

# MEMORANDUM

December 8, 2010

To: Poker Players Alliance

From: Laurence H. Tribe

Re: Constitutionality of Delayed Licensing Provision: Executive Summary

The proposed Prohibition of Internet Gambling, Internet Poker Regulation, and Strengthening UIGEA Act of 2010 (the “Act”) creates a new licensing scheme for Internet poker providers offering their services in the United States. The Act contains a provision—the “Delayed Licensing Provision”—that prevents virtually every provider now in existence from obtaining a license for an as-yet unspecified period of years, and bans them from operating in the United States in the interim. This Provision will have the effect of permanently driving existing poker providers from the American marketplace. In light of this harsh outcome, you asked me to assess the constitutionality of the Delayed Licensing Provision, and I have concluded that it presents issues of significant constitutional concern.

First, the Delayed Licensing Provision is subject to both due process and equal protection challenges: Despite a legislative finding that the new licensing scheme should favor “service providers that have an established record,” the Act proceeds to irrationally and arbitrarily exclude precisely those providers from obtaining a license for a period of years after the establishment of a licensing scheme. Moreover, the Act does so based on the providers’ presence in the United States market prior to the Act’s passage, though that presence is (to say the least) not clearly unlawful, as demonstrated by the fact that no provider has ever been prosecuted for it. Such irrational exclusion, based on conduct that occurred in the past, frustrates the providers’ existing investments in the United States and thus presents several archetypal due process problems. And as the Act lacks a rational basis for favoring one set of providers—new ones—over another, it also raises equal protection concerns.

The due process concerns are especially acute with regard to the part of the Delayed Licensing Provision that prohibits entities who purchase assets from existing Internet poker providers from obtaining a license in a timely fashion. The effect of this provision is to impair the assets, *i.e.*, the technology, knowhow, and capital, of existing Internet poker providers so that nobody can use them, and nobody can purchase them. This action not only severely devalues these assets, but also does a great disservice to consumers and to the marketplace because it renders useless years of accumulated expertise in the delivery of Internet poker services. The asset impairment portion of the Delayed Licensing Provision underscores its irrationality, and works a further arbitrary injustice against the existing Internet poker providers.

Second, Congress is forbidden to pass laws that themselves determine guilt and inflict punishment on targeted individuals or groups without any judicial process. But by denying licenses to existing operators for conduct that has never been prosecuted, the Act appears to do

exactly that. That sort of legislative conduct may render this Act an unconstitutional bill of attainder.

To correct these constitutional problems, Congress should remove the Delayed Licensing Provision from the Act, or, at the very minimum, provide other mechanisms for existing Internet poker operators to participate in the opening stages of the new American market for Internet poker, perhaps by pooling their players or conveying their assets to new operators. Such an approach would be more consistent with the purported intent of the statute as well as the mandates of the United States Constitution.

The enclosed Memorandum discusses these issues in greater detail.

# MEMORANDUM

December 8, 2010

To: Poker Players Alliance

From: Laurence H. Tribe

Re: Constitutionality of Delayed Licensing Provision

You asked me to assess the constitutionality of the transition provision of the proposed Prohibition of Internet Gambling, Internet Poker Regulation, and Strengthening UIGEA Act of 2010 (the “Act”). In general, the Act clarifies that Internet gambling is unlawful, but that Internet poker is lawful when the hosts of Internet poker games obtain licenses under a scheme that the Act establishes. The relevant provision, referred to herein as the “Delayed Licensing Provision,” singles out existing Internet poker facility operators for adverse treatment in the licensing process. This provision implicates significant due process and equal protection concerns, and may run afoul of the Constitution’s prohibition on bills of attainder. These constitutional problems are in addition to the significant treaty issues that may be implicated by the legislation, which you have not asked me to address.

