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No. 83040-1

SUPREME COURT OF THE STATE OF WASHINGTON

LEE H. ROUSSO
Petitioner,

v.

STATE OF WASHINGTON
Respondent.

BRIEF OF AMICUS CURIAE THE POKER PLAYERS ALLIANCE IN SUPPORT OF LEE H. ROUSSO

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STATEMENT OF INTEREST

Amicus curiae the Poker Players Alliance (PPA) is a nonprofit organization comprised of poker players and enthusiasts from around the United States, including over 20,000 Washington residents. PPA works to protect the legal rights of poker players. Its Washington membership has a direct interest in the outcome of this case, which will determine whether they may lawfully play over the Internet the same poker games that they play in card rooms in the State of Washington.

STATEMENT OF THE CASE

Washington regulates and licenses in-state card rooms, and it is legal to visit those card rooms to compete against other patrons—both Washington residents and visitors from other states—in the game of poker. WAC 230-15-001 *et seq*. However, in 2006, the State amended RCW 9.46.240 (hereinafter, the "Gambling Act"), making it a felony to transmit "gambling information" over the Internet, punishable by up to five years' imprisonment. The State has taken the position that this prohibition extends to the game of poker, and as a result, under the State's view, a game that is legal if played in an in-state

card room constitutes a felony if played under the identical rules against the identical people on a computer on a website located in another state.[1]

Thus, while Lee Rousso can walk into any of Washington's licensed card rooms and lawfully compete with other patrons in a game of poker, if he turns on his computer and plays the same game over the Internet, he commits a felony under the Gambling Act and can be imprisoned for five years. RCW 9.46.240. This is true of no other state in the nation; Washington is the only state to simultaneously permit poker play in comprehensively regulated and taxed in-state card rooms while expressly criminalizing online poker play.

Like hundreds of thousands of Americans, Rousso is an amateur poker player who enjoys competing against other players through online poker websites. In July 2007, he sought a declaratory judgment that among other things, the Gambling Act violates the Commerce Clause of the U.S. Constitution by criminalizing the patronage of out-of-state poker establishments.

The State moved for summary judgment, contending that its ban of Internet poker was justified by its inability to regulate poker websites. It failed to offer particularized factual evidence, instead relying upon: a May

[1] This case does not present the question whether online poker play in fact runs afoul of the Gambling Act. PPA submits that it does not; poker is a game of skill between competitors, and so-called poker "bets" are like players' "moves" in any other skill game. However, because the lower courts assumed that poker is covered by the Gambling Act, and Mr. Rousso did not contest that point, amicus here assumes as much arguendo.

1999 academic essay and a 2000 law journal article, both of which recognized the Commerce Clause perils of state prohibitions of online gaming;[2] two studies of gambling in Washington, neither of which identified online gaming (let alone poker) as a primary source of concern;[3] excerpts from a 1999 federal gambling commission report; a press release concerning indictments stemming from a Gambino family-run gambling racket (unrelated to poker); and a Washington Post article about international terrorists, which mentioned that they "laundered funds from stolen credit card accounts through more than a dozen online gambling Web sites."[4] Undisturbed by the lack of a factual record, the trial court ruled for the State as a matter of law.

The court of appeals affirmed. It summarily rejected Rousso's contention that the Act had an unconstitutionally discriminatory effect on

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[2] App. A to Def.'s Resp. Mem. in Opp. To Pl.'s Mot. for Decl. J. & in Supp. of Def.'s Cross Mot. for Summ J. (hereinafter "Def.'s Summ. J. Mot."), *Rousso v. State*, No. 07-2-22438-6-KNT (King County Super. Ct. May 6, 2008) (108 Yale L.J. 1569, 1593); App. B to Def's Summ. J. Mot. (19 Dick. J. Int'l L. 77, 94–95).

[3] One study found that "Washington State adolescents are most likely to have started gambling with friends or parents," that "[w]agering on games of skill, card, dice and board games with friends or family and sports accounts for the majority of . . . gambling among Washington State adolescents," and that "lottery gambling may be an experience that encourages young people to engage in other, less broadly sanctioned types of gambling as well as in other risk-taking behaviors, such as illicit drug use." Ex. E at vi to Decl. of H. Bruce Marvin in Support of Def.'s Resp. Mem. in Opp'n to Pl.'s Mot for Declaratory J. & in Supp. Of Def.'s Cross Mot. for Summ. J.(hereinafter "Marvin Decl."), *Rousso v. State*, No. 07-2-22438-6-KNT (King County Super. Ct. May 6, 2008). The other reported "increases in weekly participation in wagering" by Washington adults "on electronic gambling machines and card games at card rooms, mini-casinos and Indian casinos." Ex. F. at v–vi to Marvin Decl.

[4] Ex. I to Marvin Decl.

interstate commerce, stressing that the Gambling Act applied to entirely hypothetical in-state virtual poker rooms and asserting that "[this] Court rejected an identical argument in" *State v. Heckel*, 143 Wn.2d 824, 836, 24 P.3d 404 (2001). *Rousso v. State*, 149 Wn. App. 344, 359, 204 P.3d 243 (Wash. Ct. App. 2009) (hereinafter "Op. at __").

The court of appeals similarly concluded as a matter of law that the Gambling Act did not impermissibly burden interstate commerce. "[D]eclin[ing] to follow those cases that view the Internet as entirely off-limits to state regulation," the court recognized its obligation to inquire "whether the burdens on commerce that the [Gambling Act] impose[d] [were] 'clearly excessive' in relation to the interests that the regulation [sought] to serve." *Id.* at 365; *see also id.* at 359 ("[I]t is well established that whether the gambling act amendments can survive dormant Commerce Clause scrutiny depends on the balancing test articulated . . . in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970)[.]" (parallel citation omitted)). The court then conducted that balancing analysis in a single sentence, without citation: "Ultimately," it reasoned, "given the importance of the State's interests in protecting its citizens from the ills associated with gambling and the relatively small cost imposed on out-of-state businesses by complying with the Gambling Act," Rousso "failed to meet his burden of showing" a Commerce Clause violation. *Id.* at 365. The court of appeals notably did not

address the myriad regulatory options available to Washington to accomplish its goals without banning Internet poker.

ARGUMENT

As explained below, the court of appeals fundamentally misapplied governing Commerce Clause precedents. And in any event, its opinion is unsustainable in light of the undeveloped factual record. Rousso is thus at the very least entitled to a remand so that the trial court can resolve his claim on a developed factual record.

I. Because Washington's decision to prohibit rather than regulate virtual card rooms has the direct effect of perfectly protecting Washington's in-state poker card rooms from out-of-state competition, the Gambling Act runs afoul of the Dormant Commerce Clause.

1. The Gambling Act contravenes the Dormant Commerce Clause because it "has the direct effect of favoring in-state economic interests over out-of-state interests." *Mt. Hood Beverage Co. v. Constellation Brands, Inc.*, 149 Wn.2d 98, 110, 63 P.3d 779 (2003). Notwithstanding the State's lengthy, didactic exposition of the general evils of gambling and its account of the history of gambling prohibitions in Washington, "[r]esidents of Washington have the opportunity to participate in a variety of legal gambling activities operated by the state, by federally recognized tribes, and by private businesses and nonprofit organizations." Supplemental Br. of Resp't 10 (internal quotation omitted). Poker is among these legal gaming activities.

However, because the State has insisted—on pain of criminal prosecution—that poker be played in physical card rooms, only companies physically present and doing business in Washington can offer poker games to Washington residents. In this way, the law perfectly protects against out-of-state competition for the identical service; it "insidiously operates to the advantage of local" businesses. *Hunt v. Washington State Apple Adver. Comm'n*, 432 U.S. 333, 351 (1977). Whatever the State's purpose for enacting the law, the Gambling Act thus runs afoul of the core protections of the Commerce Clause. *See, e.g., Dean Milk Co. v. City of Madison*, 340 U.S. 349. 353–54 (1951) (finding no "objection to the avowed purpose of [the] enactment" at issue, but holding it unconstitutional because it "in practical effect exclude[d] from distribution in Madison wholesome milk produced and pasteurized in Illinois"). In short, the Gambling Act "erect[s] an economic barrier protecting a major local industry against competition from without the State," and it thus "plainly discriminates against interstate commerce." *Id.* at 354.

Critically, the State has failed to advance a contrary view of the law. It has not attempted to present a factual record that the harms of Internet poker differ in kind from those of card room poker or offered any inherent reason to treat the two as distinct industries. *Cf. Oregon Waste Sys., Inc. v. Dep't of Envtl. Quality*, 511 U.S. 93, 101 (1994) (stressing that the state

"ha[d] not offered any safety or health reason unique to nonhazardous waste from other States for discouraging the flow of such waste into Oregon"); *see also* App. B to Def.'s Summ. J. Mot. (19 Dick. J. Int'l L. at 97) ("Gambling is an activity that should be unaffected, legally, by the medium in which it occurs."). And the State has explicitly identified as the justification for its Internet poker ban only vaguely stated and unproven "regulatory challenges and risks that are not present in the strictly regulated and controlled 'brick and mortar' gambling operations that are legal in Washington State." *Id.* at 10–11. Finally, and most importantly, the State has failed to refute the fundamental point that the Gambling Act by definition perfectly protects Washington poker businesses from all out-of-state competition.

Thus, the State can save the Gambling Act only by demonstrating that no reasonable nondiscriminatory alternatives are available. *See Mt. Hood Beverage Co.*, 149 Wn.2d at 110 (citing *New Energy Co. of Ind. v. Limbach*, 486 U.S. 268, 278 (1988)); *Hunt*, 432 U.S. at 353.

2. In nonetheless upholding the statute, the court of appeals misperceived the dispute presented. It summarily reasoned that the Gambling Act was immune from challenge as a matter of law because the Act "appl[ies] equally to gambling information transmitted" both within the state and outside the state. Op. at 358. However, Rousso's claim is not that (nonexistent) in-state Internet poker rooms are favored, but instead that the

Gambling Act's prohibition of Internet poker rooms has the direct and precise effect of excluding all out-of-state competition. Under settled precedent, the court of appeals' observation was thus irrelevant. *Cf. C&A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 394 (1994) ("Though the Clarkstown ordinance may not in explicit terms seek to regulate interstate commerce, it does so nonetheless by its practical effect and design.").

As the U.S. Supreme Court has repeatedly explained, the court of appeals' reasoning, pressed again by the State before this Court, is erroneous. "[A] burden imposed by a State upon interstate commerce is not to be sustained simply because the statute imposing it applies alike to the people of all the States, including the people of the State enacting such statute." *Brimmer v. Rebman*, 138 U.S. 78, 83 (1891) (quotation and citations omitted). In *Dean Milk*, for example, Madison's ordinance requiring that milk be processed within five miles of the city's limits could not be saved, though it applied to Wisconsin *and* non-Wisconsin businesses alike. 340 U.S. at 356. The constitutional infirmity resulted from the statute's practical effect, which was to eliminate "competition from without the State," and it was "immaterial that Wisconsin milk from outside the Madison area [was] subjected to the same proscription as that moving in interstate commerce." *Id.* at 354 & n.4; *see also, e.g.*, *Hunt*, 432 U.S. at 349–53 (rejecting the argument that a North Carolina law prohibiting state quality rankings on

apple packaging "accomplish[ed] th[e] goal of uniformity in an evenhanded manner," though it "applie[d] to all apples sold in closed containers in the State without regard to their point of origin"). Similarly, the fact that the Gambling Act prohibits hypothetical (albeit non-existent) in-state poker websites provides it no immunity to Commerce Clause challenge. The very point is that by prohibiting *all* Internet poker, the Act eliminates *all* out-of-state competition.

Contrary to the opinion below, Op. at 259, *State v. Heckel* is inapposite, not "identical." That case concerned a challenge to Washington's anti-spam law, "the only burden" of which was "the requirement of truthfulness, a requirement that [did] not burden commerce at all but actually facilitate[d] it by eliminating fraud and deception." 143 Wn.2d at 836 (internal quotation omitted). The out-of-state spammer did not argue that the anti-spam law had the direct effect of discriminating in favor of in-state "real" mail marketers (who presumably faced a similar truth requirement). He instead invoked "two unsettled and poorly understood aspects of the dormant Commerce Clause," contending that the Act "(1) created inconsistency among the states and (2) regulated conduct occurring wholly outside of Washington." *Id.* at 837 (internal quotation omitted). In this context, the Court observed that the Act "[was] not facially discriminatory." *Id.* at 833. The Court did not hold, as the court below mistakenly understood,

that a law cannot have an impermissibly discriminatory effect under the Dormant Commerce Clause if it is "indiscriminate in [its] application to Internet" users. Op. at 359. As explained, such a holding would be foreclosed by the U.S. Supreme Court's precedents.

3. Refocusing on the parties' actual dispute, the trial judge's grant of summary judgment to the State cannot be justified. If the record does not conclusively establish that reasonable nondiscriminatory alternatives to Washington's complete ban are available, the State has certainly failed to foreclose a factual finding that Washington can regulate Internet poker in the same manner in which it regulates its in-state card rooms—an approach it has taken with success in the context of remote wagering on horse racing.

With respect to Washington's sanctioned in-state gambling establishments, the State exerts its police power to regulate by: requiring licensees to submit to criminal background checks and to open their books for inspection; requiring adherence to accounting standards and submission to audits of financial records and books to ensure proper payouts and tax payments, and to ferret out misconduct; prohibiting gambling on credit; limiting the hours licensees can operate; and prohibiting certain persons from gambling. *See* RCW 9.46.70, -130, -140, -160; WAC 230-06-010, -015, -035; WAC 230-15-025.

The State could employ similar measures to regulate, rather than prohibit, virtual card rooms. *See, e.g.*, Malcolm K. Sparrow, *Can Internet Gambling Be Effectively Regulated?: Managing the Risks* (2009) (attached hereto as Ex. A); *see also* Br. of Amicus Curiae Prospective Internet Poker Players 3–7. Indeed, many jurisdictions do precisely that. *See, e.g.*, *Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 59–70 (2007) (hereinafter "*Fin. Servs. Comm. Hearing*") (written testimony of Gerald Kitchen, Chief Executive, SecureTrading Group, Ltd.) (attached hereto as Ex. B). For example, the Isle of Man, Italy and France comprehensively regulate online poker. *See generally* Br. of Amicus Curiae Prospective Internet Poker Players 7–13. Each jurisdiction requires, among other things: employee background checks for criminality and competence; physical presence in the jurisdiction; audits of financial, data, privacy and gaming controls; the implementation of measures to detect money laundering; age verification; and/or measures to detect and prevent problem gambling. *Id.* Several jurisdictions are actively considering legislation that would implement similar regimes, including the U.S. federal government and multiple State governments. *Id.*

Washington could implement similar measures. *See, e.g.*, *Fin. Servs. Comm. Hearing* at 48 (written testimony of Radley Balko, Senior Editor,

Reason Magazine). For example, it could easily require virtual card rooms to police minimum-age requirements. Various technologies exist to verify the age of players. *Id.* at 65. While none is foolproof, nothing in the record suggests that they perform any worse than those methods used in Washington's in-state card rooms, which in 2008 failed 22% of the time to exclude minors. Press Release, State of Washington Gambling Comm'n, Penalties for Minors that Gamble – HB 1040/SB 5040 (Jan. 14, 2009).[5] And Washington could just as easily restrict players' gaming or virtual card rooms' hours of operation, as it could prohibit gaming on credit and mandate measures to prevent problem gambling. In short, virtual card rooms are susceptible to the same regulatory approach Washington applies to its in-state card rooms, and their regulation is, to put it mildly, a reasonable nondiscriminatory alternative to their prohibition under the Gambling Act.

Regulation as an alternative to complete prohibition is not merely a hypothetical possibility; it notably is an approach that Washington itself has successfully implemented in the analogous context of advance deposit wagering ("ADW") on horse racing. ADW enables Washingtonians to bet on races "in person, by telephone, or through communication by other electronic

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[5] *available at* http://www.wsgc.wa.gov/docs/press_releases/underage_gambling_011409.pdf (last visited Apr. 26, 2010).

means." WAC 26-49-010(3). It is comprehensively regulated by the State. For example, ADW operators must implement extensive measures to verify the age of their customers,[6] and the State can revoke an operator's license, or fine an operator, for violating these verification rules. WAC 260-49-100(2).

Washington thus regulates remote wagering on horse racing via "electronic means" in ways strikingly similar to those that the State simultaneously contends without explanation are impossible in the context of virtual poker—means other jurisdictions currently apply to poker with success. Compare WAC 260-49-050 with *Fin. Servs. Comm. Hearing* 122–31. The State's reflexive reliance on purportedly insurmountable "regulatory challenges and risks" thus rings hollow.

Moreover, Washington's argument to the contrary relies almost exclusively on a parade of generic horribles that can be choreographed every time a State's police power must yield to the protections of the Commerce Clause. In short, without any factual development, the State merely proclaims its inability to regulate Internet poker and defends its ban as a

[6] *See* WAC 260-49-050

necessary exercise of police power in light of that purported impotence.[7] *See generally* Br. of Amicus Curiae Prospective Internet Poker Players 17–20. This approach is insufficient to overcome the strictures of the Commerce Clause, let alone to establish an entitlement to summary judgment.

The U.S. Supreme Court's recent rejection of a similar argument by other states that sought to limit foreign commerce is instructive. In *Granholm v. Heald*, 544 U.S. 460, 489 (2005), New York and Michigan argued that allowing out-of-state wineries to ship wine directly to in-state consumers would "undermine[] their ability to police underage drinking.". As Washington's position here is undermined by its sanctioning of in-state card rooms, Michigan's claim was belied by the fact that it allowed in-state wineries to ship wine directly to consumers. *Id.* at 490. Michigan nonetheless protested, as Washington does here, that "it ha[d] greater regulatory control over in-state [operations] than over out-of-state [entities]." *Id.* The Court rejected that argument. It noted that out-of-state wineries could lose their relevant state and federal licenses for shipping to minors, and that in any event, Michigan could take less restrictive steps to prevent

[7] The State asserts, based solely on the authority of decade's old law review articles, that "[n]one of the safeguards listed above can be effectively enforced" in virtual poker rooms. Supplemental Br. of Resp't 11. Whether that proposition was ever true, Washington has undoubtedly failed to prove as a matter of law that it is true today. *Cf. Granholm v. Heald*, 544 U.S. 460, 492 (2005) (stressing that "technology ha[s] eased the burden of monitoring" the industry). This is especially so in light of the State's effective enforcement of these safeguards in the context of ADW on horse racing.

shipment to minors, such as requiring an adult signature for any wine deliveries. *Id.* at 490–91.

II. The Gambling Act violates the Dormant Commerce Clause for the independent reason that it impermissibly burdens interstate commerce.

The statute contravenes the Commerce Clause for an additional reason: Washington's complete ban on Internet poker is "clearly excessive in relation to" its "putative local" interest in regulating gambling because the State could advance that interest by evenhandedly regulating Internet poker and in-state card rooms (as it does horse racing electronic ADW). *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

The State's assertion that the enterprise of regulating virtual poker *would be* so arduous as to justify *its complete prohibition* does not survive scrutiny. The burden it imposes upon out-of-state poker establishments—complete prohibition in the form of criminalization—is "clearly excessive" because it is wholly unnecessary. As explained above, Washington can advance its interest in regulating poker by . . . regulating poker. Acknowledging the State's citation to law review articles penned in the era when even Google was an optimistic, garage-based Internet ambition, no fact—certainly no fact in the record—supports the State's contention that it wholly lacks the capacity to regulate online business. *See* Br. of Amicus Curiae Prospective Internet Poker Players 17–20. And its efforts in the arena

of horse racing, the success of other jurisdictions in regulating poker, *see* Br. of Amicus Curiae Prospective Internet Poker Players 7–17, and the pervasive state-by-state regulation of myriad online businesses discussed above all doom the State's ability ever to develop support for its uncompromising position.

In rejecting Russo's claim, the court of appeals reached the wrong answer because it asked the wrong question. Its lengthy analysis bolstered only its unremarkable conclusion that a State's interests may in appropriate circumstances justify regulation of Internet businesses consistent with the Dormant Commerce Clause. There would appear to be no dispute on that front: Rousso's entire point is that the State of Washington can and should regulate virtual poker rather than criminalize it. The court failed, however, to ask the relevant, dispositive question: Whether the State ran afoul of the constitutional strictures upon the form of the regulation that the State adopted—a complete prohibition. Convinced that Washington could regulate online poker, the court concluded in a single sentence—without citation, or even a record to which a citation could be offered—that the State's complete ban of Internet poker was not excessive as a matter of law. The implicit logic of the court's opinion was that Washington's ability lawfully to regulate virtual poker necessarily rendered constitutional its decision to ban the activity. But the holding of every case in which a court found a Dormant

Commerce Clause violation is to the contrary. *See, e.g.*, *Hunt*, 432 U.S. at 350 ("[W]hen . . . state legislation comes into conflict with the Commerce Clause's overriding requirement of a national 'common market,' we are confronted with the task of effecting an accommodation of the competing national and local interests."). And the very point of the Clause is to ensure that a State's right to regulate commerce within its borders does not become a means by which it can exclude out-of-state interests.[8]

At a more elemental level, the court of appeals fell victim to the "temptation to undertake the *Pike* balancing test" prematurely, "prior to adequate discovery and further argument by the parties." *Lebanon Farms Disposal, Inc. v. County of Lebanon*, 538 F.3d 241, 251–52 (3d Cir. 2008) (citing *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 261 F.3d 245, 263–64 (2d Cir. 2001)). The balancing inquiry requires a "fact-intensive" analysis of a developed record. *Id.* Here, the court of appeals granted the State summary judgment on the basis of academic theories about the general application of Dormant Commerce Clause

[8] The court erected *Am. Library Ass'n v. Pataki*, 969 F. Supp. 160 (S.D.N.Y.1997), as a straw man for the proposition that "practically any state law that affects the Internet is unconstitutional," *Rousso*, 149 Wn. App. at 362–63, and proceeded to attack the opponent it constructed. The court's characterization of the decision is at best controversial. *Cf. Am. Library Ass'n*, 969 F. Supp. at 178 (acknowledging that the "protection of children against pedophilia" on the Internet was "a quintessentially legitimate state objective"). More fundamentally, its success in dispatching the absolute rule it gleaned from that case should have marked the beginning, not the end, of its analysis; that Washington can regulate online poker is the logical starting point to the assessment of the manner in which it has done so here.

jurisprudence to the Internet. Op. at 362–65 (citing Jack L. Goldsmith & Alan O. Sykes, *The Internet and the Dormant Commerce Clause*, 110 Yale L.J. 785, 789 (2001); Laura Vanderstappen, Note, *Internet Pharmacies and the Specter of the Dormant Commerce Clause*, 22 Wash. U. J.L. & Pol'y 619 (2006); Recent Development, *The Dormant Commerce Clause and the Internet:* American Booksellers Found. v. Dean, 17 Harv. J.L. & Tech. 296 (2003)). At the very least, the court should have remanded the case for further factual development. *See, e.g., Nat'l Ass'n of Optometrists & Opticians v. Brown*, 567 F.3d 521, 525–28 (9th Cir. 2009) (remanding for the district court to evaluate whether the challenged laws burdened interstate commerce); *cf., e.g., Associated Gen. Contractors v. King County*, 124 Wn.2d 855, 856, 881 P.2d 996 (1994) (remanding a case to the trial court because the record was insufficiently developed to support summary judgment).[9]

In sum, the grant of summary judgment was both premised on legal errors and at best premature in light of the paucity of the factual record.

