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Internet Gambling and Secondary Liability: Understanding the Contours of Criminal Liability

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Since the late 1990s, few areas of e-commerce have grown as exponentially as Internet gambling. It is a multi-billion dollar a year industry.¹ Yet, despite wildfire growth, Internet gambling, and, in particular, Internet sports betting, remains illegal under U. S. law. Among the several federal laws that regulate gambling,² a statute known as the Wire Wager Act makes it a felony for a bookmaker to take bets on-line, or to even transmit betting-related information across state or international boundaries.³ Federal law also prohibits aiding and abetting violations of the Wire Wager Act, as well as conspiracies to violate the Act.⁴ Notwithstanding these prohibitions, however, Internet bookmakers taking advantage of the borderless nature of the Internet and the fact that gambling is lawful in certain countries are flourishing in offshore locations such as Antigua, Belize, Costa Rica, the Isle of Man, and the Channel Islands.

Due to the difficulty of arresting site operators located overseas, neither the criminal prosecutions that have been brought nor the recent federal legislation adding prohibitions to Internet gambling⁵ have slowed the proliferation of websites devoted to wagering. As a result, enforcement officials have increasingly been pursuing actions against persons and entities which, although not directly involved in the operation of such websites, are necessary to facilitate the operations of these websites. As described more fully below, these "secondary actors" have included radio stations, advertising companies, payment processors, and even "blue chip" financial institutions.

In order to understand why and how this has occurred, it is necessary to understand the Wire Wager Act; certain legal precedents established by the prosecution of Jay Cohen in the World Sports Exchange case;⁶ and distinctive aspects of how Internet gambling websites function.

The Wire Wager Act and the Cohen Prosecution

Known colloquially as the "Wire Wager Act," Title 18, United States Code, Section 1084(a) provides that:

Whoever being engaged in the business of betting or wagering knowingly uses a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers, or information assisting in the placement of bets or wagers on any sporting event or contest, or for the transmission of a wire communica-

tion which entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers, shall be fined under this title or imprisoned not more than two years or both.⁷

In order to establish a violation of Section 1084(a), the government must prove four elements:

First, that the defendant was engaged in the business of betting or wagering—in other words, that unlike a casual bettor, he or she derived all or much of his income from the business of gambling. Thus, the statute typically has been enforced against bookmakers and those working for them in connection with taking bets or wagers on sporting events or contests.

Second, that the defendant transmitted, in interstate or foreign commerce, any one of the following types of material: (a) bets or wagers; (b) information assisting in the placement of bets or wagers; or (c) a communication that entitled the recipient to receive money or credit as a result of the bet or wager.

Third, that the defendant used a "wire communication facility" (which encompasses telephone as well as Internet communications)⁸ to transmit these materials.

Fourth, that the defendant acted "knowingly." Notable for present purposes, *U.S. v. Cohen* confirmed the prevailing view that the government need *not* prove that the defendant knew that he or she was violating the law.⁹ Rather, all that must be shown is that the defendant knowingly (and not by accident or mistake) used a wire communications facility to engage in any one of the three transmissions described above.¹⁰

As far as accomplice liability is concerned, Title 18, United States Code, Section 2—the federal aiding and abetting statute—provides that:

Whoever commits an offense against the United States or aids, abets, counsels, commands, induces, or procures its commission, is punishable as a principal [and] [w]hoever willfully causes an act to be done which if directly performed by him or another would be an offense against the United States, is punishable as a principal.¹¹

Although Jay Cohen, the defendant on trial in the World Sports Exchange case, was by his own admission

personally and directly involved in the operation of the Internet gambling website (he founded the website and was its president and CEO), the case also involved secondary actors—persons who had assisted Cohen in his efforts. These included advertising and public relations personnel whom Cohen retained to popularize and promote his website.¹² Although none of these individuals was directly involved in the operations of the website, several were clearly aware of the gambling-related nature and, as such, fit the definition of “aiders and abettors.” The government called these witnesses to trial as part of its case-in-chief to describe their interactions with Cohen, recount to the jury statements made by Cohen about his operations, and describe the work they performed on his behalf. None of these individuals were prosecuted for assisting Cohen. Rather, shortly prior to trial, the government entered into non-prosecution agreements with these secondary actors.¹³

Cohen was convicted at trial, and was sentenced to a term of imprisonment of 21 months. His conviction was upheld by the Second Circuit, which confirmed that the government need not establish that a defendant know that he or she was breaking the law in order to be found guilty under the statute.¹⁴