## **I. Overview of the Act and the Relevant Provision**

The Act establishes a licensing scheme for Internet poker operators. *See* Section 104. The Act identifies qualified licensing bodies, including certain state and tribal agencies, as well as a newly established Office of Internet Poker Oversight. *See* Section 105(a). These authorities administer the licensing process in two stages. First, they determine whether a prospective Internet poker facility operator is “suitable for licensing.” *See* Section 104(d)(1)(A). The suitability inquiry deals with issues such as a track record of responsibility and good character, experience with gaming, etc. *See* Section 104(d)(2). Second, once the licensing body establishes an applicant’s suitability, it must then apply separate criteria for licensing, including, for example, mechanisms to ensure that licensees act to prevent underage gaming, cheating, and crime. *See* Section 104(f), (g). The Act provides that no licenses may issue in the fifteen months following the passage of the Act. *See* Section 118. On that date, the qualified bodies are directed to issue multiple licenses “in order to ensure a robust and competitive market for consumers and to prevent the first licensees from gaining an unfair competitive advantage.” *Id.*

One provision of the Act, the Delayed Licensing Provision, raises constitutional concerns. This provision effectively bars any existing Internet poker facility operator from obtaining a license until new entrants in the market have been licensed for an as-yet unspecified period of years. The Delayed Licensing Provision accomplishes this goal by stating that any Internet poker facility operator that has ever accepted bets from United States customers, and “that acted with knowledge or recklessness as to the fact that such bets or wagers involved persons located in the United States . . . shall not be eligible for a license or a certificate of suitability” for an as-yet unspecified period of time, which runs from the date that the first license is issued.

Importantly, the provision restricts licensing not only for the operators themselves, but also for any person who “purchased or acquired, in whole or in part,” an Internet poker facility that served United States customers. Thus, the provision encumbers the sale of assets of existing poker sites. To later qualify for a license, the Act requires an operator (or purchaser, as the case may be) immediately to cease all United States operations and to return all outstanding sums to its customers within 30 days. The language of the Delayed Licensing Provision appears in Appendix A to this Memorandum.

The Delayed Licensing Provision disadvantages existing Internet poker facility operators while simultaneously providing a competitive advantage to brick-and-mortar casinos and to other new entrants into the Internet poker business. As discussed below, this irrational preferential treatment of one class of Internet poker providers over another raises serious due process and equal protection concerns. Congress’s choice to base this distinction exclusively on past conduct and to single out such a small segment of poker operators for severe adverse treatment likewise raises concerns under the Bill of Attainder Clause.

## **II. Analysis**

### *1. Due Process/Equal Protection*

#### *a. Irrational Targeting of Existing Internet Gaming Operators*

For all practical purposes, the Delayed Licensing Provision would bar any existing Internet poker facility of any material size from obtaining a license until land-based casinos and new entrants in the market have had the opportunity to do so. Thus, the Act inexplicably singles out a closed class of existing companies for a burden – one that places those companies in a highly disfavored position vis-a-vis their competitors in the market for poker.

The harm to existing online poker operators that would be created by this provision cannot be overstated. In addition to the 15-month period during which new entrants into the online market can develop their operations free of competition, the legislation excludes existing operators from the market for an additional period of years. The combination of those two provisions places existing operators so far behind the starting line relative to their competitors, that it is questionable whether they would ever be able to regain their market foothold. During the penalty period, the companies’ entire U.S. customer base would migrate to other online gaming operators. Given the enormous loss of revenue and goodwill that would result, there

exists a very real possibility that those companies would be permanently shut out of any significant position in the marketplace.

Furthermore, the Delayed Licensing Provision bars not only existing Internet poker facilities, but also any entity that purchases or acquires, “in whole or in part,” any such poker facility, from obtaining a license on equal terms with others. Thus, Congress has effectively declared the assets of existing Internet poker facilities toxic, devaluing them and forcing them into disuse. This part of the Delayed Licensing Provision not only imposes severe financial hardship on existing Internet poker providers, but also does a disservice to consumers and the market, as the assets that Congress is threatening to devalue are the most sophisticated systems available for providing efficient, fair, and reliable poker services to consumers. Rather than put those assets to productive use, the Delayed Licensing Provision scraps them for no material gain.