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[9] *See also Town of Southold v. Town of E. Hampton*, 477 F.3d 38, 49–52 (2d Cir. 2007) (remanding a case decided on summary judgment for factual development and *Pike* balancing); *Cotto Waxo Co. v. Williams*, 46 F.3d 790, 794–95 (8th Cir. 1995) (reversing summary judgment and remanding for trial after determining that "the evidence of a burden on interstate commerce is slight, [but] the evidence of a public benefit is even more miniscule"); *Blue Circle Cement, Inc. v. Bd. of County Comm'rs*, 27 F.3d 1499, 1512 (10th Cir. 1994) (remanding summary judgment as inadequately supported by the record and instructing the district court to conduct a *Pike* analysis).

III. Congress has not authorized Washington to erect barriers to interstate gaming commerce.

Washington's remaining contention that federal law exempts the Gambling Act from the Dormant Commerce Clause fails to cohere at any level. The State's position is difficult to decipher,[10] but at bottom, it invokes two narrow lines of cases in which federal legislation is deemed to authorize state laws that would otherwise run afoul of the Commerce Clause.

As the court of appeals correctly recognized, "The problem with the State's reliance on these scenarios is that neither applies here." Op. at 353. "None of the federal statutes cited by the State" includes "express authorization for otherwise unconstitutional regulation." *Id.*[11] Nor is there "parallel state and federal criminalization of specific conduct." Op. at 356. Each of the laws upon which the State relies "does not itself criminalize"

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[10] For example, it notes that "Congress has consistently found that the regulation of gambling is a matter of local concern," but later erroneously asserts that federal laws "clearly confirm that Congress regards Internet gambling as an illegal activity." Supplemental Br. of Resp't 14, 20. Similarly, it observes that "Congress has taken steps to ensure that federal laws governing gambling do not pre-empt state law," but also inexplicably suggests that there is "literally no legitimate interstate commerce capable of being burdened." *Id.* at 15 n.5, 14.

[11] *See, e.g., South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 91 (1984).

activity and/or "has, in fact, never been interpreted by a court as a federal prohibition" of online poker. *Id.* [12]

As Washington seems to recognize, Congress has left to the States the task of setting gaming policies for themselves. Contrary to the State's understanding, however, this federal approach is not a license to contravene the Constitution. In short, nothing in federal law authorizes Washington to welcome and regulate in-state card rooms while criminalizing out-of-state poker.

CONCLUSION

For the foregoing reasons, as well as those set forth in the brief of Mr. Rousso, this Court should reverse the opinion below or vacate it and remand the matter for trial.

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[12] See also, e.g., Jonathan Conon, Comment, *Aces and Eights: Why the Unlawful Internet Gambling Enforcement Act Resides in "Dead Man's" Land in Attempting to Further Curb Online Gambling and Why Expanded Criminalization is Preferable to Legalization*, 99 J. Crim. L. & Criminology 1157, 1172 (2009) (stressing that "commentators generally agree that the Wire Act represents insufficient authority for Internet gambling prosecutions beyond sports betting").

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EXHIBIT A

Can Internet Gambling Be Effectively Regulated? Managing the Risks

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November 11, 2009

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EXECUTIVE SUMMARY

This study was commissioned by Wired Safety, an Internet Safety and Educational charity. It examines a range of harms potentially associated with online gambling, and alternative methods for mitigating or minimizing them. Recognizing that the current U.S. prohibitionist regime with respect to online gambling is largely ineffective in achieving its aims, and provides no platform or opportunity for the implementation of most of the relevant harm-reduction strategies, we find that an alternative regime of legalization and regulation of online gambling would likely improve consumer welfare and protections. The body of this report evaluates a range of strategies, both regulatory and technological, that could be used to mitigate potential harms associated with online gambling more effectively.

Notwithstanding the current prohibitionist legal and regulatory approach, millions of U.S. residents gamble online through offshore gambling sites. As a result, the United States finds itself in the unfortunate position of incurring all the social costs of online gambling while having no control over the gaming sites that serve U.S. residents. The United States cannot disqualify industry participants from competing effectively for U.S.-based customers or offer its residents any consumer protections. Nearly all states permit some form of commercial gambling, and the industry is large and well-established. Clearly, policymakers have extensive precedent from which to draw strategies to mitigate the potential social harms of gambling.

Although some controls used in bricks-and-mortar casinos may not translate well to online gambling, several of the risks we examined become *more* amenable to control online. New technologies can be effective, even for those risks that are more difficult to address online. For example, geolocation and age verification technologies can help turn potentially significant risks into manageable ones.

In this study, we analyze 10 specific risks that others have suggested are potentially associated with online gambling: gambling by minors, fraud by operators, fraud by players, organized crime, money laundering by players, money laundering by operators, violation of jurisdictional prohibitions, breaches of data confidentiality, lack of site security, and problem gambling. It is important that regulators treat each of these potential risks differently. For some risks (such as players cheating other players), the public interest and the interests of the gaming industry align, making a cooperative regulatory relationship natural. For others (such as those involving potentially criminal conduct by operators), a strict enforcement regime would be more appropriate. Still other potential risks (such as underage and problem gambling) call for a more nuanced regulatory approach involving a mixture of strict enforcement, effective nonprofit support, community education, and cooperation, in keeping with the more complex motivations and incentives facing site operators.

For each of the 10 risks, we examined a set of regulatory methods and technologies that would provide a reasonable degree of risk management in a regulated environment. Most of these methods have already been implemented in some form in other jurisdictions. The United Kingdom, Alderney, Gibraltar, and others have successfully implemented

regulation, and nearly all of the well-regulated jurisdictions we studied address the 10 risks to some degree.

The establishment of a well-regulated industry under U.S. jurisdiction would offer far better protection against online gambling's potential social harms than outright prohibition. Combining a thoughtful regulatory scheme with education, technology tools, and support appears to be the most effective means of handling the realities and risks of online gambling in the United States. Therefore, we recommend that plans for regulating online gambling include the design and use of different risk-management strategies tailored to the different classes of risk that are associated with Internet gambling. In the end, consumers in the United States would be better protected than they are now.

I. OVERVIEW OF APPROACH AND SUMMARY OF RESULTS

Congress is debating legislation that would remove the existing prohibition on the use of the Internet for most types of gambling.[1] The proposed legalization of online gambling would be conditioned on the imposition of regulation designed to limit or prevent potential harms such as underage gambling, money laundering, and problem gambling.

A key issue in the debate over legalization of online gambling is whether regulation and technology could effectively control such potential harms. Some of the opposition to legalization reflects a perception that online gambling—in contrast to gambling in bricks-and-mortar casinos—would be difficult, if not impossible, to regulate effectively.

This study reviews the research literature and international approaches to online gambling. WiredSafety (the Internet safety and educational charity) has commissioned this study to help inform the legalization debate and to help educate the public on the risks associated with online gambling and the best ways to address those risks.[2]

We note that our expertise is in regulatory policy and its relationship to risk analysis, rather than in any extensive prior knowledge of the gaming industry and gambling behavior per se. We have critically reviewed the existing literature, evaluated relevant technologies, and interviewed a range of scholars and practitioner experts, both here and abroad. We have not, however, conducted any new epidemiological studies or field research. Our distinctive contribution is the frame for risk management and regulatory analysis, rather than any new scientific inquiry.

Our analysis does not directly address whether online gambling should be legalized. In focusing on managing risks, we did not weigh moral or religious objections to gambling, nor did we examine broadly libertarian arguments in favor of allowing adults to engage in pastimes they may enjoy. We did not conduct any analysis to quantify the benefits of potential tax revenues attributable to regulated online gambling. Further, we have not focused on any issues of federalism or on exactly where regulations and laws should fit into the U.S. multijurisdictional

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[1] Internet Gambling Regulation, Consumer Protection, and Enforcement Act, H.R. 2267, 111th Cong. (2009), http://www.house.gov/apps/list/press/financialsvcs_dem/21frank_008_xml.pdf (last accessed on July 23, 2009), and Internet Gambling Regulation and Tax Enforcement Act of 2009, H.R. 2268, 111th Cong. (2009), http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h2268ih.txt.pdf (last accessed on August 28, 2009).

[2] This study was commissioned by WiredSafety.org, a 501(c) (3) charity and the largest and oldest online safety, education, and help group in the world. Originating in 1995 as a group of volunteers rating websites, it now provides one-to-one help, extensive information, and education to cyberspace users of all ages on a myriad of Internet and interactive technology safety issues. WiredSafety works in four major areas: help for online victims of cybercrime and harassment; assisting law enforcement worldwide on preventing and investigating cybercrimes; education; and providing information on all aspects of online safety, privacy and security. WiredSafety also has a longstanding interest in gambling policy and the prevention of underage gambling. The study was sponsored by Harrah's Operating Company, Inc and the Poker Player Alliance, who share many of WiredSafety's concerns. While the sponsors have provided valuable input into the framing of the research, the final decisions regarding the research approach and the final written product was solely made by the authors of the study, following consultation with WiredSafety, ensuring that the study was independent.

governance structure. Instead, we concentrated more narrowly on the obligations of government to protect citizens in general, and vulnerable groups of citizens in particular, from unnecessary exposure to harm.

We sought (1) to identify the specific risks that are associated with, or perceived to be associated with, Internet gambling; (2) to determine suitable regulatory strategies for controlling or managing those risks; and (3) to assess how effective those strategies are likely to be. We identified 10 distinct risks that fall into four broad categories. Those categories are as follows:

- Gambling by minors
- Criminal and fraudulent behavior
- Network access, data privacy and security
- Problem gambling

On the basis of our review of the existing literature and interviews with academics, regulators, industry participants, and public interest advocates, we came to the following conclusions:

- Online gambling could be regulated effectively if it were legalized.
- A well-structured regulatory regime should provide much better social and consumer protections than the status quo for the risks we identified.
- At a minimum, even an imperfect legalization and regulatory regime for online gambling would give Americans much more protection than they have now. The current prohibitionist policy is extremely weak: large numbers of U.S. residents already gamble online, but they do so using offshore sites, many of which are poorly regulated or unregulated.

For each of the 10 risks we examined, a set of regulatory methods and technologies exist that would provide a reasonable degree of control, and most of them have been implemented effectively in other jurisdictions or in other online settings.

Although some controls used in the bricks-and-mortar environment may not translate to online gambling environments, several of the risks we examined become *more* amenable to control online. Comprehensive electronic records and the ability to track financial transactions and betting patterns provide more opportunities for analysis and audit, and hence improve the chances of discovering fraud or criminal activity. They also allow gambling websites to provide tools to mitigate problem gambling in a timely manner.

A. Our Approach

Our approach has been to identify the specific risks that are perceived to be associated with Internet gambling and then to determine how best to control or manage them. Those risks are described below.

1. **Gambling by Minors**

   a. *Gambling by minors*: There is concern that minors might find it easier to access and use online gambling services in a legalized environment.

2. **Criminal and Fraudulent Behavior**

   a. *Defrauding of consumers by site operators*: There is the possibility that online site operators may be more likely than their bricks-and-mortar counterparts to rig games, refuse to pay out winnings, or simply vanish, taking with them players' account balances.

   b. *Cheating or defrauding of players by other players*: There is a concern that players could collude to defraud others, particularly in online poker. Online gambling may offer opportunities for collusion that are not available in a physical environment with visual surveillance.

   c. *Involvement of organized crime in gambling operations*: Organized crime has a history of involvement with the bricks-and-mortar casinos and is now involved in some online commerce. There is some concern that involvement in the online gambling industry may be a natural next step.

   d. *Money laundering by players*: There is concern that players or groups of players acting in concert could use legitimate gambling operations for money laundering.

   e. *Money laundering by site operators*: The possibility has been raised that site operators could use online gambling operations, with its significant financial flows, as a cover for money laundering on a large scale.

3. **Network Access, Data Privacy and Security Issues**

   a. *Violation of jurisdictional restrictions or prohibitions*: Government at the state, local, and tribal levels has traditionally exercised control over gambling within a given jurisdiction. The advent of the Internet has opened the question as to whether controls mandated by any proposed laws can be enforced within particular jurisdictions.

   b. *Breaches of data confidentiality*: To register for play, players surrender personal or financial data to site operators. Consumers might be harmed by deliberate or accidental breaches of the confidentiality of those data.

c. *Communications and computer security failures*: Some are concerned that site operators might not use appropriate security practices, procedures, and technologies to ensure the integrity of their sites, the gaming on those sites, and player interactions. Absent proper security measures, malicious code could be transmitted to players, game operations could be infiltrated, and intrusions into the systems could compromise the game play and security of users.

4. Problem Gambling

a. *Problem gambling behaviors*: Some argue that increased opportunity to gamble at any time, from anywhere, and at a faster pace might exacerbate pathological, addictive, or problem gambling behaviors.

With respect to each of these four categories of risks, we sought to answer three broad questions:

(1) In the existing prohibitionist legal and regulatory regime, what level of protection are U.S. consumers afforded?

(2) With legalization, could these risks be addressed more effectively than they are now, and assuming legalization, what regulatory strategy is best suited for addressing these risks?

(3) What are the potentially relevant technologies and methods available for effective risk mitigation, and how might other parties contribute toward effective control?

Our answer to the threshold question of whether online gambling can be effectively regulated came out of our analysis of these more specific questions.

B. The Status Quo Offers No Effective Protection

Many U.S. residents already use online gambling services despite statutory restrictions. Recent estimates indicate that U.S. gamblers constitute roughly one-fourth to one-third of the global market for online gambling services.[3] The size of the U.S. share of that global market was estimated to be $5.9 billion in 2008.[4]

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[3] G. Srinivasan, "EU Slams US on Its Remote Gambling, Betting Laws," *Business Line,* June 14, 2009, http://www.thehindubusinessline.com/2009/06/14/stories/2009061450870400.htm (last accessed on September 10, 2009). Also noted in an August 4, 2009 interview with Simon Holliday, Director of H2 Gambling Capital (U.K.). Also see Simon Holliday *et al., Internet Gambling Market Overview: AGA Internet Gaming Task Force*, H2 Gambling Capital, December 2, 2008, p. 8.

[4] From H2 Gambling Capital, cited in American Gaming Association, *Internet Gambling,* AGA Fact Sheet,
(continued...)

The mainstay of the current prohibitionist regulatory structure is the Unlawful Internet Gambling Enforcement Act (UIGEA). Instead of criminalizing gambling itself, the UIGEA was intended to prevent U.S. residents from gambling by placing restrictions on the role of financial institutions in transmitting payments to and from gaming operators. However, because workarounds such as e-wallets (essentially a payment processor situated between banks and gambling sites), phone-based deposits, and prepaid credit cards have proliferated, very few U.S.-based gamblers are presently much inconvenienced.[5] Most gamblers are either unaware of or confused by the patchwork of federal and state restrictions, and many are readily guided by unregulated online gambling sites toward financial mechanisms that they can use to make deposits and withdrawals.[6]

The net effect is that the U.S. attempt to prohibit online gambling has instead pushed it offshore. Sites are readily available to U.S. residents through the essentially borderless medium of the Internet. Some sites are well-regulated, such as those based in the United Kingdom, Alderney, and Gibraltar, and others are less-well-regulated or unregulated, such as those in Antigua, Grenada, or the Kahnawake Mohawk territory. (Of course, it is the less-well-regulated international sites that provide easier access to U.S. consumers.) As a result of the global gaming industry's adaptations to the U.S. strategy, the United States finds itself in the unfortunate position of

- incurring all the social costs related to U.S. residents' online gambling;
- exercising no jurisdiction or control over the gaming sites that serve U.S. residents;
- being unable to offer U.S. residents who choose to gamble on overseas sites any consumer protections or to implement any other harm-reducing strategies; and
- being unable to qualify industry participants or even exclude criminal groups from competing for U.S.-based customers.

In an effort to address this reality and enforce current restrictions more aggressively, federal officials recently instructed four banks to freeze accounts belonging to online payment processors. The frozen accounts apparently contained funds owed to some 27,000 people who used offshore poker websites.[7] Such financially based efforts seem to have had only a temporary

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http://www.americangaming.org/Industry/factsheets/issues_detail.cfv?id=17 (last accessed on August 27, 2009).

[5] USAplayers.com, *USA Poker Deposit Methods,* http://www.usaplayers.com/poker/deposit-methods/index.html (last accessed on August 8, 2009), and USAplayers.com, *Online Poker Deposits and the UIGEA,* http://www.usaplayers.com/deposit-methods/articles/poker/online-poker-deposits-and-the-uigea.html (last accessed on August 8, 2009).

[6] Bo Bernhard *et al., Internet Gambling in Nevada,* University of Nevada, Las Vegas, April 2007, at p. 26. Also see, Gilbert M. Gaul, "Players Gamble on Honesty, Security of Internet Betting," *The Washington Post,* November 30, 2008, p. A12.

[7] Tamara Audi, "U.S. Deals Blow to Online-Poker Players," *The Wall Street Journal,* June 10, 2009, http://online.wsj.com/article/SB124459561862800591.html (last accessed on August 3, 2009).

chilling effect.[8] Over the long run, it is probably not feasible for the federal government to prevent U.S. residents from accessing foreign sites via the Internet. Unlike China or Iran, for example, the United States has displayed no appetite for centralized control of the Internet to block citizens' access to undesirable sites.

Nor would criminalization of the gambling itself be an effective strategy.[9] First, it would likely generate a massive pool of lawbreakers, almost none of whom would make attractive targets for criminal prosecution—because it would likely be a waste of law enforcement resources to pursue individual online gamblers. Second, it would exacerbate the dangers of consumer fraud at online gambling sites by making aggrieved consumers more reluctant to report their experiences.

C. Legalization and Regulation Would Afford Significantly Better Protection than the Status Quo

At a minimum, legalization and regulation of online gambling would give Americans much more protection than does the current prohibitionist regulatory framework. Although the kind of regulation that would accompany legalization would not be failsafe, it would be a significant improvement over the current regulatory and enforcement structure. We believe that safeguards could be implemented that would, on balance, substantially improve protections against the identified risks. These safeguards would also provide protection equal to or greater than that provided within the U.S.-based bricks-and-mortar gambling industry. We recognize that no set of technical or regulatory controls could ever eliminate these risks entirely. But even if the new fence had a few holes, it would be an improvement over having no fence at all.

The view that online gambling, in contrast to its bricks-and-mortar casino counterpart, is impossible to regulate reflects an old-fashioned perception of cyber jurisdictional authority. Many offshore commercial entities that operate online are subject to U.S. legal jurisdiction under existing long-arm statutes and authority. When coupled with governmental licensing authority, the ability to police online activities is even more powerful. Legalization with regulation would provide U.S. authorities with the power to grant or deny licenses and to impose significant sanctions on noncompliant licensees. Those licenses would be highly valuable to site operators. Compliance with any regulatory requirements and strict licensing conditions that Congress chooses to impose in return for the privilege of the license would therefore become a cost of doing business.

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[8] Noted in an August 4, 2009 interview with Simon Holliday, Director of H2 Gambling Capital (U.K.).

[9] Ryan S. Landes, "Layovers and Cargo Ships: The Prohibition of Internet Gambling and a Proposed System of Regulation," *New York University Law Review,* 82 (May 2007): 913–943, at p. 927–936. Also see Gerd Alexander, "The U.S. on Tilt: Why the Unlawful Internet Gambling Enforcement Act Is a Bad Bet," *Duke Law & Technology Review,* No. 5 (2008), at ¶44. Also see Roger Clarke and Gillian Dempsey, "The Feasibility of Regulating Gambling on the Internet," *Managerial and Decision Economics,* 22 (2001): 125–132, at p. 130. Also see Testimony of John Lyons, in U.S. House of Representatives, Committee on the Judiciary, *Establishing Consistent Enforcement Policies in the Context of Online Wagers,* 110th Cong., 1st Session, November 14, 2007, p. 107.

Just as with bricks-and-mortar casinos, the requirement for site operators to maintain a license gives the government the ability to exclude bad actors as well as impose a broad array of conditions for, and oversight of, licensees. In contrast, the current prohibitionist policy is extremely ineffective: large numbers of U.S. residents already gamble online, but they do so using offshore sites, many of which are poorly regulated.[10] With legalization, we would expect that most online gamblers would prefer licensed U.S.-based sites because of their integrity and security, rather than accept the risks posed by unregulated or poorly regulated sites. A well-structured regulatory regime would provide better protections against all of the risks we identified.

This conclusion is supported by the experience of other jurisdictions in regulating online gambling. Some of these, such as the United Kingdom and Alderney, have adopted regulatory regimes that appear to provide protection against the identified risks. That may be the most compelling evidence that online gambling can be effectively regulated.

D. Regulatory Methods and Technologies for Controlling Each Type of Risk Already Exist

For each of the 10 risks we examined, a set of regulatory methods and technologies already exists that would provide a reasonable degree of risk management. Moreover, most of them have been implemented in other countries. One general insight from regulatory policy, and a review of other country's experiences, is that no one size fits all: regulators should treat different risks differently. The incentives and motivations of different parties vary across risk categories, as does the locus for detection and control interventions. Understanding the natural incentives of the gaming industry with respect to each class of risk reveals whether a cooperative regulatory strategy would likely be more effective than a traditional enforcement-centric one.

For example, for at least one of the risks we identified (protecting the integrity of poker games by preventing players from colluding or conspiring to cheat other players), the interests of the public and of the gaming industry align reasonably closely. Both groups are interested in ensuring the integrity of the games. That makes a more cooperative and less adversarial regulatory relationship quite natural.