Operating a Gambling Website

The government’s vigorous post-Cohen recent enforcement efforts directed against secondary actors, however, are not explained merely by the low level of mental culpability for criminal liability to attach. Rather, it is the *existence and proliferation* of these secondary actors—whose activities are essential to the running of a successful gambling website and who operate in the open and are therefore “easy” to investigate—that makes enforcement operations against them possible and, from a prosecutor’s point of view, even attractive. For unlike traditional “brick-and-mortar” illegal gambling operations, which can be run from places as simple as the local street corner (and whose operators may need no more resources than a deck of cards and a notebook to record debits and credits), a successful Internet gambling website must employ the same resources as any sophisticated e-commerce website in order to compete with rivals and generate revenue. Such secondary support entities include, for example: software developers; electronic funds transfer agents; web hosting companies; website designers; Internet Service Providers; advertising agencies; and search optimization consultants, to name a few. Indeed, unlike the goal of many non-regulated forms of gambling (avoiding detection), the goal of an Internet gambling website is to generate as much attention (in the form of Internet “traffic”) as possible. Many are wildly successful.¹⁵ Thus, gambling websites have advertised in newspapers, on radio, and in magazines; have conducted direct mail marketing campaigns; and have engaged in electronic mass marketing, both lawful and unlawful

(i.e., “Spam”). Moreover, as they have become ever more successful and have reached levels of economic scale and organizational complexity commensurate with the most popular web-based businesses, they have experienced the same operational needs as successful lawful e-commerce sites. With this growth, they have turned to the same vendors and providers that other e-commerce sites have used to support their operations—vendors which often are located in the United States and therefore can be brought into a courtroom in the United States.

This then is the enforcement landscape faced by a prosecutor: one in which primary actors are often beyond the reach of law enforcement, yet large numbers of secondary actors are within the prosecutor’s grasp. Given that some of these secondary actors perform important services for the gambling websites and are often corporations that have much to lose by virtue of a prosecution (or even an investigation), measured against the low level of culpability that must be proven for liability to attach under principles of aiding and abetting or conspiracy, secondary actors are appealing targets for enforcement actions.

Recent Enforcement Actions

In recent years, the federal government has investigated and prosecuted numerous secondary actors whose activities supported those of the primary website owners and operators. For example, in September 2004, the United States Attorney’s Office for the Eastern District of Missouri settled forfeiture allegations totaling \$158,000 against three radio stations that knowingly received money from operators of Internet gambling websites to advertise those sites on local radio stations.¹⁶ As the U.S. Attorney stated in announcing the settlement: “Offshore sportsbooks and on-line casino gambling operations which do business in the United States generally do so in violation of federal criminal laws [and] we will continue to investigate and pursue such activity, *as well as the promoters, aiders and abettors of such activity.*”¹⁷ In the same vein, in January 2006, the federal government settled criminal charges against the owners of an advertising and media company that performed advertising services for gambling websites.¹⁸ That company, Vulcan Sports Media, Inc., was fined \$7.2 million.¹⁹ Moreover, in 2006, federal agents arrested Stephen Eric Lawrence and John David Lefebvre, the founders of Neteller PLC, an on-line payment services company (a so-called “e-wallet”) for violating the Wire Wager Act.²⁰ Both later pled guilty, and their company entered into a deferred prosecution agreement with the government under which they avoided prosecution by, among other things, agreeing to forfeit \$136 million to the government, ceasing gambling-related transactions with persons in the United States, and imposing controls to avoid violating U.S. anti-gambling laws.²¹ Almost all of Neteller’s revenue (about 95 percent) was derived from facilitating payments to Internet gam-

bling websites.²² In contrast, in March 2007, the federal government entered into a non-prosecution agreement with Electronic Clearing House, Inc. ("ECH"), a company involved in assisting the operations of e-wallets such as Neteller.²³ According to the government, ECH cooperated fully in the government's investigation; froze \$21 million of funds belonging to e-wallets, at the request of the government; and disgorged \$2.3 million in profits that it had derived from assisting e-wallets.²⁴ Beyond these public enforcement actions against secondary actors, press reports indicate that various investment banks involved in the funding of gambling-related websites have received subpoenas from prosecutors investigating their roles in raising funds for gambling websites.²⁵

Future Prosecutions?