While Congress may in certain circumstances impose a burden on the basis of a party’s past conduct, due process prohibits imposing burdens in an “arbitrary and irrational” way. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 15 (1976). Here, the singling out of existing Internet poker companies for a competitive disadvantage bears no rational relationship to any interest advanced by the Act. And the decision to impair their assets is simply bizarre.

The exclusion of existing Internet poker operators – the entities with the most expertise, assets, and relevant infrastructure in this area – from the online gaming market is at war with the legislation’s stated intention to create a vibrant marketplace whose initial participants will be “service providers that have an established track record of complying with a strict regulatory environment, have an established track record of providing fair games to consumers, and have significant goodwill and assets at stake, in addition to their Internet poker assets.” Section 101(13). It is no answer to suggest that the Delayed Licensing Provision reasonably advances that interest by preventing existing Internet gaming operators from obtaining an unfair “first mover” advantage over brick-and-mortar casinos and other new participants in the online poker market. The 15-month period between the statutory effective date and the issuance of licenses provides ample time for new participants to ramp up operations. Thus, the legislation already addresses the issue of competitive disadvantage, and the additional licensing delay serves no rational purpose.

The Act’s differential treatment of a specific sector of the marketplace implicates not only due process, but also equal protection concerns. “[I]f the constitutional conception of ‘equal protection of the laws’ means anything, it must at the very least mean that a bare . . . desire to harm a politically unpopular group cannot constitute a legitimate governmental interest.” *Dep’t of Agriculture v. Moreno*, 413 U.S. 528, 534 (1973). The Delayed Licensing Provision imposes on online gaming operators “immediate, continuing, and real injuries that outrun and belie any legitimate justifications that may be claimed for it.” *Romer v. Evans*, 517 US 620, 635 (1996). In the absence of any rational basis for singling out those entities, the inference arises that they are being singled out for adverse treatment in violation of equal protection. See *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 883 (1985) (statute that taxed out-of-state insurance companies at higher rate than domestic insurance companies held unconstitutional under Equal Protection clause); *United States R.R. Ret. Bd. v. Fritz*, 449 U.S. 166, 180 (1980) (Stevens, J., concurring) (“When Congress deprives a small class of persons of vested rights that are protected

. . . for others who are in a similar though not identical position, . . . the Constitution requires something more than merely a ‘conceivable’ or a ‘plausible’ explanation for the unequal treatment.”).

*b. Imposition of Retroactive Liability*

The statute raises constitutional concerns not only because it arbitrarily singles out for adverse treatment a particular subset of poker facility owners, but also because it imposes that penalty on the basis of conduct that took place prior to the enactment of the statute.

It is well settled that the retrospective imposition of substantive burdens for already completed conduct has significant due process implications. “[D]ue process protection for property must be understood to incorporate our settled tradition against retroactive laws of great severity.” *Eastern Enters. v. Apfel*, 524 U.S. 498, 549 (1998) (Kennedy, J., concurring in part and dissenting in part). That is because laws that “change the legal consequences of transactions long closed . . . can destroy the reasonable certainty and security which are the very objects of property ownership.” *Id.* at 548; *see also General Motors Corp. v. Romein*, 503 U.S. 181, 191 (1992) (“Retroactive legislation presents problems of unfairness that are more serious than those posed by prospective legislation, because it can deprive citizens of legitimate expectations and upset settled transactions.”). For that reason, the “retroactive aspects of legislation” must independently “meet the test of due process.” *Turner Elkhorn*, 428 U.S. at 16-17.