For other risks (such as defrauding of consumers by site operators, involvement of organized crime, and money laundering by site operators), a strict enforcement regime focused on identification and rapid exclusion of bad actors is more obviously appropriate. Oversight in these areas would focus heavily on up-front qualification or "suitability" to exclude those with criminal histories or connections and persons otherwise lacking in "good character, honesty, and integrity" as is the case in the bricks-and-mortar space. Enforcement activity would focus on bad actors, with the goal of exclusion and sanction. The intense and strict monitoring regime for reputable sites would include provisions designed to prevent or reveal any infiltration over time

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[10] G. Srinivasan, "EU Slams US on Its Remote Gambling, Betting Laws," *Business Line,* June 14, 2009, http://www.thehindubusinessline.com/2009/06/14/stories/2009061450870400.htm (last accessed on June 30, 2009). Also see *Supra* at footnote 7.

by undesirable groups or influences. Such regulations would mirror those now in place for bricks-and-mortar casinos.

Reputable sites, whose competitive advantage lies substantially with their reputation for integrity, would not be much troubled by the type of oversight designed to keep the "good character, honesty, and integrity" bar for admission high and the bad players out. In fact, they should appreciate such oversight as a positive contribution to the overall public perception of their industry, and the regulatory certainty provided by a licensing model would help with the industry's overall long-term planning.[11]

Some risks (gambling by minors, money laundering by players, problem gambling, breaches of data confidentiality, and lack of site and technology security) present more complex challenges in terms of regulatory design. If site operators were driven solely by their short-run economic incentives, they would more likely take bets from minors, problem gamblers, and money launderers (because the sites gain financially, at least in the short run, from all such bets), and they might limit their investments in data privacy and security. Site operators might also gain, in the short run, from abusing or selling personal and financial data provided to them by gamblers.

In the longer term, of course, site operators value their brand names and reputations matter, and these five risks all figure as *reputational risks* from the industry's perspective just as they do in the bricks-and-mortar gambling industry. By setting the admission bar for licensees suitably high, U.S. regulators would intend to admit only reputable operators, whose behaviors would be guided by the value they place on establishing and maintaining a trusted brand. This is the approach taken by regulators in other jurisdictions—license only reputable firms. Probity investigations are conducted into the companies and their associates before a license is issued.[12] Hence, for these five risks, close supervision would be required if an operator were regarded as a rational but short-sighted actor. At the same time, a more cooperative and symbiotic regulatory relationship ought to emerge when reputable operators take a longer-term, strategic view. To better align site operators' short- and long-term interests, regulation also would provide for sanctions, from monetary fines up to and including loss of license for those site operators that choose to disregard mandated operational and consumer protections.

One strategy to provide longer-term, reputation-based incentives for good behavior is to create costs to entry—through the regulatory process, licensing fees, or other means—that reduce

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[11] Noted in an August 13, 2009 correspondence with Katharina Riedl of bwin (Austria).

[12] Noted in an interview with Phill Brear, Head of Gambling Regulation at the Gibraltar Regulatory Authority and an interview with Glenn Gibson, Manager of Technical and Systems Audit at the Tasmanian Gaming Commission, and Damien Jarvis, Assistant Director of the Liquor and Gaming Branch of the Tasmania Department of Treasury and Finance (Australia). Also, as noted in an August 31, 2009 correspondence with John Sealy, Manager of Information Systems and Technology Services at the Licensing, Regulation and Alcohol Strategy Division of the Northern Territory Department of Justice (Australia), licensees often wish to be seen as responsible and as good corporate citizens. Also see Testimony of André Wilsenach and Testimony of Mary Williams, in U.S. House of Representatives, Committee on Financial Services, *Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?* 110th Cong., 1st Session, June 8, 2007, p. 122 and 140.

incentives to make a quick profit and leave the industry. For all risks created by operator shortsightedness, regulators need to establish and retain sufficient audit and monitoring systems so they can see when organizations that are otherwise reputable tilt too heavily toward short-term gain at the expense of public protection. Regulators should not accept the industry's protestations that they can be entirely trusted to take care of such risks without oversight simply because it is in their interest to do so. It is indeed in the industry's long-term interests to do so, but short-term considerations sometimes prevail, even in major corporations and multibillion dollar industries.

The following sections of this study describe a variety of control technologies and regulatory tactics relevant to each risk, and identify the most promising approaches in each case. Table 1, in Appendix A, lists the 10 risks and for each outlines

- the level of protection afforded under the current regime (column 2);
- the overall structure and style of regulatory oversight most natural for each risk (column 3), and
- some key points regarding relevant technologies and control strategies (column 4).

Below we summarize key points in relation to each risk.

1. Gambling by Minors

There is a general concern that underage gamblers may access or attempt to access online gambling sites.

- Gambling by minors: A number of technologies routinely used in other industries can be used to exclude minors from online gambling, including a variety of data-matching techniques, electronic or other submission of documentary evidence of age, and possibly application of biometric identification systems. The strongest form of control would require positive matching of a player at the time of registration against existing databases of known adults, thus excluding minors, as well as identity-verification prior to initiating any session of play. U.S.-licensed operators would be expected to use filters and procedures that are as discriminating as reasonably possible. With respect to U.S. residents, we would expect available data needed for age-verification to be of high quality and reliability. Site operators could also be required to provide child-protective software to parents to help prevent minors from accessing gambling sites. Alternatively, a separate governmental or nonprofit entity could provide such software.

2. Criminal and Fraudulent Behavior

Criminal activity can stem from site operators or the players themselves. The following risks are related to criminal activity by site operators:

- Defrauding of consumers by site operators,
- Involvement of organized crime in gambling operations, and
- Money laundering by site operators.

These risks would be effectively limited by a regulatory strategy designed to keep the bar for admission high and to keep criminals out. Such controls have worked well in bricks-and-mortar casinos and would operate similarly with U.S.-licensed online site operators. Relevant tactics include rigorous vetting procedures for new applicants and monitoring of licensed site operator behavior to prevent or detect regulatory noncompliance, criminal conduct, fraudulent and deceptive practices, and disregard for consumers' rights.

Regulatory strategy with respect to these risks would be enforcement-centric with a focus on excluding operators with criminal histories or connections. Reputable site operators with brands to protect could not afford to risk damage to their reputations, loss of their licenses, or regulatory sanctions. Thus, we would expect the industry at large to support the type of demanding admission standards, regulatory monitoring, and sanctions designed to keep bad actors out of the business. Players, best positioned to detect improper conduct or consumer fraud by site operators, would be enabled and encouraged to report site operators' improper conduct directly to regulators and others in law enforcement. Players would also have access to U.S. courts for dispute resolution.

Player criminal behavior falls into two major categories—cheating or defrauding of players by other players and money laundering by players.

- Cheating or defrauding of players by other players: Most of the cases of improper player collusion or cheating that have come to light have been detected by other players. With a regulator in place for U.S.-licensed sites, players would have stronger recourse against the sites, or against other players, by lodging complaints with the regulator or relevant law enforcement agencies. More important, licensed operators could be required to maintain comprehensive databases of all betting transactions and these databases could be examined and analyzed by regulators in the event of an inquiry or the triggering of red flags. Site operators, who themselves have a strong interest in maintaining the integrity of their games, could be expected or even required to implement pattern recognition software to scan routinely for anomalous betting patterns.

- Money laundering by players: Online gambling operators, like operators of bricks-and-mortar casinos, would be subject to current anti-money-laundering regulations. These regulations would require site operators to expend some level of effort in detecting money laundering. The online environment provides *better* opportunities for detecting money laundering by players or player groups than the bricks-and-mortar casino environment. Site operators could be required to retain comprehensive data on all deposits, withdrawals, and betting transactions and to make these data available to regulators for examination and analysis. Given complete data, most patterns related to money laundering (such as light betting or

matched bets placed by collaborators) would be easier to detect than they are in a physical environment (where complete transaction histories are available only in the form of video recordings). Software that detects anomalies and suspicious behaviors could be operated easily and routinely on digital databases by the site operators, by regulators, or by both. The site operators' obligations with respect to their own detection of money laundering would form a part of their ordinary compliance obligations under the licensing regime.

3. Network Access, Data Privacy and Security Issues

Any U.S. legalization and regulatory regime would likely address the risk of access to online gambling sites from jurisdictions that prohibit such activity.

- Violation of jurisdictional restrictions or prohibitions: State, local, and tribal governments may continue to prohibit or restrict (1) the operation of gambling sites from within their jurisdictions and (2) online gambling by individuals resident or physically present within their jurisdiction. Licensed U.S. sites could be required to take all reasonable steps not to permit registration or participation by individuals in such states. A range of geolocation technologies are now available, mostly tied to identification of the user location by reference to their IP addresses. Such technologies, while not entirely foolproof, have the capability of reducing risks as much as is required by regulators. IP geolocation, together with address verification at registration and other controls, can be expected to deter the bulk of casual attempts to gamble from within restricted states. Determined users, of course, already have access to foreign sites and would probably continue to use those rather than go to the trouble of devising sophisticated technological means for defeating U.S.-based geolocation controls. Regulatory oversight methods could include audits of U.S.-based operators' software controls and routine "mystery shopping" at U.S. sites conducted from locations within states that had chosen to exercise their rights to restrict online gambling.

Data privacy and security risks include: sites not using commercially appropriate security systems and practices; intentional or accidental breach of the gambling site's and user's data security; and the introduction of spyware, adware, or malicious code into gambling websites' software or transmission of such malware to users' computers.

- Breaches of data confidentiality: Under legalization and regulation, U.S.-licensed operators would be subject to all applicable federal and state requirements regarding data confidentiality and security. Site operators would be subject to regulatory and potentially criminal sanctions and civil liability for any breaches or abuses of personal or financial data. Their data-protection controls would be subject to regulatory audit. There is no reason to believe that licensed online gambling operators would be any less able or willing to fulfill these obligations than other online merchants with similar data custody obligations.

- Communications and computer security failures: Under the current regime, U.S. authorities have no oversight over security for online gambling sites. With

legalization and regulation U.S. licensed sites would be subject to existing data protection laws. Furthermore, U.S. regulators would have an opportunity to require state-of-the-art cybersecurity controls to protect against the introduction of malicious code or the unauthorized manipulation of games.

4. Problem Gambling

It is relatively easy to demonstrate for the other risk categories that a well-structured regulatory regime coupled with relevant technologies should provide better protection than the status quo. For problem gambling, however, the potential effect of legalization is less obvious a priori. Many might assume that pathological or addictive gambling behaviors would be exacerbated by the increased opportunity to gamble at any time and from anywhere online. But research on this topic does not support this conclusion. In particular, the link between the availability of online gambling and increases in the prevalence of problem gambling has not been established. Nevertheless, some online gamblers would be problem gamblers.

In a well-regulated online environment, gamblers could have opportunities and technologies made available to them to help curb addictive or problematic gambling behaviors. Such mechanisms would permit them to limit their gambling volume, deposit rates, loss rates, and the size of each wager. Users could also access online clinical and self-help resources from links provided at the gambling site.

The relationship between legalization and potential effects on problem gambling rates must certainly be examined carefully. Opponents of legalization fear an increase in problem gambling rates. However, gambling experts in the United States and the United Kingdom have reported that the prevalence rates for pathological gambling have remained static and low (roughly 0.7% of the adult population, in both countries) for many years. A large-scale study of gambling prevalence in the U.K. found the 0.7% rate remaining stable from 1999 through 2007 despite substantial increases in gambling opportunities during this period.[13]

Because this issue is likely to receive considerable attention as the United States considers legalization, we have attempted to analyze the various arguments given as to why the act of legalization might drive the level of problem gambling up or down. We have identified five popularly discussed mechanisms through which legalization could drive problem gambling *up*, and describe them here along with some observations that help mitigate the anticipated effects:

- Mechanism: Inhibitions to gamble that are based on would-be gamblers' knowledge of current legal restrictions would be removed.

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[13] Noted in a June 10, 2009 interview with Howard Shaffer, Director of the Division on Addictions and Associate Professor of Psychology in the Department of Psychiatry at the Cambridge Health Alliance. Also see Jacob Sullum, "Some Bets Are Off: The Strangely Selective and Self-defeating Crackdown on Internet Gambling," *reasononline,* June 2008, http://www.reason.com/news/show/126022.html (last accessed on September 10, 2009). Also see Heather Wardle *et al.*, *British Gambling Prevalence Survey 2007*, National Centre for Social Research, Prepared for the Gambling Commission, September 2007, http://www.gamblingcommission.gov.uk/pdf/Britsh%20Gambling%20Prevalence%20Survey%2007%20-%20Sept%202007.pdf (last accessed on September 10, 2009), p. 10.

- ❖ *Observation*: Gamblers in the United States are generally ignorant of or completely confused about existing legal restrictions, and (until very recently) there has been no enforcement against the gamblers themselves.[14] Hence, the lifting of the prohibition itself is unlikely to have any significant impact on would-be gamblers' willingness to gamble online.

- Mechanism: Gamblers may be more comfortable gambling online because licensed operators are reputed to be trustworthy.

  - ❖ *Observation*: The gamblers most likely to be influenced by the availability of trusted brand-name sites are those who gamble already, perhaps in the casino environment, and hence know the brands. Knowledgeable gamblers may indeed shift their business, but this represents displacement, not overall growth. And the displacement would be from bricks-and-mortar to online gambling, which can offer many more options and protections for problem gamblers than can land-based casinos.

- Mechanism: Gambling opportunities would be ubiquitous and available 24/7.

  - ❖ *Observation*: U.S. residents already have online gambling options available to them all day, everyday, and from anywhere. So the addition of U.S.-licensed sites would not alter that particular reality.

- Mechanism: Lifting the UIGEA's restrictions on financial transactions might make it easier for consumers to place bets online.

  - ❖ *Observation*: Lifting the restrictions of the UIGEA would not make it significantly easier for U.S. residents to make deposits to online sites. Enough workarounds have been designed, and are energetically promoted to consumers by the offshore sites, to render the existing restrictions largely ineffective.[15]

- Mechanism: Advertising by licensed online gambling sites might lead to increased problem gambling.

  - ❖ *Observation*: Although advertising is one avenue for the expected increase in online gambling that would follow legalization, little evidence exists to show whether and to what extent advertising-induced growth in, or redistribution of, gambling volume might produce increases in problem

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[14] The recent seizure of online poker players' funds was termed an "unprecedented action" by the Poker Players Alliance. See *Supra* at footnote 7.

[15] See *Supra* at footnote 5.

gambling rates.[16] Furthermore, this mechanism (allowing advertising for online gambling sites) is controllable to the extent deemed necessary or desirable, through regulatory restriction.

We also looked at two mechanisms through which legalization and regulation could drive problem gambling *down*:

- Mechanism: Tax and license-fee revenue distributions may provide an opportunity to extend and enhance counseling, treatment, and support programs for problem gamblers.

  - ❖ *Observation*: Significant tax revenues might be anticipated from U.S. operators, and revenue distributions from taxes and license fees could substantially boost publicly funded prevention, counseling, and treatment programs, as well as research on gambling addiction. Existing budgets for counseling and treatment services for problem gamblers have been limited, and most health insurance programs do not currently cover these services.[17]

- Mechanism: Regulators could require licensed domestic sites to lead the world in offering a full suite of advice and protections for problem gamblers to an even greater extent than is the case in bricks-and-mortar casinos.

  - ❖ *Observation*: U.S.-licensed sites could be required to display offers of help prominently on their websites, including (1) registration pages that offer self-diagnostic tests designed to help would-be gamblers understand their own attitudes and vulnerabilities; (2) web pages that display prominent links to support and counseling services; and (3) availability of speed-of-play, compulsory time-outs, or player-loss-rate caps. All players should be offered the opportunity up front and at subsequent intervals to voluntarily exclude themselves or to limit their own deposit rates, loss rates, betting rates, or periods of play.

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[16] Noted in an August 4, 2009 interview with Simon Holliday, Director of H2 Gambling Capital (U.K.).

[17] Franklin (2001) discusses lack of federal funding for treatment or awareness of problem gambling, lack of insurance parity for problem gamblers, and limited or lack of funding from most states in the United States. Joanna Franklin, *Problem Gambling in the U.S: From the Beginning – Into 2001,* http://www.responsiblegambling.org/articles/Problem_and_Pathological_Gambling_A_view_from_the_States.pdf (last accessed on September 10, 2009). Also, Winslow (2008) discusses the lack of state funding for problem gambling services in Colorado and other states in the United States. Kyle Winslow, "A Problem for Gamblers," *The American Prospect,* March 10, 2008, http://www.prospect.org/cs/articles?article=a_problem_for_gamblers (last accessed on July 13, 2009). Also see the website of the Association of Problem Gambling Service Administrators (APGSA), http://www.apgsa.org/State/index.aspx (last accessed on September 10, 2009).

We believe that the opportunities to mitigate problem gambling provide significant benefits not available under the status quo. These benefits provide a significant counterweight to any potential increases in problem gambling that result from legalization. Furthermore, the potential benefits of mitigation would become available to most existing online problem gamblers.\

E. Conclusions

We have examined 10 distinct risks in four categories that may be associated with the growth and availability of online gambling. In each case, the current legislative framework is failing to provide any effective risk control or consumer protection. The establishment of a well-regulated industry under U.S. jurisdiction would offer the opportunity for much better protection. We recommend that plans for regulating online gambling include the design and use of different risk-control strategies for different risks that may be associated with Internet gambling, as well as education and consumer support.

If the United States decides to legalize and regulate online gambling sites, we would expect most U.S.-resident gamblers to be diverted from overseas sites toward reputable and trusted domestic operators. In the long run, reputable gambling operations under U.S. control should come to dominate online gambling opportunities chosen by U.S. consumers. All four categories of risk would be better controlled in such circumstances than they are at present. In the end, U.S. consumers would be better protected than they are now.

II. REGULATORY METHODS AND TECHNOLOGIES AVAILABLE FOR CONTROLLING EACH RISK

For each of the 10 risks outlined above, a set of regulatory methods and technologies already exists that would provide a reasonable degree of control. Moreover, most of them have been implemented successfully in other countries and other online settings. This section describes a variety of control technologies and regulatory tactics relevant to each risk, and identifies the most promising approaches in each case.

A. Gambling by Minors

A common concern about legalizing online gambling stems from the fact that many current online gambling sites do not have adequate regulations or safeguards against gambling by minors. The primary concern is that underage access to and use of online gambling services might increase because it may be difficult to verify age and replicate controls used by bricks-and-mortar casinos to exclude minors. However, effective measures to prevent online gambling by minors have been implemented in well-regulated Internet gambling environments in many European countries and in Australia. Moreover, a number of technologies routinely used in other industries can be applied to the online gambling environment. We discuss below the issue of online gambling by minors and strategies to prevent it.

1. The Issue of Gambling by Minors

Age restrictions apply to virtually all forms of legalized gambling, though the specific age restriction varies by jurisdiction. The typical rationale for age restrictions is that children and young persons are highly vulnerable and are more likely to become problem gamblers if they begin gambling at a young age. In the online environment, gambling by minors is a problem that stems from the inherent difficulty in separating underage users from adults on the Internet because of the absence of an official personally verifying a gambler's age.[18] Minors can gain access to online gambling websites either by providing false credentials during the registration process or by gaining access to their parents' or others' online gambling account.

Anecdotal evidence suggests and surveys have shown that underage gambling is widespread. Studies conducted between 1999 and 2004 covering Canada, the United States, the United Kingdom, and Australia indicated that 4–7% of adolescents exhibited serious patterns of pathological gambling and 10–15% were at risk of either developing or returning to a serious gambling problem.[19] More recent studies have revealed an increase in the involvement of

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[18] Ryan S. Landes, "Layovers and Cargo Ships: The Prohibition of Internet Gambling and a Proposed System of Regulation," *New York University Law Review*, 82 (May 2007): 913–943 at p. 923.

[19] Sally Monaghan, *Internet and Wireless Gambling – A Current Profile*, Australasian Gaming Council, 2008. http://www.austgamingcouncil.org.au/images/pdf/Discussion_Papers/agc_dis_internet.pdf (last accessed on July 11, 2009). Also the extent to which rates of problem gambling among adolescents are elevated is controversial. For example, in exploring the properties of two screening instruments in identifying problem gambling among students aged 15 to 17 , Ladouceur *et al.* (2005) discuss the need to clarify the construct of pathological gambling among youth and note that neither the SOGS nor the DSM-IV subscale (MAGS) was perfect in identifying problem gambling. R Ladouceur *et al.*, "Concordance between the SOGS-RA and the

(continued...)

Canadian youth in online gambling. In 2006, 9% of Canadian high school students reported having gambled online for money, an increase from 3.6% in 2005.[20] According to the National Annenberg Survey of Youth, in the United States, card playing for money on the Internet by male youth aged 14 to 22 rose to 3.3% in 2008 from 2.4% in 2007.[21] In a 2008 study of general gambling attitudes among Canadian youth aged eight to 20, 76% of those surveyed admitted to having gambled at least once in their lives.[22] Among the group aged 18 to 20, 90% had gambled at least once and approximately 39% admitted to gambling once a week or more.[23]

2. Existing Controls in Other Jurisdictions

States with commercial casino gambling typically limit access to persons 21 or over, although most lotteries and some Native American casinos allow 18-year-olds to gamble. Most other countries have an age limit of 18, which applies to both online and casino gambling. There is no established minimum age for online gambling in the United States because it is done outside of U.S. legal and regulatory safeguards.

Well-regulated overseas gambling jurisdictions require online operators to verify the identity, location, and age of their customers and to use various mechanisms to curb underage gambling. Some evidence suggests that age restrictions for online gambling have not been uniformly required or rigorously implemented. In an exploratory study of 30 U.K.-based sites conducted before the United Kingdom's regulation of online gambling, researchers noted that 11 of those sites had no age verification check.[24, 25] Although 17 sites had age checks, they simply required a person registering to either check a box to confirm that they were 18 years of age or older or

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DSM-IV Criteria for Pathological Gambling among Youth." *Psychology of Addictive Behaviors,* 19, No. 3 (2005): 271–276 at p. 274-275.

[20] J. McBride, "Internet Gambling among Youth: A Preliminary Examination," International Center for Youth Gambling Problems & High-Risk Behaviors Newsletter, 6, No. 1 (2006); cited in Sally Monaghan, Internet and Wireless Gambling – A Current Profile, Australasian Gaming Council, 2008. http://www.austgamingcouncil.org.au/images/pdf/Discussion_Papers/agc_dis_internet.pdf (last accessed July 11, 2009).

[21] The Annenberg Public Policy Center *Internet Gambling Stays Low Among Youth Ages 14 to 22 but Access to Gambling Sites Continues; Sports Gambling Makes Resurgen*ce, November 26, 2008, http://www.annenbergpublicpolicycenter.org/NewsDetails.aspx?myId=306 (last accessed July 25, 2009).

