

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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UNITED STATES OF AMERICA, :

Plaintiff, :

v. :

POKERSTARS, et al., :

Defendants, :

ALL RIGHTS, TITLE AND INTEREST IN :

THE ASSETS OF POKERSTARS, et al., :

Defendants-in-rem. :

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11 Civ. 2564 (LBS)

**MEMORANDUM OF LAW IN OPPOSITION TO THE  
PLAINTIFF’S MOTION TO STRIKE**

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## **I. Introduction**

The United States contends that the claim of Cardroom International LLC (“Cardroom”) fails to demonstrate a legally cognizable interest in the property subject to forfeiture to the United States. The actions of the United States, however, have, in tandem with Cardroom’s unique relationship to the Full Tilt Poker business, created precisely the kind of interest that the United States claims is absent. For this reason this Court should grant Cardroom the right to amend its answer to allege new facts and theories that could not be alleged prior to the Settlement Agreement among the United States, the Full Tilt Poker defendants, and the Pokerstars Group.

Cardroom is the owner of the original peer-to-peer Internet poker software created by BH Development LLC (“BH” or “BH Development”), in which latter company Defendants Chris Ferguson, Ray Bitar, Howard Lederer and others invested money. *See* the Declaration of Cyrus Sanai, Esq. (hereinafter referred to as “C. Sanai Decl.”) ¶¶2-4. When the investors and one developer, Perry Friedman, sought to take over BH, the dispute was resolved by Ferguson and his allies (called at the time the “Jesus Coalition” after Ferguson’s nickname, “Jesus”) leaving their investment in BH Development, abandoning their membership interests, and receiving a copy of the software developed by BH Development and an undivided joint ownership interest alongside BH Development. *Id.* at ¶5. BH Development’s joint ownership in the copyright and other associated rights in the software included the explicit right to block transfers of the software and its copyrights, which includes all derivative works subsequently created. *Id.*

Both BH Development and the Full Tilt Poker group used the jointly-owned software as the basis for developing their existing software systems. *Id.* at ¶6. BH

Development entered bankruptcy, and the software—which is the derivative work of the original jointly owned software—was acquired by Lilemco LLC and then transferred to its affiliate, Cardroom International LLC. *Id.* at ¶¶7, 9. The Full Tilt Poker defendants made no objection to these transfers. *Id.*

At the time Cardroom filed its claim, its joint ownership right did not translate, in this proceeding, into anything more than a right to bar transfer of the software used by the Full Tilt Poker business to any other person, and the right to receive full ownership of copyright in the original elements of the Full Tilt Poker software if all of the co-owners ceased to hold an interest in it (such as by death of individuals or dissolution in the case of corporate owners). These rights did not translate into value until the United States, at its discretion, elected to enter into two agreements:

1. An agreement with Cardroom in which Cardroom waived any objections to the transfer of forfeited assets of the Full Tilt Poker claim in return for having a \$30 million “substitute res” in which Cardroom would have the same rights as it had over any or all of the transferred assets (the “Substitution Agreement”) *See* C. Sanai Decl. ¶13; and
2. A settlement agreement among the Full Tilt Poker entities and the Pokerstars Group in which, inter alia, the Full Tilt Poker software was transferred to the Pokerstars Group for over \$500 million dollars, of which \$30 million was retained by the United States as the substitute res referenced in (1) above (the “Full Tilt/Pokerstars Settlement Agreement” Docket nos. 240, 241).

The United States thus transferred a group of assets, of which Cardroom was a joint owner of a substantial portion, into \$30 million, of which Cardroom has now a joint ownership. However, as the claims of the other joint owner of the software, the Pokerstars Group, have been eliminated over the substitute res due to their entry into the Full Tilt/Pokerstars Settlement Agreement, Cardroom is left as the sole owner of the substitute res.

Because Cardroom's claim in this action was for a maximum of \$30 million, this sum completely satisfies Cardroom's claim. Accordingly, this Court must allow Cardroom the opportunity to replead its claim to assert the new facts arising after filing of its claim that have established an ownership interest in the substitute res.

## **II. Factual Background**

The Full Tilt Poker business originated with the establishment of BH Development LLC in Delaware on or about October 15, 2001. *See* C. Sanai Decl. ¶2. This entity was established at the direction of Cyrus Sanai when he was an associate at the now dissolved Thelen Reid & Priest law firm. *Id.* Thelen had been engaged to provide certain legal and corporate advice to the founder of BH Development. Mr. Sanai handled the corporate creation of the entity. *Id.*

BH Development had offices in Los Angeles and developed one of the first peer to peer on-line poker software systems. It was initially financed by its founder. *See* C. Sanai Decl. ¶3.

