.[8] What made this case different from the other two is that the indictment was drafted to include activity occurring in the state, which activity was prohibited by the laws of the state.

The fourth case involved, Racing Services International ("RSI"), an off-track betting business licensed by the State of North Dakota to accept interstate and international wagers on horse races over

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[6] *United States v. Truesdale*, 152 F.3d 443, 446-49 (5th Cir. 1998).
[7] *United States v. Dennis Atiyeh*, (not reported) (E.D.Pa. 2001).

[8] *United States v. George Atiyeh*, 402 F.3d 354 (3rd Cir. 2005).

the telephone and over the Internet. Wagers accepted by telephone in Fargo, North Dakota were deemed to be placed in the State of North Dakota and subject to the North Dakota tax on pari-mutuel wagers. Wagers placed through an Internet hub in Mexico were considered to have been placed from outside the state and not subject to the North Dakota tax. When RSI's Mexican Internet server broke down, RSI accepted bets over its 1-800 telephone line and placed them in the pari-mutuel pool from their Fargo offices using their in-house Internet terminals. In this way, RSI was accepting telephone bets within the state but avoiding the payment of taxes because the bets appeared to be coming into the pari-mutuel pool over the Mexican Internet server outside the state. The owner of the company, Susan Bala, was convicted under the IGBA.

In reversing her conviction, the Eighth Circuit stated:

> The statute defines an "illegal gambling business" as one which 'is a violation' of state law. 18 U.S.C. § 1955(b)(1)(i). The word "is" strongly suggests that the Government must prove more than a violation of some state law by a gambling business. The gambling business itself must be illegal.[9]

It is the ownership, financing or operation of an illegal business which violates the statute, not the ownership, financing or operation of a legal business that may be operating in an illegal manner.

It is important to note that in each of the cases charged under the IGBA, whether they be successful or unsuccessful, the defendants were physically present and conducting business in the state where the charges were filed. This is to be expected, because violations of the statute require violations of law of the state **in which the business is conducted**.

However, in a Federal case in Texas involving a civil suit for breach of contract, fraud, and deceptive trade practices, the court held – as a matter of minimum contacts analyses -- that the offshore Internet gaming company had conducted business within the state of Texas by entering into contracts

[9] *United States v. Bala*, 489 F.3d 334, 340 (8th Cir. 2007)(emphasis in original).

with Texas citizens to play those games, which the residents played while in Texas."[10] But a "minimum contacts" analysis of "conducting business in the state" for purposes of one component of due process is quite distinct from "the state … in which the business is conducted" statutory analysis under the IGBA.

Many Internet gaming and Internet Poker companies are legal and licensed where their business is conducted, that is, where their corporate offices and/or servers are physically located. This is especially true in the case of Internet poker because the poker business is not conducted where any individual player is located but rather on the virtual poker table where all the players participate. The sole "gambling business" conducted by the client is the hosting of a licensed Internet poker site through a data processing server located outside of the US and, of course, outside of any state or political subdivision. Because the IGBA applies only when the "business" is a violation of the laws of the "State or political subdivision" where the "business" is conducted, and the remote iPoker "business" is not "conducted" in any U.S. state or political subdivision, there is no violation of the IGBA.

This interpretation is supported by the legislative history of the statute, which states that "it is intended to reach only those persons who prey systematically upon our citizens and whose syndicated operations are so continuous and so substantial as to be of national concern."[11] That describes organized criminal elements which operate illegal bookmaking and numbers rackets, i.e., organized crime elements which were the targets of the Organized Crime Control Act, not a foreign based business legally licensed to operate legitimate websites where customers remotely play poker amongst themselves.

