



# WHITE COLLAR CRIME REPORT



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## INTERNET GAMBLING

### Hold 'Em or Draw: The Strange Case of U.S. Enforcement Efforts Against Internet Gambling and Peer-to-Peer Poker



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**W**hile federal and state legislators around the nation parse bills to regulate Internet poker, federal prosecutors have been quietly forfeiting Internet gaming proceeds under federal forfeiture statutes. These efforts follow several notable recent prosecutions of individuals for dealing with Internet gaming proceeds.

Virtually all these forfeitures and prosecutions, however, appear to include proceeds of Internet sport betting or Internet casino gaming—involving games like Internet slots, roulette, and blackjack, and not just pro-

ceeds from Internet poker playing. Almost all these criminal cases appear to involve alleged illegal gambling activity joined with allegations of other associated unlawful conduct, such as bank fraud or illegal unlicensed money transmitting.

That is understandable given the nation's abiding fascination with poker. It is also understandable given the stampede of state and federal lawmakers supporting laws to confirm the legality of Internet poker in order to regulate it and raise revenue from up to 10 million Americans who currently play poker online to the tune of about \$6 billion per year.

## Internet Peer-to-Peer Poker And How It Works

Internet peer-to-peer poker, which dominates the Internet poker industry, involves players who log on to a gaming website, download software, then sit at a virtual table, and play against each other rather than against the “house.” The Internet operator hosts and manages the Internet game, typically with computer safeguards to make certain that minors are not playing and that the game is conducted fairly and securely. The operator is responsible for collecting each player’s stake.

The operator’s fees for managing the game—known as the “rake”—are calculated on the basis of a player’s bets during a game. The operators have no stake in which players win or lose and are responsible for returning to players their funds when they cash out of the game. Obtaining the funds from the players who play, known as the “pull,” and returning or paying funds due to players, or the “push,” involve financial transactions regardless of whether the gaming activity involves peer-to-peer poker, sports betting, or casino gaming.

Since domestic credit and debit cards have not been used for these purposes since about 2006, players typically provide bank account information to enable the pull and for any push that results. Operators have to collect the funds for the pull and pay any funds for the push through a U.S. electronic network for financial transactions called the Automated Clearing House. Collecting on ACH files generated by players and paying players involves intermediaries who handle and process the ACH files and bank transactions.

## Legislative Developments

Lawmakers have been busy joining the fray over Internet peer-to-peer poker. In 2009, Rep. Barney Frank introduced legislation in the House (H.R. 2267) to regulate Internet poker playing. The bill would direct the U.S. Treasury to license and regulate Internet gaming operations, while a companion measure would allow the IRS to impose taxes. The bill was passed by the Financial Services Committee and reported to the House in 2010, but it stalled.

At the end of the 111th Congress, in December, then-Senate Majority Leader Harry Reid prepared legislation to regulate and license Internet poker. Reid’s initiative, joined by many in the Senate leadership, drew national attention to the issue. In the flurry of legislation at the end of the 111th Congress, the Reid legislation was not passed.

For its part, the New Jersey legislature approved an Internet gaming law in January that would create the nation’s first intrastate Internet gambling regulatory structure and permit existing land-based gaming operators to offer Internet versions of their games, including Internet poker. The New Jersey legislation was vetoed by the governor in March pending a possible state referendum on the issue.

Similar legislation has been introduced in the California Senate as a possible means to help close that state’s \$25 billion budget shortfall. Legislative initiatives are also underway in other states, including South Carolina, Florida, and Iowa, and municipalities around the nation.

Just across the U.S. border, lawmakers are closely watching Quebec’s experiment in regulating Internet

gaming. Loto-Quebec began offering online gambling in November based on a rationale of “cannibalizing illegal gambling” websites that offer Internet gaming. The Ontario Lottery and Gaming Corp. announced in August that it is scheduled to commence Internet gaming offerings in 2012.