[22] Jeffrey L. Derevensky *et al.*, "Adolescent Attitudes toward Gambling," *Brazilian Journal of Cognitive Psychology,* 4, No. 1 (2008), http://pepsic.bvs-psi.org.br/scielo.php?script=sci_arttext&pid=S1808-56872008000100002&lng=en&nrm= (last accessed on September 1, 2009).

[23] See *Id.*

[24] U.K.-based online gambling operators first came under regulation with the introduction of the Gambling Act 2005 in September 2007. Before the Gambling Act, online gambling fell under no specific regulation.

[25] Michael Smeaton and Mark Griffiths, "Internet Gambling and Social Responsibility: An Exploratory Study," *CyberPsychology & Behavior,* 7, No. 1 (2004): 49–57.

enter their date of birth.[26] In addition to lax age checks, most websites required only a valid credit card to begin gambling. However, some minors in the United States as young as 13 have access to credit cards in their name, rendering this mechanism ineffective as an age check.[27] Moreover, minors may have access to their parents' credit card information. In a 2004 British study, a 16-year-old girl attempted to access 37 gambling websites using her debit card, lying about her age but being otherwise truthful. Only seven sites prevented her from registering.[28]

A more recent mystery shopping study performed between April 2008 and March 2009, after U.K.-based online gambling had come under regulation, revealed quite different results. The British Gambling Commission noted that more than 95% of gamblers were registered with websites that had sufficient age verification checks, and only 2.2% were registered with sites that had age verification weaknesses.[29]

Other jurisdictions have also had success in preventing underage gambling through effective use of restrictions and mechanisms. In his testimony to Congress, the CEO of the Alderney Gambling Commission noted that during the seven years of regulation of online gambling in Alderney, the Commission had not had any complaints about minors gaining access to an Alderney-regulated site. He further noted that the primary reason that Alderney's licensed sites are able to prevent minors from gaining access is the use of third-party verification software by most licensees.[30]

Similarly, Mary Williams of the Gambling Control Commission of the Isle of Man noted that license holders of online gambling websites use various methods of age verification, including large data services such as Experian, to ensure that customers are of legal age. Moreover,

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[26] See *Id.*

[27] Commission on Child Online Protection, *Report to Congress,* October 20, 2000, http://www.copacommission.org/report/COPAreport.pdf (last accessed on August 11, 2009), p. 25. Also see European Commission, *Background Report on Cross Media Rating and Classification, and Age Verification Solutions,* Safer Internet Forum, September 2008, http://ec.europa.eu/information_society/activities/sip/docs/pub_consult_age_rating_sns/reportageverification.pdf (last accessed on August 24, 2009).

[28] Smeaton *et al.,* "Study into Underage Access to Online Gambling and Betting Sites," 2004; cited in Ryan S. Landes, "Layovers and Cargo Ships: The Prohibition of Internet Gambling and a Proposed System of Regulation," *New York University Law Review,* 82 (2007), at p. 924.

[29] British Gambling Commission, *Online Mystery Shopping Programme,* July 2009, http://www.gamblingcommission.gov.uk/pdf/online%20mystery%20shopping%20programme%20july%202009.pdf (last accessed on August 2, 2009).

[30] Testimony of André Wilsenach, in U.S. House of Representatives, Committee on Financial Services, *Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?* 110th Cong., 1st Session, June 8, 2007, at p. 145.

withdrawal of funds requires access to a PIN number, which the gambling site mails to the user's postal address, thereby limiting the possibility of unauthorized access to funds by minors.[31]

Gibraltar's regulatory regime requires licensees to take "all reasonable steps" to verify that customers are of legal age, although operators are allowed to consider the use of a credit card as a verification of age.[32]

The United Kingdom requires that licensed gambling sites have policies and procedures to prevent underage gambling, including a warning that underage gambling is illegal, requiring an affirmation from the customer that he or she is of legal age, ensuring that staff are trained in age verification (particularly in the use of secondary forms of identification verified by staff members when initial automated procedures fail), and enabling filtering software to block the website.[33] Beyond this, secondary verification may be required, such as searching credit databases for age information, prohibiting unverified users from withdrawing winnings, and freezing the account of anyone not verified within 72 hours of applying to the site. However, these checks are not required if the user deposits funds using a credit card.[34]

The regulator in Australia's Northern Territory requires that players' ages be confirmed within 90 days of opening an online gambling account and before withdrawing any funds. Copies of identification must be e-mailed, faxed, or mailed directly to the site operator. If the individual is not confirmed within the 90-day period, he or she must seek permission from the regulator's Director of Licensing to re-open the account.[35]

In the United States, the UIGEA exempts certain forms of gambling, such as horse racing and state lotteries, from its criminal provisions if the applicable state law has a provision for age verification that is "reasonably designed to block access to minors."[36]

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[31] Testimony of Mary Williams, in U.S. House of Representatives, Committee on Financial Services, *Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?* 110th Cong., 1st Session, June 8, 2007, at p. 130.

[32] Gibraltar Regulatory Authority, *Code of Practice for the Gambling Industry,* Issued by the Gambling Commissioner, December 13, 2008, http://www.gra.gi/sites/gambling/downloads/215/generic_code_v1.0.2009.pdf (last accessed on August 6, 2009), p. 14.

[33] British Gambling Commission, Conditions and Codes of Practice applicable to: Remote Casino Licenses, Remote Casino Ancillary Licenses, December 2008, at p. 7–8.

[34] See *Id.*

[35] Noted in an August 31, 2009 correspondence with John Sealy, Manager of Information Systems and Technology Services at the Licensing, Regulation and Alcohol Strategy division of the Northern Territory Department of Justice (Australia).

[36] Anthony Cabot and John Aristotle Phillips, "Age Verification: UIGEA Compliance and Regulation," *World Online Gambling Law Report*, October 2006, http://integrity.aristotle.com/documents/AgeVerificationLawPublication.pdf (last accessed on August 10, 2009).

3. Relevant Technologies for Risk Mitigation

Although the anonymous nature of online platforms might increase the risk of underage gambling, available technologies can address such risks.

Researchers have outlined several categories of technologies for verifying the age of adults, including comparison of the registrant's credentials against public databases such as credit reports and criminal histories, or even biometrics.[37] In designing such controls, care would be needed to balance the (intended) exclusion of minors against the (unintended) denial of admission to qualified adults. The use of a credit card can often be an indicator of age, although, as noted in Section 2, some children have access to credit cards, and credit card companies do not allow cards to be used for age verification.[38] It is thus likely that any age verification technology would use government-issued identification as its basis, potentially combined with other strategies to increase its effectiveness.[39]

Exclusion of minors from online gambling can also be aided through technologies routinely used to verify age in other applications today.[40] Currently, online liquor stores employ various mechanisms, including a variety of data-matching techniques, to prevent minors from purchasing alcohol online.[41] The simplest solution requires a social security number and other forms of identification such as a driver's license, combined with a credit card registered to that individual.[42] An age-verification service is used to check the information provided against a database containing credit data, driver's license data, and registered voter information.[43]

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[37] Internet Safety Technical Task Force, *Enhancing Child Safety and Online Technologies,* Final Report to the Multi-State Working Group on Social Networking of State Attorneys, Berkman Center for Internet & Society, Harvard University, December 31, 2008, http://cyber.law.harvard.edu/sites/cyber.law.harvard.edu/files/ISTTF_Final_Report.pdf (last accessed on September 11, 2009) at p. 8.

[38] See *Supra* at footnote 36.

[39] See *Id.*

[40] Such as online liquor stores, online sellers of tobacco, and the websites of Hollywood movie studios. See Testimony of Michael Colopy, in U.S. House of Representatives, Committee on the Judiciary, *Establishing Consistent Enforcement Policies in the Context of Online Wagers,* 110th Cong., 1st Session, November 14, 2007, at p. 53.

[41] Boris Reznikov, "Can I See Some ID? Age Verification Requirements for the Online Liquor Store," *Shidler Journal for Law, Commerce & Technology* 4, No. 5 (2007), http://www.lctjournal.washington.edu/Vol4/a05Reznikov.html (last accessed on July 25, 2009). Also see Integrity, *Case Study: Age Verification for Online Alcohol Sales,* Aristotle Inc., http://integrity.aristotle.com/documents/Online_Wine_Sales-WhitePaper2006.pdf (last accessed on September 10, 2009).

[42] See *Id.*

[43] Noted in an August 5, 2009 interview with Phill Brear, Head of Gambling Regulation at the Gibraltar Regulatory Authority.

Aristotle, Inc., a technology consulting firm, produces an identity- and age-verification service called Integrity:Direct, which uses a database of government-issued identification to verify age; the vendor claims the check takes less than 5 seconds, covers 3.4 billion people, complies with U.S. privacy laws, and is not subject to the Fair Credit Reporting Act because it does not use any credit data.[44]

LexisNexis and its advanced linking technology combines real time access to billions of public records compiled from thousands of public and proprietary sources that can be used to verify age and identity of individuals.[45] For a minor to defeat this method of authentication, he or she would have to access an adult's government-issued ID card, credit card, and other information. Because this is a foreseeable scenario, this age verification technique must be combined with others.

Michigan's Liquor Control Commission has approved a "knowledge based authentication" tool for age verification. This online tool develops questions that only the specific individual would know answers to and checks the answers against public records.[46] This system, while robust, imposes potentially significant transaction costs of between 25 cents and one dollar per check, making it a costly solution if used every time a user logs on to a gambling site.[47] The LexisNexis service can deliver an interactive, knowledge-based query process to instantly "multifactor" authenticate individuals at the point of customer contact.[48]

Other technologies may prove useful to augment traditional verification, such as the use of a PIN number mailed to the address of record of the user, as in the Isle of Man, or requiring the user to enter personal information via his or her home phone. This strategy prevents a minor from simply using his or her parents' credit and ID cards and immediately creating an account.

If legalization is implemented and matching techniques are used, the U.S.-licensed site operators would be expected to develop and use filters that are discriminating. Regulators could choose where to set the balance between Type I errors (where underage gamblers are not detected) and Type II errors (where gamblers of legal age are excluded). Moreover, with respect to U.S.

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[44] Integrity, *Integrity:Direct,* Aristotle Inc., http://integrity.aristotle.com/index2.php?option=com_content&do_pdf=1&id=47 (last accessed on August 11, 2009).

[45] Noted in an August 10, 2009 interview with Chris Pinion, National Account Manager at LexisNexis Risk and Information Analytics.

[46] See *Supra* at footnote 41. Also see Tricia Pearson, *'Can I See Some ID?' Why Age Verification Is a Hot Topic for Online Retailers,* Shoosmiths, June 24, 2009, http://www.shoosmiths.co.uk/news/2372.asp (last accessed on August 11, 2009).

[47] See *Supra* at footnote 41 Boris Reznikov.

[48] Noted in an August 10, 2009 interview with Chris Pinion, National Account Manager at LexisNexis Risk and Information Analytics.

residents, we would expect available data to be of high quality and reliability, making age verification through matching techniques effective.[49]

Site operators could also be required to provide child-protective software to parents to keep minors from accessing their parents' accounts or any online gambling sites. The Nova Scotia Gaming Corporation (NSGC) commissioned and distributed BetStopper, which is a software program designed to help parents prevent children from visiting online gambling websites. Results from the pilot survey were extremely positive and indicated that 92% of parents found BetStopper to be a valuable prevention tool.[50] The BetStopper software was provided to families for free by the NSGC. Other widely available Web filtering software, such as Net Nanny, can also be used to block access to gambling sites by children. Net Nanny analyzes keywords and objects on every website visited and assigns "points" in different content categories, one of which is gambling.[51] If a site scores too high in an objectionable category, the software blocks it.[52] An administrator, usually a parent, can decide which categories to block and also whether a particular score leads simply to a warning message or to a complete block.[53] The software has generally received high reviews, and its filtering technology is resistant to circumvention.[54] Other parental control tools are contained within operating systems such as Windows Vista and Mac OS X, some are provided for free by network service providers, and many online safety organizations provide directories to help parents find appropriate protective software.[55] A regulator may require that approved filtering software be offered to anyone requesting it.

Minors may also have a weak financial motive to gamble online. If a minor usurps an adult's payment and identification information, for example, all of the minor's winnings would be paid

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[49] Noted in an August 5, 2009 interview with Phill Brear, Head of Gambling Regulation at the Gibraltar Regulatory Authority. Also noted in an August 21, 2009 interview with Andrew Fritchie, General Counsel of PartyGaming PLC.

[50] Nova Scotia Gaming Corporation, World-Leading Software Launched to Protect Nova Scotia Youth, May 29, 2009, http://www.nsgc.ca/pdf/press/Microsoft%20Word%20%20BetStopper%20Media%20Release%20FINALMay%2028%20w%20photo.pdf (last accessed on September 10, 2009).

[51] Net Nanny, Protecting Your Family on the Internet, white paper, http://www.netnanny.com/products/netnanny/protecting_your_family (last accessed on September 10, 2009).

[52] See *Id.*

[53] See *Id.*

[54] For a review of the Net Nanny software, see http://internet-filter-review.toptenreviews.com/netnanny-review-pg2.html (last accessed on September 10, 2009).

[55] Federal Communications Commission, Report in the Matter of Implementation of the Child Safe Viewing Act; Examination of Parental Control Technologies for Video or Audio Programming, MB Docket No. 09-26, released August 31, 2009, at ¶142, http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-09-69A1.pdf (last accessed on September 1, 2009).

directly to the adult's account.[56] For a minor to benefit financially from gambling, he or she would have to have access to his or her own payment mechanism, such as a credit card or bank account, but the demographic information associated with the account would more easily allow the website to verify the user's age. Similarly, the regulator could require forfeiture to the government of winnings to gamblers who are discovered to be underage, further lowering the financial incentive for minors to gamble online.[57]

Regulators could impose harsh penalties on site operators with lax mechanisms to prevent underage gambling. Frequent and widespread mystery shopping, as done in the United Kingdom, can reveal operators with inadequate safeguards in place to curb underage gambling. The regulator can impose penalties on such operators, including monetary fines, the revocation of the gambling license, and even criminal liability.

Moreover, to help combat underage gambling, a portion of online gambling tax revenues could be earmarked for educational programs for parents and minors. Given sufficient funds, a regulator may require that youth gambling prevention lessons be incorporated into school curricula. In South Australia, the "Don't Bet On It!" program was introduced as a way to educate children about the dangers of youth gambling. A 2002 report claimed a "small but statistically significant change in student attitudes towards gambling" as a result of the curriculum, which includes five lessons, a mock gambling game, and pre- and postactivity surveys.[58] The report also describes other educational programs from entities in Australia and in North America, such as the Minnesota Institute of Public Health and Saskatchewan Health in Canada.[59]

4. Conclusion

The current state of affairs, with U.S. residents accessing online gambling sites with widely varying degrees of regulation, does not provide comprehensive protections to ensure that gamblers are of legal age. Regulatory mechanisms and technological solutions, many of which are currently used in other jurisdictions and industries, can equip online gambling operators with capabilities to selectively exclude minors from engaging in online gambling. Age verification policies would be less effective in the absence of support from minors' parents and guardians; therefore, a successful regulatory strategy would provide tools with which parents can limit

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[56] Jonathan Gottfried, "The Federal Framework for Internet Gambling," *Richmond Journal of Law & Technology,* X, No. 3, at p. 10, http://law.richmond.edu/jolt/v10i3/article26.pdf (last accessed on August 6, 2009).

[57] Noted in an August 5, 2009 interview with Glenn Gibson, Manager of Technical and Systems Audit at the Tasmanian Gaming Commission, and Damien Jarvis, Assistant Director of the Liquor and Gaming Branch of the Tasmania Department of Treasury and Finance (Australia).

[58] Loris Glass, *Gambling Education: Some Strategies for South Australian Schools,* funded by the Gamblers Rehabilitation Fund, South Australia, November 2002, at p. 19–20, https://www.library.health.sa.gov.au/Portals/0/gambling-education-some-strategies-for-south-australian-schools.pdf (last accessed on September 10, 2009).

[59] See *Id.* at p. 20–22.

access to gambling websites by their children. We believe that online gambling can effectively exclude minors when it combines cutting-edge technology with a strong regulatory regime.

B. Defrauding of Consumers by Site Operators

Gambling websites, which deal with large amounts of money in a virtual setting, have the potential for fraudulent activity and unfair dealings.[60] As discussed below, unregulated gambling sites have been known to defraud customers and steal significant sums of money.[61] However, a system of effective regulation could manage the risks of fraud and ensure fair and legal dealings.

1. The Issue of Fraud by Site Operators

Fraud by site operators can be classified into three broad categories:

- Individuals can set up unlicensed gambling websites that either refuse to return customers' deposits or operate unfair games.
- Operators can model a fraudulent website after a licensed site and siphon players from the more reputable operator.
- Insiders within reputable websites can exploit inside information to cheat players without the knowledge of the larger organization.

It is reasonably easy for an individual to set up a fraudulent site, attract as many depositors as possible, and then either shut down the site and take the deposits or continue to run the site with odds or fees swung decidedly in the operator's favor. As a site's reputation became tarnished, it would quickly lose its base of players, but it could then simply shut down and open a new site, perpetrating the same fraud over and over again.[62] The identity of site owners is often unclear, and the ease of transferring between sites makes this method of fraud highly profitable.[63]

Reputation is clearly a major attribute of gambling websites. Websites can piggyback on, or usurp, the reputation of a reputable operator or jurisdiction to instill confidence in consumers. For instance, "Casino Australia (http://www.casinoaustralia.com/) is an attractive site emblazoned with images of Sydney, koalas, and the national flag but has no other connection with Australia. The online casino is physically located in the Netherlands Antilles and marketed

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[60] Gerd Alexander, "The U.S. on Tilt: Why the Unlawful Internet Gambling Enforcement Act is a Bad Bet," *Duke Law & Technology Review*, 5 (2008), at ¶9.

[61] See, for example, Financial Crimes Enforcement Network, *A Survey of Electronic Cash, Electronic Banking, and Internet Gaming*, U.S. Department of the Treasury, 2000, at p. 41; and see *Supra* at footnote 18 at p. 925.

[62] See *Supra* at footnote 18, at page 925.

[63] See *Id.*

by a Native American gambling corporation."[64] Because gambling websites are often based in countries far from their target customers, they can often avoid legal accountability, and because website creation is relatively simple, a customer can be easily confused about the licenses and controls held by a particular site.[65]

In addition to fraud by gambling sites themselves, employees or executives of sites may initiate fraud at the individual level without the knowledge of the organization as a whole. In September 2007, players at the poker website Absolute Poker initiated their own investigation into apparent cheating by a player in a tournament. The investigation revealed that a co-owner of the company and a former director of operations had acted in concert to cheat players of amounts between $500,000 and $1 million.[66] Another poker website, UltimateBet, was rocked by a cheating scandal in early 2008 triggered by concerns about one online player who could apparently see other players' hole cards during play. Investigation revealed that from January 2005 to December 2007, former employees of the company, operating from outside, had exploited security vulnerabilities in the site's software of which only they were aware.[67]

Since the enactment of the UIGEA, U.S. residents no longer have access to large gambling sites operated by publicly-traded companies; instead, U.S. gamblers look to less transparent offshore site operators that may be more likely to engage in fraud or other deceitful practices.[68] Also, given the current absence of regulatory oversight in the United States, U.S. gamblers have little or no recourse to authorities when site operators defraud them.[69]

The extent of fraud by site operators is not well documented, but cases have been recorded. A 2000 report by the Financial Crimes Enforcement Network of the U.S. Department of the Treasury claims that "[t]here is, in fact, a substantial record of shadow websites collecting...deposits for a period of time and then disappearing, in the process destroying

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64 Roger Clarke and Gillian Dempsey, "The Feasibility of Regulating Gambling on the Internet," *Managerial and Decision Economics,* 22 (2001): 125–132, at p. 128.

65 See *Id.*

66 Russell Goldman, "Online Poker Players Expose Alleged Fraud," *ABC News,* October 19, 2007. http://abcnews.go.com/print?id=3752500 (last accessed on July 24, 2009)

67 UltimateBet.com, *UltimateBet Issues Statement Regarding Unfair Play,* May 29, 2008. http://www.ultimatebet.com/poker-news/2008/may/NioNio-Findings (last accessed on July 24, 2009). Also see UltimateBet.com, *Status Update on NioNio Investigation,* July 8, 2008, http://www.ultimatebet.com/poker-news/2008/july/Investigation-Status-Update (last accessed on July 24, 2009).

68 As noted in an August 21, 2009 interview with Andrew Fritchie, General Counsel of PartyGaming PLC, U.S. customers are forced to use privately-held sites, which are generally perceived as less reputable.

69 See *Supra* at footnote 18 at p. 926. Also see *Supra* at footnote 60 at ¶¶14–15. Also see Christopher Grohman, "Reconsidering Regulation: A Historical View of the Legality of Internet Poker and Discussion of the Internet Gambling Ban of 2006," *Journal of Legal Technology Risk Management,* 1, No. 1 (Fall 2006): 34–74, at p. 62–63.

consumer confidence."[70] In a 2006 survey, the American Gaming Association reported that 55% of respondents "agree[d] at least somewhat that online casinos find ways to cheat players."[71] The website *GamesandCasino.com* maintains and publishes a long "blacklist" of websites that cheat, defraud, or otherwise manipulate their users.[72] Finally, in a 2007 survey of Nevadans conducted by the International Gaming Institute at the University of Nevada, Las Vegas (UNLV), 66.9% of respondents (who were not necessarily gamblers) claimed to have "strong doubts about the integrity of online gambling as it pertain[s] to the ability to cheat the gambler."[73] The survey also includes various anecdotes from respondents about cheating by site operators.[74]

In addition to outright fraud by site operators, operators may become bankrupt or otherwise insolvent without engaging in questionable business practices. Without adequate financial protection, customers could lose their entire fund balance with the site.[75] As shown below, existing controls such as holding customers' funds in a trust account or establishing financial reserves can help mitigate against this business risk to customers.

2. Existing Controls in Other Jurisdictions

Most regulatory regimes address the issue of operator fraud. In the United States, a regulatory strategy could combine elements from other regimes and add unique safeguards. Below are descriptions of approaches taken to prevent operator fraud in other jurisdictions:

- The Gambling Control Commission of Alderney, a Channel Island, requires sites to have "provisions enabling the customer to address complaints and disputes to an independent body."[76]

- In the Isle of Man, site operators are required to maintain either financial reserves or a bond to ensure that players are paid their winnings.[77]

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[70] Financial Crimes Enforcement Network, *A Survey of Electronic Cash, Electronic Banking, and Internet Gaming,* U.S. Department of the Treasury, 2000, at p. 41.