Although actions to date give some indication as to the focus of the government's regulatory concerns, it is unclear what entities will be the subject of future enforcement actions. Would, for example, a software company that creates software used by sportsbooks be subject to enforcement action? Does it matter if it produced gambling-related software, or *any* software that is used by or useful to an Internet gambling website? What about software designed for permissible gaming activities such as fantasy football leagues, but which could be easily customized to facilitate illegal sports betting? What about the companies that market or distribute such software with knowledge of these facts? What about website designers, network engineers, search optimization consultants and other technical professionals who knowingly provide services to Internet gambling websites? What about accountants and lawyers? What about U.S.-based temporary agencies that employ contract-based telephone operators located outside the United States to answer "Help Desk" questions for website gamblers? What about operators of social networking sites based in the United States or U.S.-based Massive Multiplayer Role Playing Games where Internet gambling exists in virtual worlds but where money can (and does) change hands through out-of-network money exchange systems? Strict application of aiding and abetting principles would suggest that *all* of these persons and businesses could be criminally liable as accomplices, assuming that they had knowledge of the underlying facts about the nature of the gambling websites. Lacking any clear guidance from Congress or law enforcement officials, such persons and businesses operate in a "gray zone" in which a prosecutor could conceivably determine that aiding or abetting liability may very well be appropriate.²⁶

In the face of such uncertainty, experience suggests that, although not legally dispositive, the following are some of the factors that a prosecutor might take into account in exercising his or her prosecutorial discretion in favor or against prosecution:

- **Nature of the subject:** Is the person or business engaged in activities whose stated mission is to assist Internet gambling companies? For example, contrast the posture of a consulting company whose main purpose is to advise the operators of Internet gambling websites on how to maximize revenue with that of an electric utility whose services—though clearly vital to the operation of a gambling website—are offered indiscriminately to everyone in a geographic area.
- **Nature of the work performed:** Is the person or business performing work that is critical to the functioning of the Internet gambling operation, or merely incidental to that functioning? For example is the business performing money transmission (or some equally important service) without which the gambling website could not function, or something more incidental to the website's operation, for example, such as supplying photocopiers or basic office equipment and furniture?
- **Client base and revenue stream:** Does the person or business have a large number of diverse clients only a few of whom are in the Internet gambling space, or does it have a small number of clients all of whom run gambling websites? Does it derive a significant percentage of its revenue from Internet gambling clients or a small or, even better, trivial amount of revenue?
- **Knowledge of illegality:** Did the person or business manager know or have any belief of wrongdoing? Although not an element that the prosecutor must prove, one who convinces a prosecutor that he or she truly had no idea of being involved in anything illegal, let alone criminal, theoretically faces a lower likelihood of being charged with a crime.²⁷
- **Response to regulators:** When the subject became aware of the regulators' interest in its conduct, what was its response? Did it cooperate with law enforcement officials and remediate the complained-of conduct, or did it persist in conduct which it knew was of dubious legality?
- **Atmospheric factors:** Does the person or company have any prior criminal history? Is it the subject of any other related (or unrelated) investigations or enforcement actions? If a business, is it a model of corporate behavior? If an individual, how "sympathetic" is the person?

While determining the likelihood of prosecution in any area of crime is no easy task, making such prediction for secondary actors in the area of Internet gambling is made even more difficult by the extraordinary success of gambling sites, the consequent proliferation of secondary

actors that provide essential services to the sides, and the relatively low standard of proof for a successful prosecution. In the end, assessing the likelihood of criminal exposure requires counsel to engage in a highly fact-specific and fact-intensive analysis of these and other factors through the prism of legislation and regulation governing this rapidly evolving area of the law.