## The Existing Legal Framework

Notwithstanding U.S. legislative efforts to regulate Internet poker, federal prosecutors persist in their efforts to seize and forfeit proceeds of Internet gaming and Internet poker. From time to time, they have brought criminal cases against some involved in dealing in the proceeds from Internet gaming—principally against those involved in the push when funds are paid to players—and usually only when alleged illegal gambling activity is joined with other allegedly illegal conduct, such as bank fraud or unlicensed money transmitting.

The primary statutes employed by federal prosecutors seeking forfeitures and considering criminal cases include 18 U.S.C. § 1955, the Illegal Gambling Business Act (IGBA), 18 U.S.C. § 1084, known as the Wire Act, and 18 U.S.C. § 1960, the illegal money-transmitters law. Other statutes include 18 U.S.C. §§ 1014 and 1344 (bank fraud) and 18 U.S.C. § 1956 (money laundering).

The Unlawful Internet Gambling Enforcement Act (UIGEA), 31 U.S.C. § 5361 et seq., which became law in 2006 but was delayed in effectiveness in certain respects until June, contains criminal penalties for breach of its provisions, but it is largely regarded only as enhancing avenues for enforcement of other laws. All these laws either do not apply or have not been sought to be used against players themselves, as contrasted with those engaging in aspects of the business of Internet gaming.

**Unclear Path.** For federal prosecutors, the way is a great deal less than clear when addressing the legal status of proceeds from Internet peer-to-peer poker, as contrasted with Internet sports betting and casino gaming. This may explain in part law enforcement’s understandable reluctance to pursue cases involving only Internet peer-to-peer poker.

IGBA prohibits conducting, managing, or supervising an “illegal gambling business.” An “illegal gambling business” involves a gambling business of five or more people conducted in violation of state law. An unresolved threshold legal issue under IGBA is whether Internet poker involves a gambling business in the first instance, since poker (unlike sports betting and casino games) is not played against the “house” and has been found by many experts to be a game in which skill predominates over chance and therefore is not gambling within the meaning of the law.

Additionally, many state anti-gambling laws have not been held to prohibit Internet peer-to-peer poker. This may help explain why many of the federal cases involving Internet gaming have been brought in states such as New York and Maryland, where federal prosecutors seem confident (whether justified or not) that state law prohibits Internet gaming, and more recently in Washington State, given a new Washington Supreme Court decision regarding the illegality of Internet gaming.

The Wire Act prohibits using an interstate wire facility to transmit bets and wagers in connection with en-

gaging in the business of betting or wagering. The Wire Act, however, has been held by the U.S. Court of Appeals for the Fifth Circuit not to “prohibit non-sports Internet gambling.” *Thompson v. MasterCard Int’l Inc.*, 313 F.3d 257, 263 (5th Cir. 2002), though at least one federal district court in Utah has disagreed with *Thompson*.

**Gaming Proceeds.** The illegal money-transmitters statute, Section 1960, is also sometimes implicated for people and businesses engaged in handling proceeds of Internet gaming. The statute prohibits conducting, managing, or controlling an unlicensed money-transmitting business. An unlicensed money-transmitting business includes an enterprise not operated with a money-transmitting license required under applicable state law or that fails to comply with money-transmitting business registration requirements under 31 U.S.C. § 5330 and applicable federal regulations. Section 1960’s provisions are sometimes available for federal prosecutors to use against unwary businesses and individuals dealing in Internet gaming proceeds that fail to consult counsel and to comply with state and federal money-transmitting license requirements.

Federal prosecutors seeking civil forfeiture of Internet gaming funds have relied on the provisions of 18 U.S.C. § 981 as forfeitable proceeds involving violation of federal money laundering and unlicensed money-transmitting business laws and the bank fraud statutes. Violation of either IGBA or the Wire Act can constitute a “specified unlawful activity” for purposes of the federal money laundering statute, since both statutes are listed in 18 U.S.C. § 1961(1) as eligible predicates for a Racketeer Influenced and Corrupt Organizations Act (RICO) violation. Additionally, IGBA contains its own forfeiture provision in Section 1955(d).