Nonetheless, in a civil forfeiture case involving an Internet sportsbook, the Court of Appeals for the Third Circuit upheld the seizure and forfeiture of funds seized from a New Jersey payment processor, even though the gambling business was located entirely in England. The court held that even

[10] *Thompson v. Handa-Lopez, Inc.*, 998 F.Supp. 738, 743 (W.D.Texas 1998).
[11] 1970 U.S.C.C.A.N. 4007, 4008.

if the bets are deemed to be placed entirely outside the country in a licensed sportsbook in England, the gambling law of New Jersey, where the payment processor was located, had been violated. The court reasoned that even if the gambling occurred where it was legal outside the state, the New Jersey payment processor acted as an intermediary and the payment processing activity inside the state was illegal because it promoted a gambling enterprise in violation of the New Jersey statute prohibiting the promotion of illegal gambling.[12] Moreover, it reasoned that "'the presence or involvement of the claimant is simply immaterial' to the government's right to seek forfeiture," relying on the legal fiction that the funds were guilty.[13]

Applying the theory of this case to poker player funds under seizure, the laws where the processors are located would be irrelevant when they are located outside the United States. . In any case, however, the legal fiction relied upon in *$734,578.82* should be inapplicable, since the player's money itself is not guilty. Additionally, even in that instance however, one still has to analyze the laws of the State to determine if the business is a violation of state law thereby resulting in a violation of the IGBA and giving a prosecutor or a grand jury in such a State a basis to exercise personal jurisdiction over funds and parties located outside their jurisdiction. One such district to do so is the Southern District of New York (SDNY) and with a specific reliance in this context upon New York State law.

New York State Gambling Law

Under New York law, "[a] person is guilty of promoting gambling in the second degree when he knowingly advances or profits from unlawful gambling activity."[14] "A person 'advances gambling activity' when, acting other than as a player, he engages in conduct which materially aids any form of

[12] *United States v. $734,57.82*, 286 F.3d 641 (3rd Cir. 2002).
[13] *Id.* at 649.
[14] N.Y. PENAL LAW § 225.05 (2007).

gambling activity."[15] "A person 'profits from gambling activity' when, other than as a player, he accepts or receives money or other property pursuant to an agreement or understanding with any person whereby he participates or is to participate in the proceeds of gambling activity."[16] "'Unlawful' means not specifically authorized by law."[17] "And it is gambling when a person "stakes or risks something of value upon the outcome of a contest of chance…upon an agreement or understanding that he will receive something of value in the event of a certain outcome."[18] "'Contest of chance' means any contest, game, gaming scheme or gaming device in which the outcome depends in a material degree upon an element of chance, notwithstanding that skill of the contestants may also be a factor therein."[19]

In summary, if poker contains a material degree of chance, then it is gambling, and since it is not specifically authorized by state law, it would be illegal gambling. Although gambling itself is not a crime, materially aiding or profiting from any form of illegal gambling activity, other than as a player, constitutes the crime of penal promoting gambling in the second degree.[20]

There are numerous cases and Attorney General opinions concluding that poker is a game in which chance is a material factor.[21] However, these all involved video poker machines and video poker games are far different from live poker games because they lack many of the skill elements of table poker such as:

[15] N.Y. PENAL LAW § 225.00(4) (2007).
[16] N.Y. PENAL LAW § 225.00(5) (2007).
[17] N.Y. PENAL LAW § 225.00(12) (2007).
[18] N.Y. PENAL LAW § 225.00(2) (2007).
[19] N.Y. PENAL LAW § 225.00(1) (2007).
[20] It may be significant at some time to note that penal promoting gambling in the second degree is a Class A misdemeanor, punishable by imprisonment for no more than one year (N.Y. Penal Law §§ 225.05 and 55.10), and therefore does not constitute a "specified unlawful activity" under the U.S. money laundering and RICO statutes, which only apply to crime punishable by sentences exceeding one year (18 U.S.C. §§ 1956 and 1961).
[21] *United States v. Gotti*, 469 F.3d 296, 342 (2nd Cir. 2006); *People v. Turner*, 629 N.Y.S.2d 222 (1995); *Matter of PJP Tavern v. N.Y. St. Liquor Auth*. 152 A.D. 578 (2nd Dept 1989); *Matter of Cos Dei San v. N.Y. St. Liq. Auth.* 147 A.D.2d 370 (1st Dept. 1989); N.Y. Op. Att'y Gen. 85-12 (1985), 84-F1 (1984), 1981-68 (1981).

Reading other players,

Raising, folding or calling strategies,

Raising to get more money in the pot,

Getting more money in the pot by not raising,

Raising to drive out opponents,

Raising as a means of cutting down opponents' odds,

Raising to bluff or semi-bluff,

Raising to get a free card, and

Raising to gain information.