[71] American Gaming Association, *State of the States: The AGA Survey of Casino Entertainment,* 2006, at p. 21, http://www.americangaming.org/assets/files/2006_Survey_for_Web.pdf (last accessed on July 23, 2009)

[72] GamesandCasino.com, *Blacklisted Casinos,* http://www.gamesandcasino.com/blacklist.htm (last accessed on September 10, 2009).

[73] See *Supra* at footnote 6 Bo Bernhard at p. 37–38.

[74] See *Id.* at p. 40–43.

[75] Noted in an August 27, 2009 interview with André Wilsenach, Chief Executive Officer of the Alderney Gambling Control Commission.

[76] See *Supra* at footnote 30 at p. 142–143.

[77] See *Supra* at footnote 31 at p. 124.

- Antigua's and Barbuda's regulations require a site operator to maintain "investments that have a market value...of not less than the aggregate amount of all its outstanding prizes and monies held on account for players."[78]

- The British Gambling Commission sets forth rules governing licensed gambling website operators, including one that requires that licensees (1) inform customers as to whether their funds are protected in the event of insolvency and (2) "be able to provide evidence to the [U.K. Gambling] Commission, if required, showing how they satisfied themselves that their terms are not unfair."[79] The U.K. Department of Culture, Media and Sport (the sponsor of the Gambling Commission) publishes the "White List," a list of nations hosting online gambling whose licensees are legally permitted to advertise in the U.K, although the list is currently in a state of suspension.[80]

- Tasmania's regulator sets technical standards and uses independent accredited testers to verify compliance before approving new software, and for some types of operations also requires that players funds be held in a trust for the protection of players.[81]

- Gibraltar's regulator requires licensees to have strong internal controls and also requires independent testing of gambling software to ensure integrity.[82]

Although the regulatory schemes described above include provisions to prevent fraud, effective regulation must include strong penalties for noncompliance and safeguards that protect customers in the event of fraud or wrongdoing. They also should mandate ordinary but rigorous due diligence by regulators and owners, including background checks on owners, operators, and

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[78] Antigua and Barbuda – Directorate of Offshore Gaming, "Interactive Gaming and Interactive Wagering Regulations," at §184(a).
http://www.antiguagaming.gov.ag/files/Antigua_and_Barbuda_Gaming_Regulations-Final.pdf
(last accessed July 23, 2009)

[79] See *Supra* at footnote 33 at p. 14.

[80] Jamie Wiebe *et al., Problem Gambling Prevalence Research: A Critical Overview*, report to the Canadian Gaming Association, December 2007, at p. 17,
http://canadiangamingassociation.com/media_uploads/pdf/78.pdf
(last accessed on July 11, 2009). Also noted in interviews with Matthew Hill, Director of Strategy, Research and Analysis at the British Gambling Commission, Paul Morris, Policy Development Manager at the British Gambling Commission, and Peter Collins, Professor of Public Policy Studies and Director of the Center for the Study of Gambling at the University of Salford (U.K.).

[81] Noted in an August 5, 2009 interview with Glenn Gibson, Manager of Technical and Systems Audit at the Tasmanian Gaming Commission, and Damien Jarvis, Assistant Director of the Liquor and Gaming Branch of the Tasmania Department of Treasury and Finance (Australia).

[82] See *Supra* at footnote 32 at p. 13 and 21.

all staff in key positions. The regulatory regime could also give aggrieved consumers the ability to bring civil lawsuits and other rights of action against the site.

3. Relevant Technologies for Risk Mitigation

An effective regulatory regime must combine strong and competent oversight with an effective method for lodging complaints with the regulator or law enforcement agencies. In the examples of cheating mentioned above, it was only after private investigations by players that the sites themselves and the regulator responded.[83] The Kahnawake Gaming Commission, the regulator for both sites noted above, ordered Absolute Poker to institute compliance programs and subject itself to random audits; it also fined the site $500,000.[84] Similarly, the Commission ordered UltimateBet to refund any money owed to players who were victims of cheating, modified UltimateBet's control system, and fined the site $1.5 million.[85]

Another potential risk-mitigating factor within a regulatory regime is the use of *Mutual Recognition Agreements* (MRAs), which are arrangements between nations to recognize each other's regulatory standards and controls in a particular area of commerce.[86] Much as the United Kingdom's "White List" permits or denies advertising on the basis of the quality of a jurisdiction's regulatory structure, an MRA could be used as a filter for permitted advertising, for referrals between sites, and even as a way of selectively retaining prohibitions on foreign sites on the basis of quality and integrity rather than the simple fact that they are foreign.

Although both monetary sanctions and regulatory oversight are key to effective regulation, technology offers methods to prevent cheating over and above what is available to land- and river-based casinos. PartyGaming Plc is a publicly-traded Internet gambling company regulated in Gibraltar, and its PartyPoker affiliate holds about an 8% share of the world's market for online poker.[87] PartyGaming's games and its random number generator are tested by iTech Labs, an independent gaming device tester. It is also a member of the European Gaming & Betting Association and of eCOGRA, both of which publish standards for gaming operators.[88] 888.com,

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[83] Gilbert M. Gaul, "Players Gamble on Honesty, Security of Internet Betting," *The Washington Post,* November 30, 2008, p. A12.

[84] Kahnawake Gaming Commission, *In the Matter of Absolute Poker – Investigation regarding Complaints of Cheating,* January 11, 2008. http://www.kahnawake.com/gamingcommission/KGC-AP-0111.pdf (last accessed on July 24, 2009), at p. 4.

[85] Kahnawake Gaming Commission, Kahnawake Gaming Commission Imposes Sanctions on Ultimate Bet with Regard to Cheating Incidents, September 29, 2008, http://www.kahnawake.com/gamingcommission/kgc092908.pdf (last accessed on July 24, 2009).

[86] See Public Citizen, Mutual Recognition Agreements (MRAs), http://www.citizen.org/trade/harmonization/MRA/ (last accessed on August 10, 2009).

[87] As noted in an August 21, 2009 interview with Andrew Fritchie, General Counsel of PartyGaming Plc. Also see http://www.partygaming.com/prty/en/ourgames/overview/poker (last accessed on September 10, 2009).

[88] See http://www.partypoker.com/about_us/ (last accessed on September 10, 2009).

another publicly traded gambling site based in Gibraltar, also uses iTech Labs for verification and is a member of eCOGRA and the Interactive Gaming Council, an online gambling trade group.[89] Betfair, an Internet betting exchange based in the United Kingdom, is a member of the Independent Betting Adjudication Service, a third-party adjudicator for gambling disputes.[90]

4. Conclusion

As demonstrated above, the most effective system of regulation to combat site operator fraud combines strict enforcement with cooperation by the site operators themselves. Reputable operators with brands to protect could not afford to risk damage to their reputations, loss of their licenses, or regulatory sanctions. However, this incentive is not perfect, and the regulator must be fully equipped to detect and punish site operator fraud. Regulations may be similar to those that apply in the bricks-and-mortar industry. We expect that the online gambling industry will support a supervisory approach that includes regulatory monitoring and sanctions to help promote and maintain an industry reputation for integrity.

C. Cheating or Defrauding of Players by Other Players

As discussed previously, both Absolute Poker and UltimateBet, two popular online poker websites, were rocked by accusations of cheating in 2007 and 2008.[91] The cheaters were players on the site who had acted in concert with employees of the gambling website. These and other high-profile examples demonstrate the potential for cheating online and the basis for fear among online gamblers of being defrauded by other players. However, a system of regulation promises to rein in such fraudulent activity.

1. The Issue of Players Being Defrauded by Other Players

U.S. gamblers currently lack any effective means to seek remedy from other players for fraud. Because players in the United States engage in online gambling outside of legal and regulatory safeguards, they are unlikely to complain to authorities about cheating experienced on a site: "Individual players are unlikely to volunteer information that would reveal that they have gambled online....Users who doubt the legality of their own actions are unlikely to snitch."[92]

Although the extent of player cheating and fraud is not well documented, it is a common concern for online players.[93] A 2008 study of Swedish online poker players revealed that one of their

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[89] See http://www.888.com/ (last accessed on September 10, 2009).

[90] See http://content.betfair.com/aboutus/?product=exchange&brand=betfair&region=GBR&locale=en (last accessed on September 10, 2009).

[91] See *Supra* at footnote 6 Bo Bernhard.

[92] See *Supra* at footnote 18 at p. 926.

[93] John McMullan and Aunshul Rege, *Cheating and Cybercrimes @ Gambling Sites.com,* presentation to the Alberta Gambling Research Institute Annual Conference, March 2009, slide 2.

biggest concerns was being cheated by other players.[94] In a 2006 survey, the American Gaming Association reported that 46% of online gamblers believed that other players find ways to cheat.[95] Finally, the aforementioned 2007 UNLV survey revealed that 63% of respondents were "not at all confident" that other players could not cheat them.[96] The survey also includes anecdotal evidence from respondents about cheating by players, although evidence on the extent of cheating is generally mixed.[97]

Cheating by players can take various forms:

- *Poker bots* are automated programs that can reportedly play poker at the level of a professional tournament player, using a decision engine utilizing advanced neural network technology.[98] These bots, such as PokerSmoke, can memorize play styles, recognize betting patterns, and calculate odds, potentially giving those who use them a distinct edge over other players.[99]

- A simpler form of cheating involves *collusion* on online poker tables, in which two or more players work together to share information to gain an unfair advantage over unsuspecting players.[100]

- Another form is *multitabling*, in which a person uses multiple accounts to enter a tournament as two or more different players and garners information in a similar way to collusion; this particular type of cheating is clearly not possible in an offline environment.[101]

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[94] Richard T. A. Wood and Mark D. Griffiths, "Why Swedish People Play Online Poker and Factors that Can Increase or Decrease Trust in Poker Web Sites: A Qualitative Investigation," *Journal of Gambling Issues,* 21 (July 2008): 80–97 at p. 90.

[95] See *Supra* at footnote 71.

[96] See *Supra* at footnote 6 Bo Bernhard at p. 38-39.

[97] See *Id.* at p. 40–43.

[98] Mike Brunker, "Poker 'Bots' Raking Online Pots?" MSNBC.com, September 21, 2004. http://www.msnbc.msn.com/id/6002298/print/1/displaymode/1098/ (last accessed on July 25, 2009). Also see *Supra* at footnote 93, slide 7.

[99] See *Id.*

[100] Bill Rini, The Definitive Guide to Online Poker Cheating, April 16, 2008. http://www.billrini.com/2008/04/16/the-definitive-guide-to-online-poker-cheating/ (last accessed on July 25, 2009).

[101] See *Supra* at footnote 69 Christopher Grohman at p. 63.

- The Absolute Poker and UltimateBet cheating cases, mentioned previously, involved players using "superuser" accounts that allowed them to see other players' hole cards in online poker, making them essentially unbeatable.[102]

- Hackers can potentially alter sites to ensure winnings or swing odds in their favor, as in a case in 2001 in which hackers rigged games on two gambling sites and managed to win $1.9 million in just a few hours.[103]

2. Existing Controls in Other Jurisdictions

Although the UltimateBet and Absolute Poker cheating scandals involved participation from insiders at the affected poker sites, it is important to note that both episodes were revealed through the investigative work of other players on the sites.[104] Although players have an incentive to reveal fraud by other players, some level of regulatory oversight and potential law enforcement involvement is needed to ensure that the site operator takes complaints lodged against players seriously. The regulator could mediate disputes between the site operator and players, independently monitor sites for cheating, and work with site operators to help them prevent cheating. The following are examples of ways that other jurisdictions combat player fraud:

- The British Gambling Commission requires that licensees "put into effect a written procedure for handling customer complaints and disputes" and also have arrangements for disputes to be referred to an independent third party if they are not resolved to the customer's satisfaction.[105]

- Tasmania's Gaming Commission requires that customer complaints can be made to it and has the power to levy fines and revoke sites' licenses as well as settle customer disputes. It also has access to the systems of its licensees.[106]

- Gibraltar also requires that sites have a formal system to handle customer complaints.[107]

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[102] See *Supra* at footnote 83.

[103] RSe Consulting, *A Literature Review and Survey of Statistical Sources on Remote Gambling*, October 2006, http://www.culture.gov.uk/images/publications/RemoteGambling_RSeReport.pdf (last accessed on July 25, 2009), at p. 20.

[104] See *Supra* at footnote 66.

[105] See *Supra* at footnote 33 at p. 15.

[106] Noted in an August 5, 2009 interview with Glenn Gibson, Manager of Technical and Systems Audit at the Tasmanian Gaming Commission, and Damien Jarvis, Assistant Director of the Liquor and Gaming Branch of the Tasmania Department of Treasury and Finance (Australia).

[107] See *Supra* at footnote 32 at p. 17–18.

- Sites' own terms of service often explicitly preclude certain potentially fraudulent behaviors.[108]

3. Relevant Technologies for Risk Mitigation

As with the issue of fraud by site operators, technology offers solutions to help combat fraud by players. The first line of defense is analysis by other players, who may be in a position to observe aberrant behavior, investigate it, and lodge a complaint with the site operator. However, players may have a hard time detecting cheating as it is occurring, because of the speed and style of online gambling. Site operators, on the other hand, can store large volumes of data on gambling transactions and present them in an easy-to-analyze format, unlike operators of land- and river-based casinos. Analysis of hand histories in poker, for example, may allow operators to identify collusion, the use of poker bots, and other unusual gameplay activities.

The regulator may require that the site operator provide these data at regular intervals for analysis in the event that an inquiry or red flag is triggered. It might also mandate implementation of pattern recognition software to scan routinely for anomalous betting patterns. Finally, the regulator could provide sites' data history to third-party verification companies that conduct their own analyses, including checks for randomness, collusion, and other suspicious patterns.

Clearly, players want to know that their online gambling experience is fair. According to the survey of Swedish poker players, "[t]he response of the operator to [issues of cheating] played a major role in whether or not they were trusted in the long term."[109] Gambling sites, especially reputable ones, have an incentive to control cheating to maintain their good reputation. However, although the revelation of cheating can itself be damaging to a site's reputation, the site can often continue to make money as usual even while players are being defrauded.[110]

A regulatory structure, therefore, must balance these contradictory incentives. It must combine strong internal controls by site operators with strict regulatory oversight, perhaps by requiring that mandatory hand history reports or other similar data be submitted to the regulator or through the use of regulator-verified poker bot detection software.[111] Also, the regulator could maintain a

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[108] For example, multitabling and collusion are considered cheating according to poker room rules. See Christopher Grohman, "Reconsidering Regulation: A Historical View of the Legality of Internet Poker and Discussion of the Internet Gambling Ban of 2006," *Journal of Legal Technology Risk Management,* 1, No. 1 (Fall 2006): 34–74, at p. 63; and Bill Rini, *The Definitive Guide to Online Poker Cheating,* April 16, 2008, http://www.billrini.com/2008/04/16/the-definitive-guide-to-online-poker-cheating/ (last accessed on July 25, 2009).

[109] See *Supra* at footnote 94 at p. 90.

[110] As in the UltimateBet and Absolute Poker scandals. Also see *Supra* at footnote 98 Mike Brunker.

[111] For example, bwin has dedicated staff that deploy "[s]tate-of-the art systems [that] are used to analyze hands and to detect chip dumping, collusion or the use of poker bots." From an August 13, 2009 correspondence with Katharina Riedl of bwin (Austria).

database of known cheaters, and sites' own verification processes could help exclude such gamblers at the point of registration. This strategy also has the benefit of preventing cheaters from skipping easily from one website to another. Regulation could also grant players the right to bring a civil claim against a gambling site for not preventing cheating by its users, providing additional incentives for sites to implement effective controls.[112]

4. Conclusion

Site operators, players, and regulators share an interest in detecting and protecting against player fraud. This naturally leads to cooperative regulatory oversight. Such oversight would recognize the inherent opportunities in the online environment for comprehensive data storage, allowing a level of analysis to detect fraud that is unavailable in the bricks-and-mortar environment. Consequently, legal, regulated online gambling should provide greater protections against player fraud than does the current environment.

D. Involvement of Organized Crime in Gambling Operations

Casino gambling, in which nearly all transactions are in cash, is particularly susceptible to *skimming,* in which profits are removed by the owners or other insiders before being declared, as well as money laundering.[113] Moreover, its illegal status in many jurisdictions implies that those who offer gambling services in those jurisdictions are, by definition, law breakers. Online gambling, however, presents different challenges and opportunities than does its bricks-and-mortar counterpart. On the one hand, identities can be easier to conceal online, transactions can occur far from where regulators are located, and members of collaborating crime networks can be located in far-flung locations.[114] On the other hand, online transactions are easier to aggregate and analyze, providing richer opportunities to detect the operations of organized crime groups.[115] The lack of cash transactions makes auditing and the detection of skimming easier than in a bricks-and-mortar environment.

1. The Issue of Involvement of Organized Crime in Online Gambling

Organized crime has been largely eliminated from bricks-and-mortar casinos.[116] In Nevada, for example, the regulatory regime has largely eliminated criminals from the ownership of

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[112] See *Supra* at footnote 69 at p. 67–68.

[113] Jay Albanese, "Casino Gambling and Organized Crime: More Than Reshuffling the Deck," in *Contemporary Issues in Organized Crime*, edited by Jay Albanese (Monsey, New York: Criminal Justice Press, 1995). Also see Kevin B. Kinnee, *Practical Gambling Investigation Techniques* (New York: Elsevier, 1992), at p. 3–5.

[114] See *Supra* at footnote 64 at p. 128.

[115] As noted in an August 5, 2009 interview with Phill Brear, Head of Gambling Regulation at the Gibraltar Regulatory Authority, online gambling allows a perfect audit trail to be kept.

[116] Jay Albanese, "Casino Gambling and Organized Crime: More Than Reshuffling the Deck," in *Contemporary Issues in Organized Crime*, edited by Jay Albanese (Monsey, New York: Criminal Justice Press, 1995), at p. 4–5.

casinos.[117] Another factor in the Nevada transformation has been the introduction of large, publicly held companies as casino owners, which cannot afford associations with organized crime.[118] The same effect may hold true for online gambling enterprises, some of which are already publicly traded.

In the past, when organized crime had been involved in bricks-and-mortar casinos, it traditionally controlled the gambling organization itself, usually behind the presence of a front man in cases of legal gambling establishments.[119] Similarly, gambling websites could be controlled by organized syndicates. Finally, as discussed more fully in Section F, criminals can use online gambling for the purpose of money laundering.

2. Existing Controls in Other Jurisdictions

In bricks-and-mortar casinos, background checks and verification for site operators and employees are standard procedures across all jurisdictions in the United States. In New Jersey, those who wish to operate a casino are required to obtain a casino license.[120] Applicants must prove their financial stability and integrity; the financial integrity of their investors or backers; their good character, honesty, and integrity; and their business ability and casino experience. They must also submit to a criminal background check.[121] Each casino employee must obtain a valid casino employee license, which involves providing his or her name, address, and fingerprints; and to consent to a criminal background check, which the New Jersey State Police performs at the applicant's expense.[122] The State Police are also obliged to notify the New Jersey Division of Gaming Enforcement if a license holder is arrested at any point after the initial background check.[123] To eliminate small gambling establishments, casinos in Atlantic City are required to have a minimum of 500 hotel rooms, and all games are tightly regulated and controlled. Also, those that provide a certain amount of ancillary services (such as cleaning, food, construction, and security) to casinos must be licensed and submit to background checks.[124]

Similarly, Nevada laws impose on operators of gambling establishments licensing requirements that require that the applicant (1) be a person of good character, honesty, and integrity; (2) be a person whose prior reputation and criminal record do not pose a threat to the public interest of

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[117] See *Id.* at p. 4.

[118] See *Id.* at p. 7–8.

[119] See *Id.* at p. 3.

[120] New Jersey Permanent Statutes, Title 5, Amusements, Public Exhibitions and Meetings, 5:12-82: Casino license – applicant eligibility.

[121] *Id.* at 5:12-84: Casino license – applicant requirements.

[122] See *Id.*

[123] See *Id.*

[124] See *Supra* at footnote 116 at p. 10.

the state or of its gambling regulations; and (3) have sufficient financial resources and business acumen to operate the establishment.[125] Employees in general are required to register as gaming employees, to submit fingerprints, and to be subjected to an FBI background check. The Nevada Gaming Control Board is empowered to object to any applicant for "any cause deemed reasonable."[126]

Many jurisdictions across the world that license online gambling include provisions for checks on the site's operators. The following are examples of such provisions:

- In the Isle of Man, the Gambling Control Commission has the duty "[t]o investigate the character and financial status of persons behind online gambling operations."[127]

- The U.K. Gambling Act of 2005 allows the Gambling Commission, when issuing a license, to consider "the integrity of the applicant or of a person relevant to the application" and to refuse a license to a person convicted of a "relevant offence."[128]

- Alderney's Gambling Control Commission has the duty to "determine whether an applicant is 'fit and proper' to hold a license. Investigations can include interviews with key individuals, and the Commissioners may also require their own meeting with representatives of the applicant before deciding whether to grant a license."[129] The regulator also requires that business associates of site operators and software providers hold licenses.[130]

- Tasmania's Gaming Commission conducts thorough probity investigations on site operators, including credit checks and fingerprint background checks; the checks are also required for employees of the gambling website.[131]

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[125] Nevada Revised Statutes, Chapter 463.170.

[126] *Id.* at Chapter 463.335.

[127] See *Supra* at footnote 31 at p. 128.

[128] Gambling Act, 2005 Chapter 19 (Eng.), at §§70–71, http://www.opsi.gov.uk/acts/acts2005/pdf/ukpga_20050019_en.pdf (last accessed on September 11, 2009).

[129] See *Supra* at footnote 30 at p. 140–141.

[130] Noted in an August 27, 2009 interview with André Wilsenach, Chief Executive Officer of the Alderney Gambling Control Commission.

[131] As noted in an August 5, 2009 interview with Glenn Gibson, Manager of Technical and Systems Audit at the Tasmanian Gaming Commission, and Damien Jarvis, Assistant Director of the Liquor and Gaming Branch of the Tasmania Department of Treasury and Finance (Australia).