These federal statutes present risks of prosecution and forfeitures for operators of online gaming sites, those involved in processing the proceeds of Internet gaming, including payment processors, banks, and other financial institutions (which are also required to comply with Regulation GG<sup>1</sup>), and even advertisers.

## Recent Cases

Most of the prosecutions and cases involving Internet gaming activity have been filed in only a few federal districts and primarily in the Southern District of New York. To date there have been no known jury trials or any other contested matters solely involving Internet peer-to-peer poker. The only known trial regarding Internet gaming was the 2000 Internet sports betting case of *United States v. Cohen* in the Southern District of New York.<sup>2</sup> More recent developments include the following:

■ In what prosecutors hailed as an early victory, in 2008 billionaire Anurag Dikshit of Gibraltar pleaded guilty in the Southern District of New York to violation of the Wire Act in connection with his role in dealing

with proceeds from the Internet gaming site PartyGaming. Dikshit was sentenced in December to one year of probation and agreed to forfeit \$300 million.<sup>3</sup>

■ In September 2009, UK site operator Sportingbet PLC reportedly agreed with the U.S. Attorney’s Office in the Southern District of New York to civilly forfeit \$33 million in proceeds from Internet casino, sports betting, and peer-to-peer poker.<sup>4</sup> The Sportingbet forfeiture did not involve any known prosecution of the company in the United States.

■ In 2009, the U.S. Attorney’s Office for the Southern District of New York seized more than \$13 million from Ahmad Khawaja, and his companies Allied Wallet and Allied Systems, for reportedly processing proceeds for Pokerstars. In August, Khawaja and the Allied entities reportedly reached a settlement with the U.S. Attorney’s Office involving civil forfeiture and sparing them any criminal prosecution. In September, Arizona’s Goldwater Bank, which allegedly processed transactions for Khawaja, reportedly settled with the government for about \$733,000.

■ In January 2010, David Carruthers, former CEO of the UK-based Internet sports gaming business Betonsports PLC, was sentenced in the Eastern District of Missouri to 33 months and fined \$75,000, following his July 2006 arrest<sup>5</sup> as he changed planes in the Dallas airport. Carruthers pleaded guilty to one count of RICO conspiracy to violate IGBA and the Wire Act in 2009. Carruthers’s sentence was preceded by the November 2009 sentencing of Betonsports founder Gary S. Kaplan in St. Louis federal court to 51 months and forfeiture of more than \$43 million on essentially the same charges. Six other associates were also charged in the case.

■ In April, Australian Daniel Tzvetkoff was indicted in the Southern District of New York for conspiracy, money laundering in operating an illegal gambling business, and bank fraud for allegedly processing \$543 million in Internet gaming proceeds involving both casino gaming and peer-to-peer poker through his company, Intabill. Though Tzvetkoff’s case is pending, an Intabill associate, Andrew Thornhill, pleaded guilty in June to one count of conspiracy to conduct an illegal gambling business and bank fraud in the Southern District of New York. He was sentenced in October to three months in prison and fined \$25,000. Both cases included criminal forfeiture allegations.

■ In May, Douglas Rennick pleaded guilty in the Southern District of New York to violation of the Wire Act involving his processing of about \$350 million in proceeds from poker and casino Internet gaming.<sup>6</sup> Rennick was sentenced in September to six months of probation. Rennick also consented to the entry of an order of forfeiture.

