

Internet Gaming: Is Payment Blocking an Adequate Solution?

Comments about the USA, France, and Norway.

(See this interview in its entirety at www.publicgaming.com.)

By Sharie A. Brown, Robert A. Burka and Philippe Vlaemminck

In a recent discussion with a European based gaming operator, the question was raised whether it would be possible to block the transfer of money related to Internet gambling services. The operator quoted his Minister who had declared that “if the USA can do it, why would we not be able to do the same”. This statement requires indeed an analysis of the issue from different angles. Does it work in the USA and/or can it be working? In Europe the question is even more complex, as internal market rules do also need to be taken into consideration. Rules regarding so-called “information society services” are subject to a notification procedure (managed by the European Commission) prior to their entry into force. If the assessment made by the EU Commission leads to the conclusion that the proposed legislation affects the EU internal market rules in an unacceptable way, the concerned EU Member State is not allowed to put the system into place without the necessary adjustments. In the absence of adjustments, the concerned EU Member State can face an infringement case.

But, let's start with the USA.

In October 2006, just before mid-term elections in the United States, President George W. Bush signed the Unlawful Internet Gambling Enforcement Act of 2006, 31 U.S.C. §§5361 et seq. That statute did not make Internet gaming illegal, as that was already the position of the United States Department of Justice for many years. Rather, the

statute sought to choke off the transmission of funds between Americans and Internet gaming sites, regardless of where the gaming sites are located. The statute attempts to prohibit acceptance of credit cards, funds, bank instruments, or proceeds of any other form of financial transaction in connection with unlawful Internet gaming.

As one of the statute's principal sponsors, former Rep. James Leach (R-IA), stated when the statute was enacted, “Basically, we are shutting down the payment system for Internet gaming.” By making it “illegal to use a financial instrument to settle an Internet wager,” Congress is “putting responsibility on the financial community” to choke off the funds that drive Internet gaming.

The thrust of the UIGEA statute is that internet gaming, considered illegal in the United States even though many Americans participate, cannot be directly stopped by American law enforcement authorities. That is because internet gaming hardware is located offshore and in locations where it is legal. Thus, the belief that if internet gaming funds transfers can be stopped, so will the underlying activity. The statute should have no effect on existing lotteries in the United States since, in general, the interstate sale of lottery tickets is illegal – and federal law enforcement authorities would have little difficulty locating and prosecuting operators attempting to cover too broad a market.



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As is frequently the case in the United States, details are omitted from the legislation and, instead, created through a rule making process. This statute instructed the Department of the Treasury and the Board of Governors of the Federal Reserve System (the central bank), in consultation with the Department of Justice, to issue the necessary regulations to flesh out these gaming and payment prohibitions. Notwithstanding the statutory mandate that these regulations be completed within a year, they were not issued until last October, with a request for public comments to be submitted by December 12th. Those voluminous comments are now in, and the three federal agencies are trying to finalize the implementing regulations, likely to occur sometime during the current year. (You can view these comments at http://www.federalreserve.gov/generalinfo/foia/index.cfm?doc_id=R%2D1298&doc_ver=1&showall=yes)

Once issued in final form, these regulations will be subject to judicial scrutiny and possible (and substantial) modification. They go into effect six months after judicial finality – likely several years away.

These proposed regulations require certain companies with payment systems to establish policies and procedures reasonably designed to identify and block or otherwise prevent transactions in connection with unlawful Internet gaming. Caught in their net are credit card systems, automated clearing house systems, check collection systems, money transmitting businesses, and wire transfer systems.

Trying to isolate illegal Internet gaming transactions from the billions of legal financial transactions in the United States every day would be expensive, so much so that it could adversely affect the economy. Accordingly, the regulatory compliance requirements in the proposed regulations are driven by whether any benefits would likely be outweighed by the associated costs of compliance with the proposed regulations.

To that end, consistent with the statute, there are two major safe harbors included in the proposed regulations, exemptions from compliance with the statute and adoption of programs and procedures reasonable designed to prevent or prohibit restricted transactions. If a funds transfer to an illegal gaming operation is affected, the unknowing participant in the restricted transfer is absolved of statutory penalties if it falls into one of these safe harbors.