- The regulator in Australia's Northern Territory checks the reputation of operators and their associates and proposed managers, as well as operators' financial background, resources, and business ability.[132]

- Gibraltar's Gambling Act 2005 prevents the licensing authority from granting a license to a person who is not "fit and proper" or if granting the license would be against the public interest. The Gambling Act allows the regulator to take into account the licensee's character, honesty, and integrity, as well as his or her reputation, business plan, experience, and other factors.[133]

As can be seen, each jurisdiction considers the exclusion of criminals to be essential to maintaining an effective regulatory regime.

3. Relevant Technologies for Risk Mitigation

Any regulatory regime that wishes to exclude criminals must focus on erecting sufficiently high barriers to entry.[134] Simple techniques such as requiring background checks, interviews, and letters of reference can familiarize the regulator with its license applicants and allow it to make a more informed decision on whether to grant a license. This level of investigation of site operators could extend to owners, beneficiaries, business associates, managers, and security personnel.[135] Rigorous vetting of new applicants can combine with ongoing compliance checks to ensure that once a license is granted, it is not clandestinely transferred to criminal control.

4. Conclusion

Although criminal control of gambling websites is a possibility, strict regulation would exclude unwanted site operators. It is unlikely that criminals would subject themselves to strict regulatory checks and demanding admission standards. Instead, they may attempt to operate gambling sites without licenses. Regulators can work to educate consumers about the dangers associated with unlicensed websites, and steer them toward licensed, regulated sites which offer protection against criminal activity. At the risk of losing their licenses, legitimate operators would have a strong interest in avoiding ineligible associates as is the case with bricks-and-mortar casinos. We would expect legitimate, licensed sites to be receptive to a fair degree of scrutiny because such scrutiny would enhance the reputation of the industry.

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[132] As noted in an August 31, 2009, correspondence with John Sealy, Manager of Information Systems and Technology Services at the Licensing, Regulation and Alcohol Strategy division of the Northern Territory Department of Justice (Australia).

[133] Gibraltar Gambling Act 2005, Schedule 1, at §3, http://www.gra.gi/sites/gambling/downloads/42/gambling%20ord%202005.pdf (last accessed on August 6, 2009).

[134] See *Supra* at footnote 30 at p. 140.

[135] See *Id.*

E. Money Laundering by Players

A major concern of law-enforcement authorities is money laundering facilitated by online gambling.[136] However, many financial analysts believe that the risks of money laundering in online gambling is low because electronic transactions are closely monitored and recorded.[137] A combination of anti-money-laundering regulations, currently in place for bricks-and-mortar casinos as well as other financial institutions, and the use of technology would provide the online gambling environment with better opportunities for detecting money laundering by players than those available in land- and river-based casinos.

1. The Issue of Money Laundering by Players

Money laundering is a process through which proceeds derived from illegal activity are legitimized.[138] Money laundering is typically accomplished in three stages: (1) the placement stage, (2) the layering stage, and (3) the integration stage.[139] The *placement* stage is defined as the first entry of illegal money into financial institutions or the retail economy. The *layering* stage consists of activities meant to hide the trail of money, generally involving the transfer of money among multiple entities. The final stage, the *integration* stage, is when the illegal funds are reintroduced into the economy to appear as though they were legitimate. It is difficult for law enforcement to detect this reintroduction of illicit funds into the economy without an audit trail established during the first two stages of the laundering process.[140]

The following (hypothetical) example demonstrates how online gambling websites can be used to launder money: A customer could establish an Internet gambling account under a false name and use illicit funds to conduct a minimal amount of betting. After a few losses, the customer could request repayment from the Internet gambling site and claim them as winnings, thereby creating a legitimate source for the remaining funds.[141]

The U.S. Department of Justice is concerned that online gambling offers criminals an easy vehicle for money laundering because of its anonymous nature, use of encryption, volume,

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[136] Government Accountability Office, *Internet Gambling: An Overview of the Issues,* GAO-03-89, December 2002, at p. 34–37.

[137] See *Id,* at p. 37–38.

[138] Mark D. Schopper, "Internet Gambling, Electronic Cash & Money Laundering: The Unintended Consequences of a Monetary Control Scheme," *Chapman Law Review,* 5, No. 1 (2002): 303-330.

[139] Financial Crimes Enforcement Network, *The SAR Activity Review – Trends, Tips & Issues,* May 13, 2008, http://www.fincen.gov/news_room/rp/files/sar_tti_13.pdf (last accessed on August 5, 2009).

[140] See *Supra* at footnote 138.

[141] Testimony of John G. Malcolm Before the Committee on Banking, Housing, and Urban Affairs, March 18, 2003, http://www.usdoj.gov/criminal/cybercrime/malcolmTestimony318.htm (last accessed on September 11, 2009). Also see *Supra* at footnote 136.

speed, international reach, and offshore locations.[142] In his testimony before Congress in 2003, Deputy Assistant Attorney General John G. Malcolm noted that e-casinos are an excellent vehicle for money laundering because in addition to using the gambling services offered to hide or transfer money, online gambling websites offer a wide variety of financial services to their customers, including credit accounts, fund transmittal services, check cashing services, and currency exchange services.[143]

There is little documentation by which to gauge the extent of actual money laundering in online gambling. In 2002, the U.S. General Accounting Office (GAO) examined the vulnerability of online gambling to money laundering and concluded that the "views on the vulnerability of Internet gambling to money laundering are mixed."[144] Its report provides only hypothetical examples of how online gambling sites could be used to launder money and does not describe any actual cases. A 2005 report prepared for the Interactive Gaming Council in Canada calls evidence of the existence of money laundering in online gambling "scant" and claims that the Internet Crime Complaint Center had never logged a complaint of money laundering through gambling sites.[145] It goes on to claim that "Internet gaming does not, in and of itself, contribute to money laundering. Rather, it is the financial transactions that are used to move money on the Internet that may be susceptible to money laundering."[146]

One can understand money laundering patterns that might occur in online gambling by extrapolating from the patterns of money laundering seen in bricks-and-mortar casinos. Various betting patterns associated with money laundering in bricks-and-mortar casinos have been identified, including the use of hedged bets by colluding players, light betting or *minimal play* (i.e., using bets that are small relative to the size of deposits and withdrawals), splitting transactions up into units smaller than reporting thresholds, splitting transactions across reporting "days," and pressuring staff to not comply with their reporting obligations.[147]

A problem related to money laundering is that of terrorist financing, in which funds that are intended for terrorist groups are moved through the financial system in an apparently legitimate way. Effective anti-money-laundering provisions must specifically address the risks of terrorist financing, although many techniques to combat money laundering are also effective against

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[142] See *Id.* John G. Malcolm.

[143] See *Id.*

[144] See *Id.*

[145] NFC Global, "Internet Gaming & Money Laundering: Measuring the Scope, Assessing the Risks," Prepared for the Interactive Gaming Council, Vancouver, British Columbia, Canada, August 2005, at p. 4.

[146] See *Id.*

[147] American Gaming Association, Suspicious Activity Reporting Policy, http://www.americangaming.org/assets/files/SARC_Policy_(6).pdf (last accessed on July 28, 2009).

terrorist financing.[148] The only known case of money laundering through gambling sites was related to terrorist financing: in 2007, a suspected terrorist named Al-Daour used stolen credit cards to deposit funds at 43 different gambling sites and then withdrew the winnings to various online bank accounts.[149]

2. Existing Controls in Other Jurisdictions

Congress has enacted legislation to detect money laundering. Under the Bank Secrecy Act (BSA) of 1970, all U.S. financial institutions, including banks, credit unions, securities firms, and casinos, are required to report large currency transactions and suspicious activities.[150] The Financial Crimes Enforcement Network (FinCEN) administers these regulations. The casino gambling industry has been covered by the BSA since 1985, and FinCEN has specific regulations that pertain to casino gaming. The BSA requires the reporting of any currency transactions exceeding $10,000 in a single gaming day on a Currency Transaction Report (CTR).[151] Because money launderers can structure transactions such that they never result in a CTR being filed, all land- and river-based casinos are also required to file Suspicious Activity Reports (SARs). Casinos have to file SARs if they know, suspect, or have reason to suspect that a transaction involving $5,000 or more meets certain criteria, including involvement of illicit funds, intention to avoid or prevent proper reporting, exhibiting of abnormal behavior, or use of the casino to facilitate criminal activity.[152]

The leading online gambling jurisdictions have created regulatory structures that resemble traditional regulation for land- and river-based casinos in the United States. These jurisdictions require some form of anti-money-laundering monitoring, ranging from restricting customers to a single account to identifying and reporting suspicious transactions or players' abnormal betting patterns.[153]

In addition to regulation that combats money laundering in its financial services sector, the Isle of Man has put in place the Anti-Money Laundering Code to prevent money laundering through gambling websites.[154] Operators are required to comply with strict anti-money-laundering

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[148] MHA Consulting, *The Threat of Money Laundering and Terrorist Financing through the Online Gambling Industry,* report prepared for the Remote Gambling Association, June 2009, at p. 6–8.

[149] See *Id* at p. 31.

[150] American Gaming Association, *Money Laundering,* AGA Fact Sheet, http://www.americangaming.org/Industry/factsheets/issues_detail.cfv?id=3 (last accessed on September 11, 2009).

[151] See *Id.*

[152] See *Id.*

[153] David O. Stewart, *An Analysis of Internet Gambling and Its Policy Implications,* AGA 10th Anniversary White Paper Series on Internet Gambling, 2006.

[154] See *Supra* at footnote 31 at p. 126–127.

procedures, which include identification of prospective customers, evidence of identity, changes to patterns of transactions, record keeping, records of transactions, retention of records, reporting suspicious transactions, and training.[155] In addition, site operators are legally required to report any suspicious transactions to the Financial Crime Unit (FCU). Specialized software can flag these transactions.

Similarly, to combat money laundering, Alderney requires operators of online gambling websites to implement business risk assessments, customer due diligence procedures, monitoring of transactions and other activity, suspicious activity reporting procedures, employee screening and training procedures, and record-keeping procedures.[156]

3. Relevant Technologies for Risk Mitigation

An anti-money-laundering regulatory regime for online gambling may be modeled on the current regulatory structure for traditional bricks-and-mortar casinos. A regulatory framework for online gambling may leverage the technological environment for online gambling and require (1) preservation of an audit trail of transactions for analysis by federal authorities; (2) implementation of customer identification standards; (3) controls to prevent anonymous, structured transactions; (4) establishment of an anti-money-laundering compliance program; (5) training for all appropriate personnel; and (6) compliance with all relevant BSA requirements.[157]

The IGC notes that "online gambling, with a combination of regulatory oversight and use of technology—while facing the same threats as real-world gambling facilities—is in a better position to address these risks."[158] For example, all electronic fund transfers can be electronically recorded, thus providing a detailed and automatic transaction trail not currently available in land- and river-based casinos.[159]

The IGC further notes that a basic requirement to combat money laundering is to "know your customer." Stringent player registrations and ongoing verification processes combined with appropriate regulatory oversight and banking regulations help fulfill this requirement.[160] Italy's regulatory regime, for example, requires a potential customer to submit a signed contract along with a copy of his or her identification.[161] Tasmania requires strong identity verification

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[155] See *Id.*

[156] See Alderney Gambling Control Commission, *The Alderney eGambling Regulations,* 2006., http://www.gamblingcontrol.org/userfiles/file/97.pdf (last accessed on August 19, 2009), at Schedule 6, Part VI.

[157] See *Id.*

[158] Interactive Gaming Council, "Online Gambling Sites Less Susceptible to Money Laundering Than Real-World Counterparts," *Winner Online,* September 24, 2002, http://www.winneronline.com/articles/september2002/fatf.htm (last accessed on September 11, 2009).

[159] See *Supra* at footnote 115.

[160] See *Supra* at footnote115.

[161] As noted in an August 13, 2009 correspondence with Katharina Riedl of bwin (Austria).

procedures to be in place on player accounts.[162] Moreover, technology can equip site operators with tools to scrutinize inconsistent player behavior, and then capture and report the transaction.[163]

Another essential anti-money-laundering measure noted by the IGC is to require that gamblers be paid any winnings in the same way in which the money was originally deposited.[164] This system allows an audit to track transfers of funds much more easily and removes the ability of launderers to use an account as a pass-through for funds.[165] Also, care must be taken when allowing transfers of funds between players, which could potentially be a conduit for money laundering. Alderney's money laundering guidance suggests that transferred funds be allowed only for gambling and not for withdrawal or that site operators undertake further due diligence on players involved in transfers.[166]

In addition to a system modeled on requirements for bricks-and-mortar gambling, a regulator can require the same procedures that are required of online merchants, banks, and payment providers. In Europe, online gambling operators have been bound by these requirements since 2003 under the Third European Money Laundering Directive.[167] U.S. licensed operators would also be bound by relevant anti-money-laundering requirements. Most nations are also subject to the recommendations of the Financial Action Task Force, an international body formed to combat money laundering and terrorist financing. Each nation may also have its own money laundering regulations, such as the United Kingdom's Money Laundering Regulations, which cover both financial and nonfinancial businesses.[168]

Although financial businesses are still subject to the most stringent regulation, all of these regulations use a risk-based approach, in which the level of scrutiny of transactions is commensurate with the risk of money laundering in those transactions.[169] The most important aspects of financial companies' risk mitigation involve three broad activities: (1) "know your customer" procedures, (2) monitoring for suspicious activity, and (3) procedures for reporting suspicious activity.[170] Identity verification can involve both paper and electronic identification,

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[162] As noted in an August 5, 2009 interview with Glenn Gibson, Manager of Technical and Systems Audit at the Tasmanian Gaming Commission, and Damien Jarvis, Assistant Director of the Liquor and Gaming Branch of the Tasmania Department of Treasury and Finance (Australia).

[163] See *Id.*

[164] See *Supra* at footnote 158.

[165] See *Supra* at footnote 148 at p. 26.

[166] *Id.* at p. 20.

[167] *Id.* at p. 1.

[168] Id.

[169] *Id.* at p. 2.

[170] *Id.* at p. 29–31.

and the level of additional identification required rises with the risk in the particular industry and transaction. Suspicious activity monitoring involves standard procedures that are designed to reveal signs of monitoring while retaining privacy protection. All suspicious activity must be reported to law enforcement, which takes over the investigation immediately. Suspicious activity reporting, as part of the regulations, is the responsibility of all company staff members, who must be trained in the signs of money laundering and be able to report their suspicions expeditiously. In the United Kingdom, not reporting suspected money laundering is a criminal offense with a maximum sentence of two years in prison.[171]

4. Conclusion

Players or groups of players acting in concert may attempt to use legitimate gambling operations for money laundering. To curb such activities, regulators could subject online gambling operators to anti-money-laundering regulations that are currently in place for bricks-and-mortar casinos and for online merchants, banks, and payment providers. The online environment provides better opportunities for detecting money laundering by players or player groups than do bricks-and-mortar casinos.

In an effective anti-money-laundering regime, site operators would be required to retain comprehensive data on all deposits, withdrawals, and betting transactions and to make these available to regulators for examination and analysis. Given complete data, most patterns related to money laundering (such as light betting or matched bets placed by collaborators) would be easier to detect than they are in a physical environment (where complete transaction histories are available only in the form of video recordings).[172] Software for detecting anomalies and suspicious behavior may be operated easily and routinely on digital databases by operators, regulators, or both.

The site operators' obligations with respect to their own detection of money laundering would form a part of their ordinary compliance obligations under such a licensing regime. Because of the absence of cash in online gambling transactions, the auditable record that is created, and the regulator-imposed reporting requirements for most transactions, it is likely that site operators can prevent money laundering by players and terrorist financing at least as effectively as can bricks-and-mortar casinos.[173] In contrast, the current prohibitions related to online gambling forces players to use unconventional forms of payment that leave harder-to-follow audit trails, and may therefore increase the risk of money laundering.

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[171] *Id.* at p. 23.

[172] As noted in an August 5, 2009 interview with Phill Brear, Head of Gambling Regulation at the Gibraltar Regulatory Authority.

[173] As noted in an August 3, 2009 interview with Paul Mathews, Former Senior Vice President of IGT Wagerworks.

F. Money Laundering by Site Operators

In addition to money laundering by players, there are concerns about money laundering by site operators.[174] The volume, speed, and international reach of Internet transactions, along with the offshore location of many Internet gambling sites, increase the potential for misuse of these sites by operators for laundering money. As such behavior would constitute criminal conduct by site operators, effective management of the problem involves regulatory restrictions designed to keep criminals out of the Internet gambling industry.

1. The Issue of Money Laundering by Site Operators

The GAO reported in 2002 that U.S. law-enforcement officials believed money launderers might develop Internet gambling sites for the sole purpose of laundering money.[175] GAO sited the possibility that a gambling site operator could design software to skim a percentage of customer deposits and cloak the transactions as gaming losses. In reality these deductions would serve as the operator's service fee for laundering illicit funds. An alternate scenario might involve a gambler transferring funds to the site operator or to a collaborator within the e-casino by continuing to play until he loses the requisite amount. Conversely, if the site operator wanted to transfer funds to a gambler, the games could be rigged so the gambler won.[176]

Two recent cases, involving NETeller and playwithal.com, highlight the possibility of online gambling operators using third-party conduits to engage in money laundering, concealing the true nature and purpose of financial transactions. In early 2007, the founders of NETeller, a popular third party payment processor based in the Isle of Man, were arrested and charged with laundering billions of dollars of Internet gambling proceeds.[177] In 2006, the Federal Bureau of Investigation (FBI) began investigating how NETeller processed payments and helped facilitate sports bets. NETeller used payment and shell companies to process Automatic Clearinghouse (ACH) transactions, thus hiding the nature of payments made to U.S. customers. To get money out of the United States, NETeller would have a payment service company receive funds on its behalf and transfer the funds to an account controlled by NETeller in Alberta, Canada.

In the case involving playwithal.com, a sports betting website, 27 people were charged with numerous counts, including money laundering.[178] The defendants were accused of laundering

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[174] General Accounting Office, *Internet Gambling: An Overview of the Issues,* GAO-03-89, December 2002, at p. 36.

[175] See *Id* at p. 37.

[176] Testimony of John G. Malcolm Before the Committee on Banking, Housing, and Urban Affairs, March 18, 2003, http://www.usdoj.gov/criminal/cybercrime/malcolmTestimony318.htm (last accessed on July 29, 2009).

[177] Verrinder, Matthew, *NETeller Ex-directors on Money Laundering*, January 16, 2007, http://www.reuters.com/article/internetNews/idUSN1622302920070116 (last accessed on September 11, 2009).

[178] Online Gambling Operations in Queens Busted, November 16, 2006, http://online.casinocity.com/article/online-gambling-operation-in-queens-busted-68919 (last accessed on September 11, 2009).

and stashing away millions of dollars using shell corporations and bank accounts in Central America, the Caribbean, Switzerland, and Hong Kong.

2. Existing Controls in Other Jurisdictions

The United States has already enacted strict regulations to detect and deter money laundering, and site operators should clearly be forced to comply. Control strategies for this risk thus focus on keeping organized crime, other criminals and criminal behavior out of the industry.[179] As for all the other concerns about criminal conduct by operators, regulators will set a high bar for initial qualification and conduct periodic reviews of key personnel and their associations. Other jurisdictions do this already. The Isle of Man, U.K., and Alderney assess the suitability of license applicants and require them to submit documentation to satisfy the enforcement authorities that they are persons of good character, honesty and integrity.[180] Operators in these jurisdictions are also required to provide comprehensive financial statements and internal accounting records for audit.[181]

In many U.S. states, background checks and employee verification are already standard procedure for bricks-and-mortar casinos. For example, in New Jersey and Nevada, to obtain a license, each casino employee must supply his or her name, address, fingerprints, and consent to a criminal background check.[182] Bricks-and-mortar casinos are also required to provide periodic financial reports at a level of detail and in formats specified by regulators.[183]

3. Relevant Technologies for Risk Mitigation

Effective strategies to combat money laundering by site operators involve frequent and comprehensive auditing, the application of pattern recognition to aggregated financial transaction data, and exclusion of criminals.

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[179] McCormick, Amanda, *Review of Online Gambling Literature*, British Columbia Center for Social Responsibility, 2007.

[180] Testimony of Mary Williams, in U.S. House of Representatives, Committee on Financial Services, *Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?* 110th Cong., 1st Session, June 8, 2007, p. 128. Also see *Supra* at footnote 128. Also see Testimony of André Wilsenach, in U.S. House of Representatives, Committee on Financial Services, *Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?* 110th Cong., 1st Session, June 8, 2007, at p. 140–141.

[181] Testimony of Mary Williams, in U.S. House of Representatives, Committee on Financial Services, *Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?* 110th Cong., 1st Session, June 8, 2007, at p. 126–127.

[182] New Jersey Permanent Statutes, Title 5, Amusements, Public Exhibitions and Meetings, 5:12-82: Casino license – applicant eligibility. Also see Nevada Revised Statutes, Chapter 463.335.

[183] See *Id* Nevada Revised Statutes at Chapter 463.156–159.

4. Conclusion

As with the prevention of fraud and any other criminal conduct by site operators, an effective regulatory regime would seek to bar criminals from entering the Internet gambling industry, and seek to detect and prevent linkages developing between site operators and criminal organizations. Regulators would also develop the capacity to search for laundering patterns among the betting transaction data, as well as among the external financial flows data for regulated sites. Regulators of the online gambling industry would also become natural partners for the broader law-enforcement community seeking to detect and prevent money laundering.

G. Violation of Jurisdictional Restrictions or Prohibitions

A key concern of some policymakers is the ability of regulated online gambling sites to adhere to various jurisdictional restrictions and prohibitions.[184] For example, with bricks-and-mortar casinos, some states have complete prohibitions (e.g., Utah) while others have legalized most forms of gambling (e.g., Nevada).[185] Add to this mix the numerous Native American tribal areas, and a complicated multilayered jurisdictional map emerges. This section does not comment on federalism or the appropriateness of various levels of jurisdictional control over online gambling. Rather, we look at the ability to ensure through federal regulation that restrictions and prohibitions imposed at various other jurisdictional levels continue to be respected.

1. The Issue of Violation of Jurisdictional Restrictions

A central issue in the debate over legalization of online gambling pertains to different jurisdictions' abilities to preclude gambling website operators from operating from, or serving customers within, specific states or territories.[186]

Federal laws, such as the Wire Act and the UIGEA, removed some aspects of states' ability to choose legalization and regulation.[187] On the one hand, the passage of the UIGEA in 2006

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[184] In October 2008, Governor Steve Beshear of Kentucky initiated a lawsuit against gambling sites serving customers in Kentucky; a court ordered 141 website domain names to be transferred to the state's control. The case was later overturned on appeal in January 2009 and is currently being appealed to the Kentucky Supreme Court. In April 2009, the state of Minnesota sent notice to 11 Internet service providers (ISPs) seeking to force them to block access to gambling sites for Minnesota residents. In June, the state rescinded its order. See *Poker News Daily,* "Minnesota Rescinds Internet Gambling Notices to ISPs after iMEGA Settlement," June 8, 2009, http://www.pokernewsdaily.com/minnesota-rescinds-internet-gambling-notices-to-isps-after-imega-settlement-2749/ (last accessed on August 10, 2009).