Subsequently, the founder of BH Development recruited Defendant Chris Ferguson as an investor. *See* C. Sanai Decl. ¶4. Mr. Ferguson in turn introduced Defendants Ray Bitar, Howard Lederer and others to the company, and they became

members and investors. *Id.* A different group of investors associated with a Santa Barbara, CA company called Westerland also invested in BH Development. *Id.*

At the time Westerland was to make its investment at or about 2003, Ferguson and the investors he recruited allied themselves with an employee of BH Development, Perry Friedman, and as the self-proclaimed “Jesus Coalition” sought to take over the company or acquire its software and its trade name, “Full Tilt Poker”. *See* C. Sanai Decl. ¶5. This spawned a short-lived lawsuit and a settlement agreement (the “BH Development Settlement Agreement”). The Settlement Agreement was negotiated on behalf of BH Development by Westerland’s counsel at the law firm of Straddling Yocca. *Id.* It provided<sup>1</sup> that:

1. The Jesus Coalition relinquished their respective membership interests in BH Development without refund of their invested funds.
2. The Jesus Coalition and BH Development released all claims against each other arising prior to the date of the Agreement.
3. The Jesus Coalition received the right to use the name “Full Tilt Poker” as well as relevant URLs.

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<sup>1</sup> Mr. Sanai was required to hand over his copy of the BH Development Settlement Agreement to the attorney for the Chapter 7 trustee of BH Development, John Melissinos, after the company entered Chapter 7 bankruptcy. *See* C. Sanai Decl. ¶8. Mr. Sanai has spoken to Mr. Melissinos, who has agreed to arrange for production of the document. *Id.* However, Mr. Melissinos has some complex issues to resolve involving ownership of the files. At the time Mr. Melissinos began work on the case in 2007, he was a partner at the Los Angeles office of Andrews & Kurth. He moved to Rutter Hobbs & Davidoff in 2009, taking the case with him to that firm. In 2011 the Rutter Hobbs firms was hit with a \$10 million malpractice verdict, and it soon shut its doors. *See* D. Weiss, “Boutique Hit with Malpractice Verdict Loses 19 Lawyers; Closing Is Imminent, Ex-MP Says,” ABA Journal, January 12, 2012 at [www.abajournal.com/news/article/boutique\\_hit\\_with\\_malpractice\\_verdict\\_loses\\_19\\_lawyers\\_closing\\_is\\_imminent/](http://www.abajournal.com/news/article/boutique_hit_with_malpractice_verdict_loses_19_lawyers_closing_is_imminent/). Mr. Melissinos and a group from Rutter Hobbs created a new short-lived law firm which merged two months ago with the Los Angeles law firm of Greenberg Glusker. *See* Greenberg Glusker, “Greenberg Glusker Brings Brian Davidoff and Bankruptcy, Corporate Group on Board” June 20, 2012 at <http://eon.businesswire.com/news/eon/20120620005076/en>. The files are technically in the possession of the short-lived law firm, Davidoff Gold, and Mr. Melissinos needs some time to sort through the appropriate permissions. *See* C. Sanai Decl. ¶8.

4. The Jesus Coalition received a joint copyright interest in the software developed by BH Development, excluding certain graphics elements, and neither BH Development nor the Jesus Coalition could transfer the copyright to unaffiliated persons or entities without permission of the other side.

Both the Full Tilt Poker group and BH Development further developed the software. C. Sanai Decl. ¶6. The fully developed software constituted a combination of original and derivative works of the jointly owned software. *Id.* Accordingly, the joint ownership applied as to all original code and features thereof, though not to completely independent additions. 17 U.S.C. §103.

BH Development entered Chapter 11 bankruptcy in 2006. C. Sanai Decl. ¶7. *See In Re BH Development LLC*, CDCA BK Docket No. LA 06-10031 EC. By 2007 the Chapter 11 case had been transformed into a Chapter 7 case and Rosendio Gonzales was appointed Chapter 7 trustee, with John Melissinos hired as attorney for the trustee. *Id.* The Chapter 7 trustee sold all right title and interest of the bankruptcy estate, which comprised, inter alia, the joint copyrights in the software, to Lilemco LLC in 2007. C. Sanai Decl. ¶9. At about that time, Mr. Sanai was hired as general counsel of Cardroom (an affiliate of Lilemco) and Cardroom acquired the software assets from Lilemco in 2008. *Id.*