■ In May, in the District of Maryland, Kenneth Wienski was charged in a criminal complaint with violation of IGBA and money laundering conspiracy involving his alleged dealings in proceeds from well-known sports betting and peer-to-peer poker websites. The case is apparently still pending. The Wienski complaint followed numerous seizures in 2009 in the District of Maryland from at least 15 bank accounts of pro-

<sup>1</sup> UIGEA required the Federal Reserve Board to issue regulations, now contained in Regulation GG, that require financial institutions and certain others to adopt policies and procedures to identify and block “restricted transactions” related to unlawful Internet gambling. Regulation GG, 73 FR 69381 and 74 FR 62687, became effective June 1.

<sup>2</sup> *United States v. Cohen*, 260 F.3d 68 (2d Cir. 2001).

<sup>3</sup> 4 WCR 12 (1/2/09). PartyGaming agreed to forfeit \$105 million as part of a nonprosecution agreement.

<sup>4</sup> 5 WCR 672 (9/24/10).

<sup>5</sup> 1 WCR 405 (7/21/06).

<sup>6</sup> 5 WCR 351 (5/21/10).

ceeds tied to online gaming. The U.S. Attorney's Office in Maryland has indicated it has seized for forfeiture about \$60 million in Internet gaming proceeds in the past three years.

■ In November, Michael Schuett, a German national, pleaded guilty in the Southern District of Florida to illegal money transmitting under Section 1960 involving proceeds from Internet gaming. Schuett agreed to forfeit \$2.3 million. He served about 80 days in jail after his arrest. He was sentenced to time served in November.

■ In October and December, the U.S. Attorney's Office in Seattle seized funds from bank accounts of Arrow Checks Inc., Blue Lake Capital Management and Logistics, and Secure Money Inc. as alleged proceeds of various Internet gaming operators, including Pokerstars, UltimateBet.com, and BetUS.com.

■ In December, Michael Garone was sentenced in the District of Maryland for laundering \$7.9 million in proceeds from an unspecified illegal gambling business. Garone was reportedly involved in both push and pull transactions. It is unclear to what extent peer-to-peer poker proceeds were involved. He was sentenced to four months of home confinement.

■ On Jan. 4, 2011, James Davitt pleaded guilty in the District of Maryland to an IGBA violation relating to alleged push and pull transactions associated with HMD Inc. on behalf of an online peer-to-peer poker operator. He is awaiting sentence. In another HMD case, on Jan. 19, Martin Loftus pleaded guilty in the District of Maryland to money laundering in conducting an illegal gambling business under IGBA. Loftus's case references about \$1.5 million that was transferred to an HMD Citibank account from Basel, Switzerland. He, too, is awaiting sentence.

■ On Feb. 10, Don Hellinger and five associates of Payment Processing Center Inc. were indicted in the

Eastern District of Pennsylvania for allegedly distributing \$44 million in Internet gaming proceeds (and paying for Internet gaming advertising) in connection with websites such as betonusa.com, bodog.com, sportsbook.com, and betonsports.com. The charges, which appear to relate to Internet sports gambling, include violations from 2005 and 2006 of the Wire Act, IGBA, money laundering, and operating an unlicensed money-transmitting business. Reports indicate that Payment Processing Center allegedly was also operating a telemarketing fraud.

## Conclusion

Analysis of the actions brought against those engaging in financial transactions with Internet gaming proceeds reveals that such cases have not usually involved standalone charges under IGBA, the Wire Act, or the money laundering laws. For website operators, this suggests a need to enhance their compliance efforts with those downstream of the operators to make sure they are complying with applicable state and federal banking and money-transmitting laws and regulations.

In any event, the pace and intensity of law enforcement efforts against Internet gaming in the U.S. appear to be increasing at the same time legislators in Congress and around the nation are considering the wisdom of regulating and taxing online peer-to-peer poker. While it may be one thing for the Department of Justice to continue to pursue civil enforcement actions against Internet sports and casino gaming, law enforcement authorities seem generally to recognize it is currently dysfunctional to be trying to forfeit proceeds or prosecute those involved in Internet peer-to-peer poker given the legislative landscape and the unsettled state of the law.