[185] American Gaming Association, *States with Gaming,* AGA Fact Sheet, http://www.americangaming.org/Industry/factsheets/general_info_detail.cfv?id=15 (last accessed on July 21, 2009).

[186] Kevin F. King, "Cutting Internet Gambling's Gordian Knot: Geolocation and Federalism on the Internet," *Northwestern University Law Review,* July 14, 2009, http://ssrn.com/abstract=1433634 (last accessed on July 20, 2009).

increased the federal government's control over online gambling and restricts users' ability to fund their online accounts, casting a broad net over any state attempts to legalize online gambling.[188] On the other hand, states have no recourse against offshore sites that provide gambling services to their residents.[189]

Despite concerns that the legalization of online gambling would override various jurisdictions' rights to regulate gambling, technology can give states that opt out of legalization some assurance that their restrictions will be enforced.[190] A well-crafted federal regulatory regime could respect jurisdictional differences with regard to legalization of online gambling.

2. Regulatory Strategy

Proposed legislation provides for the ability of states and Native American tribal groups to opt out of legalization.[191] A federal licensing system would need to ensure (1) that site operators "adopt and implement systems to enforce any applicable Federal, State, and Indian tribe limitations on Internet gambling" and (2) that license applicants have a program "to verify the State or tribal land in which the customer is located at the time the customer attempts to initiate a bet or wager."[192] Further, currently proposed legislation prohibits licensees only from "knowingly" accepting bets from jurisdictions that opt out, presumably to prevent state actions against operators for mere negligence.[193] It would be possible to press operators further, requiring them to acquire and operate state-of-the-art methods in this area, effectively guaranteeing their "knowledge" in all but the most unusual of circumstances.

A regulatory strategy to solve jurisdictional issues must entail oversight by a regulator that can monitor site operators, including the use of mystery shopper, to ensure compliance. Beyond that, however, the issue of different jurisdictional restrictions or prohibitions is essentially a technical question: does the technology exist to implement such restrictions or prohibitions?

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[187] See *Id.* at p. 2–5.

[188] See *Supra* at footnote 18 at p. 933.

[189] See *Id.* at p. 930.

[190] Spencer Bachus, "Online Gambling Leads to Crime and Hurts Young, So Why Encourage It? Asks Spencer Bachus," *US News & World Report,* June 1, 2009, http://www.usnews.com/articles/opinion/2009/06/01/online-gambling-leads-to-crime-and-hurts-young-so-why-encourage-it-asks-spencer-bachus.html (last accessed on July 30, 2009).

[191] "There is a need to extend the regulatory provisions of this Act to all persons, locations, equipment, practices, and associations related to Internet gambling, with each State and Indian tribe having the ability to limit Internet gambling operators from offering Internet gambling to persons located within its territory by opting out of the provisions of this Act" (Internet Gambling Regulation, Consumer Protection, and Enforcement Act, H.R. 2267, 111th Cong. (2009), §5381, ¶6).

[192] See *Id.* at §5381, ¶5. Also see *Id* at §5384(b)(1).

[193] See *Id.* at §5386(a)(1)(A). Also see *Supra* at footnote 186 at p. 17.

3. Relevant Technologies for Risk Mitigation

Many technologies are available to mitigate the risks of jurisdictional violations of restrictions or prohibitions.

To adhere to UIGEA restrictions that prohibit funding of online gambling accounts, some overseas gambling operators, such as PartyGaming, Sportingbet, and Paradise Poker, have used geolocation techniques to selectively deny services to their customers on the basis of their location within the United States.[194] Similar technology may also be applied to help address the problem of jurisdictional differences in gambling law within the United States.

Geolocation entails using "Internet infrastructure information to determine the geographic location of Internet Protocol (IP) addresses associated with Internet-connected devices."[195] It is a way of determining the physical location of an Internet user, with varying degrees of accuracy. When an Internet user types a website address into a Web browser, the browser sends an access request to the server of the requested website. This request reveals the IP address of the user, which the requested website forwards to a geolocation provider. The provider, which has built a database of the locations of IP addresses, assesses the location of the user. Public-source geolocation data can often identify the location of IP addresses at the country, state, and even city levels.[196]

Gambling websites would, of course, require initial registration information from their users, including the users' name and address. This is the first line of defense against jurisdictional concerns, because a person attempting to register with a Utah address, for example, would be precluded from opening an account.[197] This information can be cross-checked against supplied information, such as credit card information, bank account numbers, driver's license details, or passport information to determine any mismatch in the reported location.[198] Players from excluded jurisdictions, or ones whose physical location cannot be verified, can summarily be prevented from opening an account.

This process should serve as a deterrent to casual users in prohibited jurisdictions who do not intend to circumvent the laws of their jurisdiction. Subsequently, however, the site must use geolocation to ensure that users, even if they were eligible at registration, are in a permitted

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[194] See *Supra* at footnote 60, at ¶¶34–36.

[195] Quova, *The Factors of Geolocation,* iGaming Business, http://gw.vtrenz.net/index.cfm?method=cMicrositeSecurity.displayLogin&dkey=XOV3IU9JU5 (last accessed on July 21, 2009).

[196] D. J. B. Svantesson, "How Does the Accuracy of Geo-Location Technologies Affect the Law?" *Masaryk University Journal of Law and Technology,* 2, No. 1 (Summer 2008): 11–21, at p. 12.

[197] Assuming that the state of Utah, which currently prohibits gambling, would continue to do so under a federal regulatory regime.

[198] As noted in an August 21, 2009 interview with Andrew Fritchie, General Counsel of PartyGaming PLC.

jurisdiction while gambling. Geolocation software can pinpoint the user's location and, if in doubt, flag it for site operators to either further investigate or block access immediately.

Critics of geolocation claim that it is inherently unreliable and subject to relatively easy circumvention, citing failure rates in the range of 20% to 30%.[199] For example, a wireless access card, a common method of accessing the Internet on a laptop while traveling, may confuse geolocation services, and each service may show the user to be in highly disparate locations.[200] The online gambling firm bwin uses a geolocation service, and although the company believes that the service can reliably determine the country in which a player is located, it does not currently rely on results at a state or city level.[201] Supporters and geolocation companies themselves, however, insist that the technology is highly accurate. Quova, a market leader in geolocation technology, claimed virtually 100% accuracy in helping Ladbrokes, the world's largest bookmaker, to block Dutch users from accessing its site.[202] Other estimates of accuracy run from 85% to 99%.[203]

Geolocation technology is already used for a number of purposes, such as restricting access to content, protecting media rights, and delivering location-based content to users. It is used by organizations such as the New York State Lottery, the British Columbia Lottery, Major League Baseball, and the Alaska Permanent Fund.[204] It is also used to detect and deter fraud at online retailers by comparing the user's location with his or her credit card address, for example, and governments and law enforcement agencies use geolocation to help track Internet criminals.[205]

Technologies to circumvent geolocation do exist, such as "overt and transparent proxies, firewalls, filters and filtering services, Network Address Translators, private address spaces, point-to-point links, tunnels, and Virtual Private Networks (VPNs), that further obfuscate the

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[199] Statement of Jeff Schmidt, in U.S. House of Representatives, Committee on Financial Services, *Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?* 110th Cong., 1st Session, June 8, 2007, at p. 18–19.

[200] See *Id.*

[201] As noted in an August 13, 2009 correspondence with Katharina Riedl of bwin (Austria).

[202] A Dutch court had ordered Ladbrokes, a U.K. bookmaker, to prevent domestic users from accessing its site. See *Supra* at footnote 195.

[203] See *Supra* at footnote 186 at p. 15.

[204] See *Supra* at footnote 40 at p. 53. Also see Larry Barrett, "Major League Baseball Struggles to Reach Fans Online," *Baseline*, March 7, 2005, http://www.baselinemag.com/index2.php?option=content&do_pdf=1&id=3506 (last accessed on September 4, 2009). Also see Quova, *Quova Helps the Alaska Permanent Fund Dividend Division Run Like a Well-Oiled Machine*, Quova case study, 2008, https://www.vtrenz.net/imaeds/ownerassets/818/08277_Alaska_casestudy_REV2.pdf (last accessed on September 10, 2009).

[205] Quova, *The Science of Geolocation*, http://www.quova.com/Technology/thescienceofgeolocation.aspx (last accessed on September 4, 2009).

true source and destination of communications."[206] In some cases, the user could be on a different continent from the one indicated by their IP address because he or she may be using one of the above technologies that masks the true location. VPN programs, which many people use to access work networks from home or while traveling, effectively mask one's location. In fact, many gateways to the Internet, such as America Online or proxy servers, by their nature offer geographic separation between the IP address and the end user.[207]

Geolocation software, however, can exploit the physical characteristics of the connection, such as the round-trip delay, to detect these countermeasures and assign a "confidence factor," indicating the probability that the reported location is the user's actual location.[208] Also, the software can determine if the destination address belongs to a cable company, a DSL provider, or a dial-up ISP. Thus, the destination can indicate the user's connection type and whether it is too risky to accurately verify the user's location.[209] In these cases, the customer's account can be blocked completely from using the service until his or her location can be determined with greater certainty, or the site's compliance department can flag the account for further review. Further review could involve requiring the user to submit additional information, which then may be subject to manual or real-time verification.[210]

The regulator may impose specific requirements on the confidence of any geolocation information, on the basis of the confidence factor determined by the software, in essence to "tune" the thresholds for acceptance, rejection, and further verification.[211] For example, the New York Lottery and the British Columbia Lottery use Aristotle's verification service for geolocation. Both organizations require nearly 100% confidence scores in order to allow users to participate in their respective lotteries.[212] In this way, regulators can have as much assurance as they require in the geolocation system, making it an effective means of excluding individuals in any specific jurisdiction.

4. Conclusion

Beyond the issue of sanctions, licensed sites may have an incentive to be lax with geolocation controls: excluding users from certain states lowers their overall customer base. Therefore, a

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206 See *Supra* at footnote 199 at p. 83.

207 As noted in an August 21, 2009 interview with Andrew Fritchie, General Counsel of PartyGaming PLC.

208 Quova, *GeoPoint by Quova*, white paper, July 2006, https://www1.vtrenz.net/imarkownerfiles/ownerassets/818/GeoPointbyQuova_WHITEPAPER.pdf (last accessed on July 21, 2009), at p. 7.

209 See *Supra* at footnote 195.

210 See *Id.*

211 As noted in an August 3, 2009 interview with Paul Mathews, Former Senior Vice President of IGT Wagerworks. Also see *Supra* at footnote 162.

212 See *Supra* at footnote 40 at p. 53.

regulator must ensure that geolocation controls are updated frequently and meet desired standards of quality. Frequent mystery shopping at U.S. sites conducted from locations within restricted states is one option, and violators could risk losing their valuable operating license if they chose to operate lax verification techniques. This combination of oversight and state-of-the-art technology should help ensure that various jurisdictions maintain control over their own gambling laws and prevent complex interstate legal disputes.

H. Breaches of Data Confidentiality

Online gambling websites often hold personal and confidential information of their customers, including credit card and bank account numbers, names, addresses, and other sensitive information. One of the challenges for a regulator is to ensure that personal information is used only for legitimate purposes and is not disseminated or accessed improperly.

1. The Issue of Data Confidentiality

All online businesses involved in monetary transactions are susceptible to breaches of data confidentiality.[213] Breaches can include hackers stealing credit card or other personal information, employees storing or accessing sensitive information improperly, and sites accidentally releasing personal information.[214] Although the deliberate theft of data is a significant problem, more than 88% of all cases of data breaches in 2008 resulted from insiders' negligence.[215] Once released, the data can then be used for various illegal purposes and may lead to identity theft and credit card fraud.

Unlike other countries, the United States does not maintain any general data privacy laws at a federal level.[216] Instead, individual states have wide latitude to enact laws protecting consumers' data, and currently 45 states have laws governing data breaches by companies.[217] Online

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[213] In January 2009, Heartland Payment Systems, the United States' fifth-largest payment processor, announced a data breach caused by hackers that may have compromised up to 100 million credit cards. TJX, a major operator of retail stores, experienced a data breach in 2006 that exposed tens of millions of cards. See Rachel King, "Lessons from the Data Breach at Heartland," *Business Week*, July 7, 2009, http://www.msnbc.msn.com/id/31778540/ns/business-businessweekcom/ (last accessed on July 29, 2009).

[214] *Identity Theft Daily*, "Identity Theft News: 2008 Data Breach Count is 69% greater than 2007," *Identify Theft Daily,* http://www.identitytheftdaily.com/index.php/20080716371/Latest/Identity-Theft-News-2008-Data-Breach-count-is-69-greater-than-2007.html (last accessed on July 29, 2009).

[215] PGP Corporation, *2008 Annual Study: Cost of a Data Breach,* conducted by the Ponemon Institute, LLC, February 2009, at p. 5, http://www.encryptionreports.com/download/Ponemon_COB_2008_US_090201.pdf (last accessed on July 31, 2009).

[216] Dan Kaplan, "Leahy, for Third Time, Submits Federal Data Security Law," *SC Magazine,* July 24, 2009, http://www.scmagazineus.com/Leahy-for-third-time-submits-federal-data-security-law/article/140604/ (last accessed on July 29, 2009).

[217] See *Id.* Also see National Conference of State Legislatures, *State Security Breach Notification Laws,* as of July 27, 2009, http://www.ncsl.org/Default.aspx?TabId=13489 (last accessed on September 10, 2009).

gamblers residing in the United States currently have no protection against breaches of their personal data beyond those implemented by the online gambling site itself.

2. Existing Controls in Other Jurisdictions

In 2003, California became the first state to pass a comprehensive law on notification of data breaches. The law requires companies that experience a breach to notify all data subjects "in the most expedient time possible and without unreasonable delay" if certain types of personal information are released unintentionally. It is important to note that the data must have been unencrypted to trigger the notification.[218]

A 2009 bill proposed by Senator Patrick Leahy of Vermont, dubbed the Personal Data Privacy and Security Act, aims to "require data brokers and companies to establish and implement data privacy and security programs."[219] Leahy notes that more than 250 million records containing personal information have been breached since 2005.[220] The law would require companies that store customers' personal data to establish internal control policies and to give notice when a breach of data occurs. The bill would preempt state laws on these matters.[221] It also would establish an Office of Federal Identity Protection to assist consumers with issues of identity theft and data correction.[222]

In Europe, most data privacy laws are highly stringent—much more so than in the United States. The European Union's Data Protection Directive, issued in 1995, introduced strong controls on data privacy and the rights of consumers.[223] Among other provisions, it requires that data be relevant to the purpose for which it is kept, stored no longer than necessary, and verifiable by consumers. It also requires that, if data are to be processed (i.e., collected and used), (1) the data subject should have given explicit consent for its use and (2) the processing must be necessary for the performance of a contract, required by a legal obligation, necessary to protect the data subject's life, or necessary to perform a task of public interest.

Various jurisdictions across the world that have legalized and regulated online gambling maintain rules on data confidentiality and privacy:

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[218] See California Office of Privacy Protection, "Recommended Practices on Notice of Security Breach Involving Personal Information," May 2008, http://www.oisp.pp.ca.gov/consumer_privacy/pdf/secbreach.pdf (last accessed on July 31, 2009), at p. 8.

[219] Office of Senator Patrick Leahy, *Leahy Introduces Cybersecurity Legislation,* July 22, 2009, http://leahy.senate.gov/press/200907/072209b.html (last accessed on July 29, 2009), at p. 1.

[220] See *Id.*

[221] See *Id.* at p. 5-8.

[222] See *Id.* at p. 9.

[223] *Data Protection in the European Union,* European Commission, United Kingdom, http://ec.europa.eu/justice_home/fsj/privacy/docs/guide/guide-ukingdom_en.pdf (last accessed on September 10, 2009).

- The Isle of Man's gambling regulations "specify detailed rules on the way accounts must be managed, privacy of information on account holders and prescribe the penalty for contravention which is £5,000 for each violation."[224] Site operators in the Isle of Man are also bound to the rules in the Data Protection Act 2002, the island's legislation concerning data privacy. One of the Act's provisions provides for compensation for "[a]n individual who suffers damage by reason of any contravention by a data controller of any of the requirements of this Act."[225]

- Iderney's regulatory system requires that "[c]ustomer privacy and data protection principles are observed."[226]

- Gibraltar requires that information about a player not be disclosed to a third party except under certain circumstances.[227] Gibraltar's regulator also requires that data be obtained lawfully, kept and used only for the purposes for which it was obtained, stored safely, and accessible by the customer.[228]

3. Relevant Technologies for Risk Mitigation

Effective data protection begins with the establishment of internal controls and policies by the gambling website. Betting site 888.com states in its privacy policy that it is "committed to respecting your privacy and to complying with applicable data protection and privacy laws and we have therefore provided this Privacy Policy to help you understand how we collect, use and safeguard your PII [personally identifiable information]."[229] It also states that the site's employees and data processors have an obligation to respect users' privacy. Betfair's privacy policy claims the site "endeavour[s] to ensure that [its] business practices that involve the use of...Personal Information are compliant with privacy regulations in the countries where [it] operate[s]," and it claims that it has assembled a "world class Information Security Management System."[230]

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[224] See *Supra* at footnote 31 at p. 126.

[225] Data Protection Act 2002, Treasury of the Isle of Man, at §11(1).

[226] See *Supra* at footnote 30 at p. 144.

[227] See *Supra* at footnote 133 at §30.

[228] See *Supra* at footnote 32 at p. 16.

[229] See http://www.888.com/, under "Privacy Policy for Users" (last accessed on September 10, 2009).

[230] See http://content.betfair.com/aboutus/?product=exchange&brand=betfair&region=GBR&locale=en (last accessed on September 10, 2009).

Maintaining secure computer systems is a demanding task. Although the various technological solutions—secure operating systems, file encryption, network firewalls—have their weaknesses the primary failure mechanism for data security is human mistakes and carelessness.[231]

Absent regulation, gaming site operators would not bear many of the costs associated with the improper disclosure of personal information. Thus, a regulatory mechanism is needed to align the operator's incentives with those of consumers. A significant fine for each consumer record improperly released is one such incentive.

With the proper incentives, the gaming site operator will engage in the security engineering, training of staff, and auditing needed to protect consumer records.

4. Conclusion

In an effective regulatory regime, the regulator would require the internal controls and privacy policies described in this section to be present on gambling websites and be highly visible to customers. The regulator would ensure that employees receive training in relevant data protection policies and that players have the ability to access and, if necessary, modify their personal information. It would also establish the types of data that can be stored and the length of time after which the data must be deleted. Finally, the regulatory regime may impose criminal or civil liability on site operators whose data is breached, and it can require regular audits, either by the regulator itself or by independent third parties, of data encryption policies and other protection systems. There is no reason to believe that licensed online gambling operators would be any less able or willing to fulfill these obligations than other online merchants with similar data custody obligations. For more discussion on technological strategies to protect sites' integrity and customers' personal data, see Section I, Communications and Computer Security Failures.

I. Communications and Computer Security Failures

Security of websites, to prevent improper use of or access to sensitive data, is a ubiquitous and serious concern in e-commerce. Hackers can undermine site security, alter a site's behavior, shut it down, access customers' confidential information, or use one site as a platform from which to launch broader malicious activities across the web. Online gambling sites would be responsible, in just the same way as other merchant sites, for implementing proper controls and in cooperating with law enforcement agencies in the control of cybercrime.

1. The Issue of Communications and Computer Security Failures

Web server security can be compromised from two directions. The first is over the network (i.e. through internet connections). Second, and perhaps more importantly, a website's servers are also subject to attack or misuse by the gaming site's own employees. A key employee may be able to install software that subverts a system, destroys the integrity of games, interferes with

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[231] See Ross Anderson, Security Engineering, A Guide to Building Dependable Distributed Systems 2nd Edition, Wiley, 2008, at p. 17-62.

customer accounts, or improperly transmits customers' personal or financial information. Even an ordinary virus may render a site inoperative, making it impossible for customers to access their accounts or recover their deposits. Phishing attacks, directed at customers through a gambling website, may also be a concern.

Attacks may involve unauthorized attempts to login using someone else's account, or exploitation of some security weakness in the web server software itself or in the communications software on the server.[232]

Protecting gaming websites from intruders is little different from the problem faced by government agencies or online merchants such as Amazon. Many organizations do this quite well as a matter of course, and licensed gambling site operators should be held to a high standard.

There are currently no U.S. federal laws regarding data breaches, and the issue is left to individual states. However, acts of hacking and computer fraud are addressed by the Computer Fraud and Abuse Act, originally enacted in 1986, which covers any interstate or international computer communications.[233] The Act criminalizes a wide range of computer fraud, including improperly accessing a "protected" computer with intent to defraud and knowingly transmitting a program or code that causes damage to multiple computers. A 2008 amendment to the law eliminated the requirement for the communications to be interstate or international in cases involving theft and broadened the definition of a "protected computer" to mean any computer used in interstate or foreign communication.

Like other heavily-used websites, gambling sites are susceptible to denial-of-service attacks, which overload a website's servers and force it to shut down.[234] The threat of such attacks has been used to extort money from website operators. Perpetrators of such extortion have included organized crime groups from the Middle East and Asia.[235] In 2004, British bookmakers alone lost $70 million due to "cyber-extortion" by just one hacking team, and companies such as

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[232] For a description of a recent (September 2009) discovery of a security weakness in web server software, see Gregg Keizer, *Microsoft promises patch for critical Web server bug*, Computerworld, September 2, 2009, http://www.computerworld.com/s/article/9137438/Microsoft_promises_patch_for_critical_Web_server_bug (last accessed on September 9, 2009).

[233] See U.S. Department of Justice, *Chapter 1 – Computer Fraud and Abuse Act*, Computer Crime & Intellectual Property Section, http://www.usdoj.gov/criminal/cybercrime/ccmanual/01ccma.pdf (last accessed on July 29, 2009).