In general terms, the proposed regulations would exempt all participants in ACH systems, check collection systems, and wire transfer systems, except for the participant that possesses the customer relationship with the Internet gaming business in question and certain participants in cross-border transactions. Thus, a given ACH, check collection or wire transfer system could be exempt from statutory coverage for certain transactions but not for others. Credit card systems and money trans-

fer businesses would enjoy no exemptions under the proposed implementing regulations.

In addition, there is another safe harbor for transactions that are not exempted from the statute if the payments system in question has established policies and procedures to prevent or prohibit restricted transaction, and the participant relies on, and complies with, the policies and procedures of the designated payment system. These include addressing methods for conducting due diligence in establishing and maintaining a commercial customer relationship as well as procedures reasonably designed to prevent or prohibit restricted transactions. The policies and procedures are also expected to address ongoing monitoring or testing to detect possible restricted transactions.

In some sense, designing such programs is probably not an unreasonable burden for financial institutions, which already are subject to other, similar requirements related to, for example, money laundering, transfers by terrorist organizations and identity theft. But it still remains to be seen how effective these implementing regulations will be.

In addition to the two substantial safe harbors, which will permit millions if not billions of transactions to occur with impunity, the comments submitted to the Federal Reserve System point out the difficulties in enforcing even the proposed watered down rules, particularly in dealing with foreign banks that have the customer relationships. In short, even though many foreign banks are not exempted from the sweep of the statute, their being outside the United States makes it difficult, if not impossible, for American legal authorities to take action.

Commenters also point out the difficulties in distinguishing between legal and illegal Internet games and between legal and illegal transactions – or even knowing which transactions are illegal. As one commenter noted, customer and card codes could be identical for transactions, some of which are legal while others are illegal.

And, as some commented, what about the World Trade Organization dispute? They argue that the current, ongoing dispute should that be resolved before the United States embarks on a substantially new regime to control and discourage Internet gaming.

It is not yet clear how effective the statute and its implementing regulations will be once these regulations are promulgated, court challenges resolved and the six-month implementation period expires. Like the attempt to prohibit sales of alcohol in the United States between 1919 and 1933, these efforts may turn out to be more show and bark than actual bite.

And now about Europe

Some months ago the Norwegian government has notified a proposal on a prohibition against accessory involvement in re-

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remote gambling activities in the form of payment processing for remote gambling without a Norwegian license. Other European jurisdictions are considering to follow the same route.

Under the General Civil penal Code, the Lottery Act, the Gaming Act and the Totalisator Act, all gambling in Norway must be licensed under statute in order to be lawful. The holding, mediation and marketing of gambling activities without a Norwegian license are prohibited, as is accessory involvement in such actions.

According to Norway, electronic payment processing is an important precondition for the viability of remote gambling. In many instances, the person performing the payment processing will have access to information that the payment is for participation in gambling without a Norwegian license. However, under the current rules it is unclear as to whether payment processing is to be regarded as simple "mediation" or as accessory involvement in the holding of gambling activities without a Norwegian license.

Due to the essential link between the means of obtaining payment processing and offerings of remote gambling to Norwegian gamblers, the Norwegian government wishes to establish that processing payments for remote gambling without a Norwegian license is punishable accessory involvement in the holding and mediation of such unlawful types of gambling. The Norwegian Ministry of Culture and Church Affairs stated that this form of specification of the provisions on accessory involvement will

serve to prevent remote gambling activity from causing problems in the form of increased gambling dependency in the population, tax exemption on prizes, money laundering etc.

This specification of the rules of accessory involvement in the Lottery Act and the Gaming Act and the penalty clause in the Totalisator Act will affect Norwegian credit card companies, banking institutions and other enterprises assisting in the transfer of payments for remote gambling from gamblers in Norway. The proposal presupposes that the payment can be identified as payment for remote gambling. Individual gamblers will not be affected by the specification.

More recently France did face some problems with the EU Commission by trying to do the same. According to the French government blocking the transfer of payments to illegal gambling sites and vice versa, would create an environment causing players not to play on these illegal sites. Early March the EU Commission issued a reasoned opinion objecting against this approach. This approach came as a surprise as France is currently negotiating with the Commission in order to find a solution for on-line gambling. The current move of the Commission gives the French Government four months to look for an alternative solution and to make the necessary adjustments. In the absence, the Commission has already announced to start another infringement case against France. As the French say: "Affaire à suivre!" ... to be followed. ♦