Though the New York statute uses slightly different language than the classic "predominance test" for assessing chance and skill used in other States, it employs essentially the same dominance factor test. *See, e.g.*, N.Y. Penal Law § 225.00(1) (McKinney 2008) ("[A] '[c]ontest of chance' [is] any contest, game, gaming scheme or gaming device in which the outcome depends in a material degree upon an element of chance, notwithstanding that skill of the contestants may also be a factor therein."); *see also New York v. Hua*, 2009 WL 1575188, *3 (N.Y.C. Crim. Ct. Queens County June 5, 2009) (dismissing case because there was "no support given for the claim that mahjong is a game of chance"). As the *Hua* court explained:

> [W]hile some games may involve both an element of skill and chance, if "the outcome depends in a material degree upon an element of chance," the game will be deemed a contest of chance. "The test of the character of the game is not whether it contains an element of chance or an element of skill, but which is the *dominating element* that determines the result of the game?" It follows then that wagering on the outcome of a game of skill is therefore not gambling as it falls outside the ambit of the statute.

Id. at *2 (emphasis added) (citations omitted).

There is also the issue of the extraterritorial application of New York State law. This is significant because the gambling which allegedly occurs within the State of New York is not illegal. It is the advancing and profiting which is illegal and that occurs outside the State. State laws generally do not apply to parties outside the state unless they so state. It is not a matter of whether the state has the power to apply state laws extraterritorially, which is a jurisdictional issue, but whether the statute was ever intended to apply beyond the borders of the state. Unless there is a separate statute giving extraterritorial reach to the state's criminal code or a statute specially states that it applies to parties or acts outside the state, there is a strong presumption that it does not.[22] Although 28 states have enacted statutes extending their penal codes beyond their borders to activities which occur outside the state but have an effect within the state, New York is not one of them. And, if there is no violation of New York State law, then there can be no violation of the IGBA.

However, the absence of an extraterritoriality statute notwithstanding, there was a New York case where the court held that an Internet casino operator outside the State was guilty of profiting from illegal gambling under state law because the gambling purportedly occurred where the gambler was within the State.[23] In that case, the court reasoned that to hold otherwise would put anyone outside the State beyond the reach of the State courts. But that is not true. There is nothing preventing the State of New York from following the lead of other states and enacting a statute extending the reach of its laws beyond the borders of the State. It has simply chosen not to do so.

In addition, that particular case can easily be distinguished from Internet poker because it involved telephone bookmaking, where the bets were arguably accepted over the telephone. In the case

[22] Congressional Research Service, The Library of Congress, *Extraterritorial Application of American Criminal Law* 20 (2006); I. Nelson Rose, *Gambling and the Law 7, The Future Legal Landscape for Internet Gambling § VII, The Second Emerging Major Fight: States v. States* (2000).

[23] *People v. World Interactive Gaming Corp*., 714 N.Y.S.2d 844 (2000).

of Internet poker, the game is being played on an out-of-state server by individuals located all over the world. Moreover, defendants in that case "operated their entire business from their corporate headquarters in Bohemia, New York." Finally, the case involved a civil action concerning the sale of securities in the State in violation of State law and was decided by the lowest level court for such an action. It was not appealed and the holding is not binding precedent on any other courts or cases.

CONCLUSION

There appear to be at least four viable arguments and defenses to the ongoing actions which have recently been instituted by the United States Attorney's Office in the Southern District of New York.

First, as indicated in *Bala*, for a § 1955 violation to exist, the very existence of the business must be a violation of state law where the business is conducted. The Internet poker business is conducted outside the United States, where it is legal and licensed.

Second, as indicated in *Truesdale* and *Atiyeh*, the alleged illegal activity must occur within the state in violation of the state law. The Internet poker business is not doing any activity in the State of New York.

Third, as indicated by the Congressional Research Service, state laws are presumed NOT to apply outside the state unless the statutes contain specific provisions extending their application extraterritorially. The New York State gambling statutes contain no extraterritorial provisions which would render them applicable to conduct outside the State even if such conduct results in a prohibited effect within the State.

Fourth, insofar as the funds seized are not the proceeds, whether they be legal or illegal, of the gambling business, but the proceeds of the players and the players in New York are not committing any crime. Therefore the funds are not illegal proceeds subject to seizure.