As indicated, Internet poker operators have undertaken substantial investments in the United States. Their efforts have included large-scale marketing campaigns, the development of relationships with vendors and casinos, and the establishment of a physical presence in the U.S., among many other activities. For the reasons discussed above, barring those entities from the online gaming market while granting their competitors an extended period in which to gain a market foothold would seriously threaten the ability of existing operators to maintain those investments, or indeed any significant market presence. The effective restrictions on the sale of these assets would further encroach on the legitimate interests created by the poker operators’ investments. The imposition of such a severe penalty on the basis of pre-enactment conduct would have precisely the type of “severely retroactive impact” that triggers fundamental due process principles. *Eastern Enters.*, 524 U.S. at 537.

*2. Bill of Attainder*

The combination of the Act’s imposition of burdens for past conduct, and its singling out an identifiable class of companies for this punishment, gives rise to serious questions under the Bill of Attainder Clause.

Article I, Section 9 of the United States Constitution forbids the Congress from passing such a law, which the Supreme Court has characterized as a “law that legislatively determines guilt and inflicts punishment upon an identifiable individual without provision of the protections of a judicial trial.” *Selective Serv. Sys. v. Minnesota Pub. Interest Research Grp.*, 468 U.S. 841, 846-847 (1984). The Supreme Court has assumed that the Bill of Attainder Clause applies to corporations as well as persons. *See Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211, 239 n.9

(1995). To qualify as a bill of attainder, a law must satisfy three elements. It must: (1) specify the affected persons, and (2) without a judicial trial, (3) impose punishment on them. *See ACORN v. United States*, 618 F.3d 125, 136 (2d Cir. 2010).

The first two elements are satisfied in this case. The Act targets large online poker sites, who are “easily ascertainable members of” the group of poker providers described in the Act. *United States v. Lovett*, 328 U.S. 303, 315 (1946). Furthermore, when, as here, a statute describes an “individual . . . in terms of conduct which, because it is past conduct, operates only as a designation of particular persons,” the specificity requirement is satisfied. *Community Party of United States v. Subversive Activities Control Bd.*, 367 U.S. 1, 86 (1961). It is equally apparent that the Act does not provide for trials to determine whether an Internet poker operator has knowingly accepted wagers from the United States.

This leaves only the question whether the Delayed Licensing Provision inflicts punishment within the meaning of the Bill of Attainder Clause. The Supreme Court has noted that “the Bill of Attainder Clause was . . . to be read in light of the evil the Framers had sought to bar: legislative punishment, *of any form or severity*, of specifically designated persons or groups.” *United States v. Brown*, 381 U.S. 437, 447 (1965) (emphasis added).

Read in light of the applicable caselaw, the Delayed Licensing Provision probably inflicts punishment. The provision has two effects on existing poker operators. First, as discussed above, it permanently disadvantages them in the marketplace, possibly to the point where they will not be able to compete at all. In corporate terms, this is a death sentence. Second, it severely devalues their existing assets by imposing licensing restrictions on potential purchasers. These deprivations are severe enough to constitute punishment. *Cf. Nixon v. Administrator of Gen. Servs.*, 433 U.S. 425, 474-475 (1977) (reasoning that the deprivation of employment opportunities constitutes punishment); *Lovett*, 328 U.S. at 317 (same).

One might respond that the point of the Delayed Licensing Provision is not to punish existing Internet poker facility operators, but to create a competitive market for Internet poker by eliminating the advantage of incumbents. Some courts have recognized that when an entity is prohibited from obtaining a license or employment because of its past conduct, the key issue is whether the deprivation is “punitive” or “prophylactically regulatory.” *See SBC Communications, Inc. v. FCC*, 154 F.3d 226, 235 (5th Cir. 1998). However, the Supreme Court has noted that the legislature’s assertion that a law is not punitive does not make it so. Instead, a court must compare “the type and severity of burdens imposed” with the statute’s “nonpunitive legislative purposes.” *See Nixon*, 433 U.S. at 475-476. If the burdens imposed are excessive when compared to the nonpunitive purposes, then the court should treat the statute as punitive. Under this test, the Delayed Licensing Provision will likely fail. As noted above, there is no evidence that the provision actually furthers Congress’s goal of creating a competitive marketplace that would benefit consumers. If anything, the Delayed Licensing Provision risks the opposite result by barring some of the most competent, experienced, and efficient service providers from the market, and granting a temporary monopoly over Internet poker to casino operators. Furthermore, the Provision is not designed to identify a class of prior law-breakers who should be barred from participating in gaming for prophylactic reasons on the basis of some assumption of moral failure. *Cf. Hawker v. People of New York*, 170 U.S. 189, 197 (1898)