Endnotes

1. See <http://www.cbsnews.com/stories/2005/11/17/60minutes/main1052420.shtml>.
2. See, e.g., 18 U.S.C. § 1952 (interstate travel in aid of racketeering enterprises (including enterprises involving gambling)); 18 U.S.C. § 1953 (interstate transportation of wagering paraphernalia); and 18 U.S.C. § 1955 (prohibiting operation of illegal gambling businesses). For its part, New York Law prohibits Internet gambling under the state constitution (Article I, § 9 of which bans all forms of gambling not specifically authorized by the Legislature) and § 225.05 of the Penal Law (which makes it a crime to advance or profit from any unlawful gambling activity, which is defined as gambling activity not specifically authorized by law). In addition, § 5-401 of the General Obligation Law provides that "all wagers, bets or stakes made to depend on . . . any gaming by lot or chance . . . or unknown or contingent event[s]" are unlawful.
3. 18 U.S.C. § 1084. Section 1084, which was enacted in 1961 as part of a series of anti-racketeering laws, complements other federal anti-bookmaking statutes. "The purpose of the statute is two-fold: (1) to assist the various States and the District of Columbia in the enforcement of their laws pertaining to gambling, bookmaking, and like offenses and [(2)] to aid in the suppression of organized gambling activities by prohibiting the use of wire communication facilities which are or will be used for the transmission of bets or wagers and gambling information in interstate and foreign commerce." *United States v. McDonough*, 835 F.2d 1103, 1105 n.7 (5th Cir. 1988) (quoting legislative history).
4. 18 U.S.C. § 2 (aiding and abetting); 18 U.S.C. § 371 (conspiracy).
5. Title VIII of the Security and Accountability for Every Port Act of 2006 (or "SAFE Port Act") is known as the Unlawful Internet Gambling Enforcement Act of 2006. Found at §§ 5361-5367 of Title 31 of the U.S. Code, it prohibits, among other things, the transfer of funds from financial institutions to Internet gambling sites, with limited exceptions.
6. *United States v. Cohen*, 260 F.3d 68 (2d Cir. 2001).
7. 18 U.S.C. § 1084.
8. A "wire communication facility" is defined in § 1081 of Title 18 as "any and all instrumentalities, personnel, services . . . used or useful in the transmission of writings, signs, pictures, and sounds of all kind by aid of wire, cable, or other like connection." By its terms, it plainly covers Internet transmissions.
9. See *United States v. Cohen*, 260 F.3d 68, 75-76 (2d Cir. 2001).
10. See *id.*
11. Title 18 U.S.C. § 2.
12. See *United States v. Jay Cohen*, 98 Cr 434 (TPG) (S.D.N.Y. 1998), Trial Transcript ("Tr.") at 376-419 (testimony of advertising company executive), 466-93 (testimony of public relations company executive).
13. See *id.* Government Exhibit ("GX") 3505-2 (non-prosecution agreement between government and advertising executive), GX 3507-5 (non-prosecution agreement between government and public relations executive). As is typically the case, under those agreements the government granted immunity to the witnesses in exchange for their cooperation in the investigation and their truthful testimony at trial. It is axiomatic that such agreements are entered into only with persons exposed to criminal liability, here as aiders and abettors.
14. *Cohen*, 260 F.3d at 75-76.
15. Although individual gambling websites rarely disclose the scale of their operations, in the *Cohen* case, the evidence established that over the course of one 15-month period (when the business was just getting off the ground), Americans wire-transferred in excess of \$5.3 million to the sportsbook in order to wager. See *Cohen*, 260 F.3d at 70.
16. Press release "St Louis Sports Radio Stations Pay Over \$158,000 to the Justice Department to Settle Forfeiture Allegations Involving the Stations' Aiding and Abetting Illegal Offshore Gambling Activities," United States Attorney's Office, Eastern District of Missouri, September 24, 2004.
17. See *id.* (emphasis supplied).
18. Press release "Past Promotion of Illegal Gambling Costs the Sporting News \$7.2 Million," United States Attorney's Office, Eastern District of Missouri, January 20, 2006.
19. *Id.*
20. See <http://www.usdoj.gov/usao/nys/pressreleases/January07/Neteller%20Arrests%20PR.pdf>.
21. See <http://www.internetnews.com/bus-news/article.php/3689631>.
22. See <http://www.usdoj.gov/usao/nys/pressreleases/January07/Neteller%20Arrests%20PR.pdf>.
23. See <http://www.usdoj.gov/usao/nys/pressreleases/March07/echonpapr.pdf>.
24. See *id.*
25. See <http://www.redherring.com/Home/20863> (discussing subpoenas served on HSBC, Dresdner Kleinwort, Credit Suisse, and Deutsche Bank).
26. Nor is the issue contained to the activities of sports-related websites. In testimony before Congress, at least one Department of Justice official has opined that all forms of wagering are regulated by the Wire Wager Act. See *Proposals to Regulate Illegal Internet Gambling, Including S. 627, to Prevent the Use of Certain Payment Instruments, Credit Cards and Fund Transfers for Unlawful Gambling Before the S. Comm. On Banking, Housing, and Urban Affairs, 108th Cong. 9 (2003)* (statement of John G. Malcom, Deputy Assistant Att'y Gen., Criminal Division, U.S. Department of Justice (asserting that any business that accepts any kind of bet or wager from customers located in the United States violates the Wire Wager Act). In addition, at least one New York Court has ruled that the Wire Wager Act covers gambling which is unrelated to sporting events. See *People v. World Interactive Gaming Corp.*, 714 N.Y.S.2d 844 (N.Y. Sup. Court 1999).
27. In light of significant publicity surrounding the application of secondary liability to those who facilitate the creation and operation of such websites, it will likely be difficult to persuade a prosecutor that one's client was unaware of the potential for criminal sanctions.

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