The software Cardroom acquired was then made operable and made available to the public for free play on [www.cardroom.com](http://www.cardroom.com) in 2008. C. Sanai Decl. ¶10. Cardroom sought to license its software for free and promotional play in the United States. *Id.* However, it was repeatedly stymied by the efforts of the Full Tilt Poker and Pokerstars



groups to monopolize all on-line play of poker in the United States, as set forth in the complaint filed in the Los Angeles County Superior Court attached to the answer. *Id.*

Cardroom filed its complaint in Los Angeles County Superior Court at about the time it filed its claim in this proceeding. C. Sanai Decl. ¶11. The action in California was improperly removed to federal court and recently remanded to the Superior Court. *Id.*

On or about June 19, 2012, Mr. Sanai and Jason Cowley of the United States Attorney's Office reached an agreement, memorialized in an email, in which Mr. Cowley agreed that the United States would reserve \$30 million from a proposed settlement if Cardroom waived its claims to property being transferred, and such property would be treated as if it had all of the characteristics of property transferred. *See* C. Sanai Decl. ¶12. At that time Mr. Cowley refused to give Mr. Sanai any further information. *Id.* Mr. Sanai and Cardroom were therefore shocked when the motion to strike was filed. *Id.* Mr. Sanai and Mr. Cowley agreed that Cardroom could have an extension of time to respond. *Id.*

Prior to the extended deadline for responding, Mr. Cowley contacted Cardroom's attorneys and informed them that the settlement agreement was on again. *See* C. Sanai Decl. ¶13. The United States Attorney provided a written agreement to Cardroom to sign. Mr. Sanai proposed some comments based on certain assumptions he had about the settlement which Mr. Cowley stated were erroneous, but again, the United States Attorney refused to provide a copy of the settlement agreement. *Id.* Cardroom therefore signed the Substitution Agreement without any effective ability to negotiate its terms. *Id.*

Shortly after the Substitution Agreement was executed, this Court approved the Full Tilt/Pokerstars Group Settlement Agreement.

**III. The Motion of the United States is a Pleading Motion So Leave to Amend Must Be Freely Granted.**

The United States has quoted a mish-mash of opinions arising at different stages of the civil forfeiture process. The key statement that the United States makes about its motion is as follows:

Where the claimant's own allegations are insufficient to demonstrate standing, a motion to strike his claim should be granted. *See United States v. \$38,570 U.S. Currency*, 950 F.2d 1108, 1111-13 (5th Cir. 1992) ("Unless claimant can first establish his standing he has no right to put the government to its proof").

US Mem at 9.

Standing is established by verified allegations. In *\$38,570 U.S. Currency*, the Fifth Circuit held that the district court judge ERRED in striking a complaint on grounds of standing where the claimant made the bare assertion of ownership and the United States made allegations showing a relationship between the currency and the claimant. This decision and the language of the United States makes clear that so long as an amended verified complaint can be made, standing will be satisfied. In civil forfeiture proceedings, the Court must evaluate the request to amend or supplement the answer in the same manner as a request to amend or supplement a complaint in a civil proceeding. *See, e.g. US v. Premises Known as 281 Syosset Woodbury Rd.*, 791 F. Supp. 61, 64-65 (E.D.N.Y. 1992).

Here the new facts are set forth in the declaration of Cyrus Sanai. Mr. Sanai is a California attorney. *See* C. Sanai Decl. ¶11. He is the general counsel of Cardroom, and was an attorney for BH Development with personal knowledge of the dispute that resulted in the split of the Full Tilt Poker and the agreement which granted joint ownership of the software.<sup>2</sup> *Id.* He is in a position to execute the verification based on personal knowledge of the facts demonstrating a joint ownership of the Full Tilt Poker software and the facts behind the execution of the Substitution Agreement between the United States and Cardroom.

It cannot be stressed strongly enough that the request to amend the answer is timely, because the two agreements which transformed Cardroom's joint ownership of the software into sole ownership over the substituted res, the Substitution Agreement and the Full Tilt/Pokerstars Settlement Agreement, did not come into existence until AFTER the United States filed its motion to strike. Accordingly it was impossible for Cardroom to request amendment of its answer prior to the United States' filing of its motion to strike, and so incorporating the request for leave to amend could only occur at this stage.

#### **IV. The Court Must Allow Cardroom the Opportunity to Amend and Supplement Its Answer**

Cardroom's financial demand in the Superior Court action is \$30 million. These damages arose from the injury to Cardroom's business caused by the Full Tilt Poker group and Pokerstars Group using the billions of dollars obtained from illegally providing Internet poker to United States citizens to crush competition in related areas such as free and fantasy poker, which are legal businesses.