(allowing the state to deny medical licenses to felons because the state was “not seeking to further punish a criminal, but only protect its citizens from physicians of bad character”). To the contrary, Congress chose to allow existing Internet poker companies to participate in the market eventually, belying any suggestion that Congress determined that such companies are morally or otherwise unsuited to provide online gaming services. Finally, the portion of the Delayed Licensing Provision that burdens the sale of existing Internet poker assets discourages competition in the marketplace by preventing the spread of technologies and ideas that are designed to enhance the customer experience and ensure consumer protection. If the statute were truly geared at protecting consumers and ensuring a competitive marketplace, then it would allow all Internet poker facility operators to begin licensed operations 15 months after the date of enactment, instead of arbitrarily disadvantaging the most capable operators through a delayed licensing scheme.

In light of these significant constitutional concerns, the most advisable course would be to omit the Delayed Licensing Provision in its entirety, and permit existing Internet poker operators to apply for and receive licenses on the same terms as other potential operators. In the alternative, Congress should, at a minimum, permit existing Internet poker operators to transfer their assets to prospective licensees on commercially reasonable terms.

\* \* \* \*

Please let us know if I can be of further assistance on this matter.



## **APPENDIX A: TEXT OF THE DELAYED LICENSING PROVISION**

### **SEC. [\_\_\_]. ORDERLY TRANSITION**

(a) **DATE OF FIRST ISSUANCE-** No Qualified Body may issue a license under this Act prior to the date that is fifteen months after the date of enactment of this Act. Qualified Bodies shall, to the extent possible while meeting all requirements and standards in this Act, issue multiple licenses on the date of first issuance 15 months after enactment in order to ensure a robust and competitive market for consumers and to prevent the first licensees from gaining an unfair competitive advantage.

### **(b) ORDERLY CESSATION OF UNLICENSED ACTIVITY AND SAFEKEEPING OF CUSTOMER FUNDS.**

(1) This section applies to any person that –

- a. owned, in whole or in part, operated or managed, purchased or acquired, in whole or in part, an Internet gaming facility (as defined in section 8201 of title 15, United States Code), which accepted bets or wagers from persons located in the United States prior to the enactment of this Act, or
- b. that was a significant vendor (as defined in section 8201 of title 15, United States Code) with respect to such bets or wagers

and that acted with knowledge or recklessness as to the fact that such bets or wagers involved persons located in the United States.

(2) A person identified in subparagraph (1) must –

- A. except as noted in subparagraphs (B) and (C), cease offering, accepting and providing services with respect to bets or wagers from persons located in the United States immediately upon enactment of this Act;
- B. within 30 days of enactment of this Act, return all outstanding sums to customers located in the United States; and
- C. place those sums whose return to U.S. customers is not feasible due to change in customer address, bank details or similar difficulty, in escrow with a financial institution in the United States for safekeeping and orderly disposition as the Secretary may direct.

The requirements of this subsection apply to any person identified in subsection (b)(1) regardless of whether such person applies for a license or seeks a suitability certificate with respect to an application for a license under this Act.

(c) Any person identified in subsection (b)(1) shall not be eligible for a license or a certificate of suitability under this Chapter until the date that is [xx years] after the first license issues under this Act, and a license or certificate of suitability may be issued to such person on or after that date only if such person complied with subsection (b)(2).