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<sup>2</sup> Mr. Sanai is also Cardroom's attorney in the lawsuit in California. *See* C. Sanai Decl. ¶1. He has elected not to be counsel of record pro hac vice in this proceeding for a number of reasons, including any potential objections of the United States if he is called to be a witness at trial.

The actions of the United States actually worsened this problem. According to Mr. Sanai's conversations with Mr. Cowley and his colleague, the U.S. Attorney believes that Pokerstars earned US\$1.5 billion from its activities. *See* C. Sanai Decl. ¶14. It lost at most \$300 million in confiscated funds that it repaid to its players, and paid over \$500 million to settle its claims. In return, it eliminated its strongest competitor, Full Tilt Poker, and retained \$700 million dollars. Mark Scheinberg has issued interviews and press releases in which he claims that Pokerstars is now free to return to the United States. *See* C. Sanai Decl. ¶15.

The United States has thus knocked out two of Pokerstars competitors and given it license to return to the United States and use its \$700 million or so in illegal earnings to dominate the US markets. In addition, the United States gave Pokerstars the assets of Full Tilt to help in this process.

The conduct of the United States—eliminating two competitors of Pokerstars and handing the assets of its biggest competitor to it, while allowing it to keep \$700 million or so and re-enter the country—is unprecedented in law enforcement history. It is as if the United States took the planes, submarines and speed boats of one Mexican drug cartel and sold them to another while exonerating the second cartel for its past violations of law. While the result was money to partially pay off the players defrauded by Full Tilt, it injured very company in this space that sought to play by the rules.

Had the United States consulted Cardroom or other legitimate companies in the on-line gaming sector, they would have opposed the settlement; in addition, Cardroom would have demanded that the Full Tilt assets be forfeited and never utilized by anyone. However, the United States gave no one an opportunity to express their views. The

actions of the United States did, however, create a monetary fund in which Cardroom has an ownership interest by virtue of the Substitution Agreement's providing that the \$30 million shall act as a substitute for the assets transferred, in which Cardroom co-owned a substantial portion and in which Cardroom had the right to block transfer. As all other rights in the substitute res of Pokerstars and Full Tilt Poker have been terminated by agreement, Cardroom is left with sole ownership.

There is, of course, the very interesting question of whether Cardroom's joint ownership in a portion of the assets transferred is carried over into a portion of the \$30 million or all of it. There is an additional interesting question of whether the United States action, which exacerbates the very anti-competitive advantages obtained by the Pokerstars Group from its felonious conduct merits increasing the amount to which Cardroom may claim. There is a third interesting question of whether the brief transfer of the software to the United States, including the co-ownership in the copyright of the software, allows Cardroom a larger share in the money received by the United States. *See Goodman v. Lee*, 78 F.3d 1007, 1012 (5th Cir. 1996); *Oddo v. Ries*, 743 F.2d 630, 633 (9th Cir. 1984); *Shapiro, Bernstein & Co. v. Jerry Vogel Music Co.*, 221 F.2d 569, 571 (2d Cir. 1953), *modified*, 223 F.2d 252 (2d Cir. 1955); *Visitors Industries Publications, Inc., v. NOPG, LLC*, 91 F. Supp. 910, 913 (E.D. La. 2000); *See H.R. Rep. No. 1476, 94th Cong., 2d Sess. 121 (1976)*(Each co-owner has "an independent right to use or license the use of a work, subject to a duty to accounting to the other co-owners for any profits.") However, it is clear that Cardroom can, in an amended answer, allege a joint ownership right in some of the property transferred to Pokerstars, and therefore can make the threshold constitutional showing of verified allegations demonstrating a prima

facie interest in the substitute res and possibly the sums received by the United States or otherwise claimed by the United States.

Cardroom has additional arguments that the motion to strike is precipitate. However, they need not be addressed at this time given that the answer should first be amended.

Cardroom would prefer to file the amended complaint with a copy of the BH Development Settlement Agreement. Accordingly, Cardroom requests 30 days to file the amended answer; however, if it is not available by then, it will eventually become available during discovery.

## V. CONCLUSION

For the reasons sets forth above, the Court should deny the Government's motion to strike Cardroom's claim and should grant Cardroom leave to file an amended verified answer within 30 days of the date of its order disposing of this motion.

Dated: August 20, 2012

Respectfully submitted,

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