[234] Denial-of-service attacks use computers to inundate a website with large amounts of internet traffic that eventually slows the site or shuts it down completely. See Jack M. Germain, "Global Extortion: Online Gambling and Organized Hacking," *Tech News World*, March 23, 2004, http://www.technewsworld.com/story/33171.html?wlc=1248627730 (last accessed on July 26, 2009). Also see Jordan Robertson, "Tech 101: How a Denial-of-Service Attack Works," *Associated Press*, July 8, 2009, http://www.usnews.com/articles/science/2009/07/08/tech-101-how-a-denial-of-service-attack-works.html?PageNr=1 (last accessed on July 28, 2009).

[235] See *Id.*

Canbet, Harrods Casino, Inter Casino Poker, Totalbet, VIP Casino, and William Hill have been the victims of denial-of-service attacks.[236]

Users of gambling websites are also susceptible to phishing, or the use of fraudulent but credible-looking website-mimics to deceive the user into releasing personal information or to install viruses and other malware onto their computers.[237] Phishing may take many forms including fraudulent or misleading email, website pop-up advertisements, or other forms of electronic communication such as text messaging. Phishing attacks cost consumers more than $3 billion annually in the form of fraudulent credit card charges, withdrawals from compromised bank accounts, time spent rectifying fraud problems, and reduced trust in online commerce.[238] Depending upon factors such as the website's payout policy or the ability to transfer funds between players, gambling websites can be attractive targets for phishing.[239]

2. Existing Controls in Other Jurisdictions

In a licensed regulatory environment, gambling site operators would be expected to play their part—just like any other e-commerce merchant—in eliminating their own security vulnerabilities and cooperating with law-enforcement agencies in cybercrime control. Existing U.S. laws (federal and state) regarding computer intrusion would apply, and sites would have recourse to law enforcement support if they suffered attacks. Other nations have legal regimes similar to the U.S. with respect to cybercrime. France, Germany, and the United Kingdom all have laws specifically targeting cybercrime, and the European Union is currently looking to both strengthen its laws on cybersecurity and harmonize the laws of its member states.[240] The European Union is also considering a system through which members can report Internet-based attacks to each other and record arrests and prosecutions.[241] The Licensing, Regulation, and Alcohol Strategy division

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[236] See John McMullan and Aunshul Rege, *Cheating and Cybercrimes @ Gambling Sites.com*, presentation to the Alberta Gambling Research Institute Annual Conference, March 2009, slide 17. Also see John McMullan and David Perrier, "The Security of Gambling and Gambling with Security: Hacking, Law Enforcement and Public Policy," *International Gambling Studies* 7, No. 1 (2007): 43–58 at p. 47.

[237] Rachna Dhamija *et al.*, *Why Phishing Works*, Experimental Social Science Laboratory (Xlab), Paper XL06-013 (August 14, 2006): 581–590 at p. 581, http://repositories.cdlib.org/iber/xlab/XL06-013 (last accessed on August 3, 2009). Also see Cyveillance, *The Cost of Phishing: Understanding the True Cost Dynamics Behind Phishing Attacks*, white paper, December 2008, http://www.cyveillance.com/web/docs/WP_CostofPhishing.pdf (last accessed on August 3, 2009). Also see APWG, *Phishing Activity Trends Report Q1/2008*, January–March 2008, http://www.antiphishing.org/reports/apwg_report_Q1_2008.pdf (last accessed on August 3, 2009).

[238] See *Id* Cyveillance.

[239] Marvin Fabuli, "Online Casinos an Easy Bet for Phishers," Symantec, February 27, 2008, http://www.symantec.com/connect/blogs/online-casinos-easy-bet-phishers (last accessed on August 3, 2009).

[240] Palmer, Maija, "EU plans tougher cybercrime laws," *FT.com*, June 14, 2009, http://www.ft.com/cms/s/0/10a407b6-5913-11de-80b3-00144feabdc0.html (last accessed on August 2, 2009).

[241] See *Id.*

in Australia's Northern Territory requires license applicants to submit their information technology security protocols for a risk assessment, and their controls must adhere to Australian and New Zealand AS/NZS 4444 standards for information security.[242]

The issue of hacking is not completely unfamiliar to bricks-and-mortar casinos. They use quite sophisticated electronic systems, which are vulnerable as well.[243] A regulatory strategy for online gambling would require implementation and maintenance of state-of-the-art security controls, cooperation with law-enforcement on cybercrime issues, comprehensive testing of site and account security for the sake of defending consumers' privacy and interests, and mandatory reporting of any attacks.[244]

3. Relevant Technologies for Risk Mitigation

The key technologies for gambling website security are the same as those used by other on-line merchants. These include (1) network firewalls that isolate databases, administrative systems, and development systems from the Internet, (2) high-quality servers with up-to-date security patches, (3) a continuing process of monitoring and logging attempts to break into the system over the Internet, (4) secure database and transactional software, and (5) the use of secure, encrypted protocols for communications between users and the gambling website.[245]

Intruders who gain access to a user's credentials and use those credentials to open a fraudulent connection can be combated in several ways. Many gambling sites work by having users download and install dedicated client software to access the site rather than relying on standard web browsers. This dedicated client software can implement security protocols that resist a variety of exploits such as keystroke loggers and "man-in-the-middle" attacks.[246] For example, the gambling site could use encryption keys based, in part, on information exchanged at registration and stored on the user's computer. This approach, however, is not as user friendly as a simple login (e.g., user name and password), as it would make the use of any computer other than the user's regular computer more difficult.

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[242] As noted in an August 31, 2009 correspondence with John Sealy, Manager of Information Systems and Technology Services at the Licensing, Regulation and Alcohol Strategy division of the Northern Territory Department of Justice (Australia).

[243] See John McMullan and David Perrier, "The Security of Gambling and Gambling with Security: Hacking, Law Enforcement and Public Policy," *International Gambling Studies* 7, No. 1 (2007): 43-58 at p. 44.

[244] See *Id.* at p. 53.

[245] Keys Botzum, WebSphere Application Server V6 advanced security hardening -- Part 1, Overview and approach to security hardening, IBM WebSphere Developer Technical Journal, December 2005, http://www.ibm.com/developerworks/websphere/techjournal/0512_botzum/0512_botzum1.html (last accessed on September 14, 2009)

[246] Keystroke loggers are programs that record users' keystrokes for the purpose of garnering private information such as passwords. "Man-in-the-middle" attacks are cryptographic attacks in which an eavesdropper relays messages between two victims. The eavesdropper can read and even alter the messages.

Another approach is to add a feature to the user's password. It is common for high-value websites to put an additional password on a physical device, such as a small keyfob that displays a six-digit number that changes once per minute.[247] The user logs in by supplying the user name, password, and the number on the fob, and these are passed through to the server, which authenticates them and permits the user to log in. This technology protects against lost and easy-to-guess passwords but not against man-in-the-middle attacks. However, if the site requires the user to employ dedicated client software, that client software can use the 6-digit number as part of the encryption key for establishing the connection between the user's computer and the web server; this technique would successfully protect against man-in-the-middle attacks.[248]

Gambling site operators are already aware of some of these options. For example, PartyGaming's privacy policy states that it stores all players' personal information in a password-protected database behind a state-of-the-art firewall, and the site itself supports SSL version 3 security with 128-bit encryption.[249] It also states that it ensures that affiliates, subsidiaries, agents, and suppliers use secure technology. The site 888.com claims that it uses advanced SSL and PGP protocols for security along with public/private key encryption and firewalls.[250] Both sites employ secure, dedicated client software. Other gambling sites also enumerate details about their security policies and procedures, all of which are designed to prevent unauthorized access to personal information.

Denial-of-service attacks present a particular challenge to gaming site operators. The harmful traffic usually arises from thousands or tens of thousands of computers that have been infected with a virus that permits the author of the virus to remotely control the infected computer. The individual commanding such a network can direct the entire network to begin loading pages from the gambling website. If the website is designed to serve a thousand active users but ten thousand computers begin loading web pages at ten times the rate of a normal user, service from the website could collapse.

Some technological countermeasures are available to the website operator—for example the website could place limits on the number of new computers from which it will accept connections. However, if the flow of incoming traffic is big enough it will overload the connections between the gambling site and the rest of the Internet. Thus, the ultimate control of denial-of-service attacks must come from web administrators, providers of operating system software, and network service providers.

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[247] This process is called two-factor authentication. One factor is the normal password which the user types, and the other is the code from the key fob. The interactive role-playing game service World of Warcraft provides such key fobs to its users for a fee of $6.50. See http://www.blizzard.com/store/details.xml?id=1100000622 (last accessed on September 9, 2009).

[248] If the 6-digits are used as a shared secret to generate part or all of the encryption key for the communications between the user and the game site, then a man-in-the-middle attack is impossible because the attacker lacks the shared secret.

[249] See https://secure.partyaccount.com/about/privacy_s.do (last accessed on August 24, 2009).

[250] See http://www.888.com/ (last accessed on August 24, 2009).

Security failures in computer operating systems are the gateway through which most viruses infect computers. Network service providers have the ability to monitor traffic flows on many different paths and can detect patterns of activity that indicate the beginnings of a denial-of-service attack. They may also be able to control denial-of-service attacks at locations far from the connection to the gambling site.

For this reason, sites must work closely with regulators and government agencies to identify and deal with cybercriminals. Regulators should develop cooperative relationships with private security experts and advocate for cost-effective, industry-wide benchmarks for cyber-security.[251] Finally, legislators should consider imposing civil liability on site operators for any harm caused by computer intrusions, at least when site security precautions were not up to the requisite standard.[252]

Finally, gambling site operators, like all other online merchants, should implement anti-phishing measures to prevent financial harm to consumers and maintain the integrity of their operations. The sites should play their role in helping to educate consumers about safe browsing habits and how to recognize phishing.[253]

4. Conclusion

Significant international attention is already being paid to cybercrime in general. Website security is a matter of global concern for businesses and government alike, by no means specific to online gambling. According to a Cyberspace Policy Review report released in 2009 by the Cybersecurity Chief at the National Security Council, "a growing array of state and non-state actors are compromising, stealing, changing, or destroying information and could cause critical disruptions to U.S. systems."[254] The report recommends a coordinated effort by federal, state, and local governments along with security experts in the private sector, and it urges the government to "identify procurement strategies that will incentivize the market to make more secure products and services available to the public."[255] It goes on to recommend "adjustments to liability considerations (reduced liability in exchange for improved security or increased

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[251] See John McMullan and Aunshul Rege, *Cheating and Cybercrimes @ Gambling Sites.com*, presentation to the Alberta Gambling Research Institute Annual Conference, March 2009, slide 23.

[252] John McMullan and David Perrier, "The Security of Gambling and Gambling with Security: Hacking, Law Enforcement and Public Policy," *International Gambling Studies* 7, No. 1 (2007): 43–58 at p. 56.

[253] MarkMonitor, "Rock Phishing: The Threat and Recommended Countermeasures," White Paper, August 2007, http://www.markmonitor.com/download/wp/wp-rockphish.pdf (last accessed on August 3, 2009), at p. 7–8.

[254] Cyberspace Policy Review, *Assuring a Trusted and Resilient Information and Communications Infrastructure*, National Security Council, May 2009, http://www.whitehouse.gov/asset.aspx?AssetId=1906 (last accessed on August 2, 2009), p. iii. Also see http://www.whitehouse.gov/cyberreview/.

[255] See *Id* at p. iv-v.

liability for the consequences of poor security), indemnification, tax incentives, and new regulatory requirements and compliance mechanisms."[256]

While all online merchants would benefit from increased governmental and law enforcement support, online gambling operators are ultimately responsible for their own sites' security. Site operators will naturally be concerned with their reputations for integrity and reliability, but regulation can introduce new incentives to ensure that operators deploy effective security. The regulator might choose to mandate some specific technologies, such as SSL encryption and dedicated client software; and it can sharpen the incentives for effective control by imposing higher levels of liability for any sites that fail to implement adequate precautions.

J. Problem Gambling

1. Problem Gambling

We expect that problem gambling behaviors may receive more attention in the upcoming debates than any of the other categories of risk. Therefore, we discuss problem gambling in more detail in Section III below.

[256] See *Id* at p. v.

III. SPECIAL ATTENTION TO PROBLEM GAMBLING

A. Introduction

Unlike the other nine risks, the potential effect of legalization on problem gambling is less obvious a priori. On the one hand, in a well-regulated online environment, gamblers (including existing U.S.-based online gamblers) would have more access to mechanisms with which to try to curb their problem behavior. These include tools for self-exclusion and self-limits as well as greater awareness of and access to clinical and self-help resources. On the other hand, pathological or addictive gambling behaviors might nevertheless be exacerbated by the increased opportunity to gamble at any time and from anywhere.

B. What is Problem Gambling?

1. Terminology

Problem gambling is a term without a specific definition that refers to the fact that some individuals who gamble do so irresponsibly and damage or disrupt personal, financial, or social pursuits.[257] The term can apply to a wide spectrum of cases, from less severe ones where individuals experience some degree of gambling-related problems to more severe cases in which individuals are clinically diagnosed with *pathological gambling*—an impulse control disorder.[258]

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[257] Lack of specific definition noted in an August 5, 2009 interview with Phill Brear, Head of Gambling Regulation at the Gibraltar Regulatory Authority. National Council on Problem Gambling, *FAQs – Problem Gamblers,* http://www.ncpgambling.org/i4a/pages/Index.cfm?pageID=3315 (last accessed on July 11, 2009).

[258] In 1980, the American Psychiatric Association (APA) first included pathological gambling in the Diagnostic and Statistical Manual for Mental Disorders (DSM). It was described as a "chronic and progressive failure to resist impulses to gamble, characterized by undesirable outcomes ranging from borrowing money from family or friends and losing time at work, to being arrested for offenses committed to support gambling." National Research Council, *Pathological Gambling: A Critical Review*, Washington, DC: National Academy Press (2005), at p. 2. In the most current manual, DSM-IV, the APA lists 10 diagnostic criteria of which five have to be met to make a clinical diagnosis of pathological gambling. See *Id* at p. 27. Various screening mechanisms have been developed to assess levels of problem gambling, including the South Oaks Gambling Screen (SOGS), the Problem Gambling Severity Index (PGSI) of the Canadian Problem Gambling Index (CPGI), and the National Opinion Research Center DSM Screen for Gambling Problems (NODS). See Michael Belletire *et al., Legislating and Regulating Casino Gaming: A View from State Regulators,* paper commissioned by the Regulation, Enforcement and Internet Subcommittee of the National Gambling Impact Study Commission, 1999, at p. 11. Also noted in interviews with Peter Collins, Professor of Public Policy Studies and Director of the Center for the Study of Gambling at the University of Salford (U.K.), and Sam McQuade, Graduate Program Coordinator at the College of Applied Science and Technology at the Rochester Institute of Technology.

2. Prevalence Rates and Trends

Worldwide: Most research indicates that about 1% of the adult population worldwide experiences severe problem gambling.[259] Moreover, studies indicate that severe problem gambling rates globally have stabilized over time at about 1%.[260]

United States: Various studies have been conducted to estimate the prevalence of problem gambling in the United States. According to the National Council on Problem Gambling, about 1% of the U.S. adult population meets the criteria for pathological gambling in a given year. Another 2% to 3% would be considered problem gamblers.[261] In a meta-analysis of 120 previously conducted prevalence studies in the United States and Canada, researchers at the Division of Addictions at Harvard Medical School derived point-in-time estimates of problem gambling rates. They noted that 1% to 2% of the adult population met criteria for lifetime pathological gambling.[262] A more recent estimate from a nationally representative survey in the United States found lifetime pathological gambling rates within the general population of 0.4%.[263] In an interview in mid 2009, Howard J. Shaffer, an addiction expert at Harvard University, noted that despite the substantial growth in gambling opportunities and overall gambling volume over the last two decades in the United States, the rate of problem gambling among the adult population has stayed roughly constant. Shaffer also stated that the incidence of problem gambling in the United States had declined slightly since the 1970s, from 0.7% to 0.6%.[264]

Online Gambling and the Incidence of Problem Gambling: Some studies have claimed an association between increased gambling exposure and increased incidence of problem

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[259] Jamie Wiebe *et al.*, *Problem Gambling Prevalence Research: A Critical Overview,* a report to the Canadian Gaming Association, December 2007, at p. 2, http://canadiangamingassociation.com/media_uploads/pdf/78.pdf (last accessed on September 10, 2009).

[260] See *Id.* Also see D. A. LaPlante and H. J. Shaffer, "Understanding the Influence of Gambling Opportunities: Expanding Exposure Models to Include Adaptation," *American Journal of Orthopsychiatry,* 77, No. 4 (2007): 616–623 at p. 619.

[261] See *Supra* at footnote 257. Also noted in a June 5, 2009 interview with Keith Whyte, Executive Director of the National Council on Problem Gambling.

[262] Howard Shaffer *et al.*, "Updating and Refining Prevalence Estimates of Disordered Gambling Behaviour in the United States and Canada," *Canadian Journal of Public Health,* 92, No. 3 (2001): 168–172 at p. 169. Also see Howard Shaffer *et al.*, *Estimating the Prevalence of Disordered Gambling Behavior in the United States and Canada: A Meta-Analysis,* Boston: Presidents and Fellows of Harvard College, 1997, at p. iii. Also see Howard Shaffer *et al.*, "Estimating the Prevalence of Disordered Gambling Behavior in the United States and Canada: A Research Synthesis," *American Journal of Public Health,* 89, No. 9 (1999): 1369–1376 at p. 1370.

[263] N. M. Petry *et al.*, "Comorbidity of DSM-IV pathological Gambling and Other Psychiatric Disorders: Results from the National Epidemiologic Survey on Alcohol and Related Conditions," *Journal of Clinical Psychiatry,* 66, No. 5 (2005): 564–574 at p. 564.

[264] As noted in a June 10, 2009 interview with Howard Shaffer, Director of the Division on Addictions and Associate Professor of Psychology in the Department of Psychiatry at the Cambridge Health Alliance.

gambling.[265] In addition, commentators have suggested that the increased accessibility inherent in online gambling magnifies such risks.[266] However, more recent studies specific to online gambling, most conducted since the advent of legal and regulated online gambling, have indicated that online gambling does not inherently encourage excessive gambling.[267] For example, researchers at Harvard Medical School studied real-time betting activities of 48,000 Internet players over two years and found that their betting levels in Internet sports gambling and casino games were moderate. Most gamblers placed fewer than four bets per day, and sports gamblers tended to moderate their play based on their wins and losses; i.e., they played less often when they lost money and more often when they won money.[268] Also, a large-scale British study in 2007 found no increase in the rate of problem gambling in the United Kingdom since 1999, despite a large increase in the number of new gambling opportunities (although the number of people who had gambled in the past year decreased between 1999 and 2007).[269]

C. Potential Effects of Legalization of Online Gambling on Problem Gambling

Some researchers and policymakers have expressed concerns about the impact of online gambling on problem gambling.[270] They fear that legalization of online gambling might spur excessive gambling and problem gambling incidence by facilitating (1) unlimited access and availability of gambling platforms; (2) anonymity, which would allow gamblers to participate without fear of stigma; (3) gambling under the influence; (4) decreased perception of value of

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[265] See Brian Rush *et al.*, "Mapping the Prevalence of Problem Gambling and Its Association with Treatment Accessibility and Proximity to Gambling Venues," *Journal of Gambling Issues,* 20 (2007): 193–214.

[266] As noted in interviews with Howard Shaffer, Director of the Division on Addictions and Associate Professor of Psychology in the Department of Psychiatry at the Cambridge Health Alliance, and Simon Holliday, Director of H2 Gambling Capital (U.K.).

[267] Richard LaBrie *et al.*, "Assessing the Playing Field: A Prospective Longitudinal Study of Internet Sports Gambling Behavior," *Journal of Gambling Studies*, 23, No. 3 (2007): 231–243. Also see Richard LaBrie *et al.*, "Inside the Virtual Casino: A Prospective Longitudinal Study of Actual Internet Casino Gambling," *European Journal of Public Health*, 18, No. 4 (2008): 410–416. Also see Debi LaPlante *et al.*, "Sitting at the Virtual Poker Table: A Prospective Epidemiological Study of Actual Internet Poker Gambling Behavior," *Computers in Human Behavior*, 25, No. 3 (2009): 711–717.

[268] See "Real-Time Betting Analysis of Internet Casino Gambling," *Responsible Gaming Quarterly*, 6, No. 2 (Fall 2008), at p. 9, http://www.americangaming.org/assets/files/RGQ_Fall_08.pdf (last accessed on August 10, 2009). Also, as noted in interviews with Peter Collins, Professor of Public Policy Studies and Director of the Center for the Study of Gambling at the University of Salford (U.K.), Bo Bernhard, Director of Gambling Research at the UNLV College of Hotel Administration, and Charles Wellford, Professor of Criminology and Criminal Justice at the University of Maryland, College Park, the availability of new forms of gambling does not necessarily lead to increased incidence of problem gambling.

[269] See *Supra* at footnote 13, Heather Wardle *et al.* at p. 9-10.

[270] Martin Owens and Guy C. Clark, "Internet Gambling Deserves a New Chance," The Debate Room, *Businessweek*, 2007, http://www.businessweek.com/debateroom/archives/2007/09/internet_gambli.html (last accessed on September 10, 2009). Also see Michael P. Scharf and Melanie K. Corrin, "On Dangerous Ground: Passive Personality Jurisdiction and the Prohibition of Internet Gambling," *New England Journal of International and Comparative Law*, 8, No. 1 (2002).

money; and (5) isolation.[271] A notable example of this concern is the 1999 assertion by the National Gambling Impact Study Commission that the three main reasons to prohibit online gambling are abuse by underage gamblers, addiction by pathological gamblers due to its high speed and instant gratification, and the potential for criminal activities.[272] Policymakers are also concerned about negative spillovers to the rest of society, including increases in crime, lost work and school hours, and increase in personal debt. However, the only reason cited in the Safe Port Act (the sponsoring legislation of the UIGEA) for banning financial transactions to and from online gambling sites is that it leads to debt collection problems for U.S. financial institutions.[273]

The following sections describe and analyze mechanisms through which legalization could affect the level of problem gambling in the United States. We identify several mechanisms by which legalization is commonly expected to increase the incidence of problem gambling and two mechanisms by which regulation might be expected to alleviate problem gambling.

1. Potential Adverse Effects of Legalization

The following section describes several mechanisms by which legalization is commonly expected to increase the incidence of problem gambling.

a. *Removal of Legal Deterrence*

Potential Effect: It is commonly believed that current legal restrictions on online gambling have deterred would-be gamblers from engaging in the Internet's version of gambling. Therefore, legalization may accentuate problem gambling by eliminating any legal inhibitions would-be gamblers have toward online gambling. In the 2007 UNLV survey of Nevadans, researchers found that approximately 12% of "non-online gamblers" (defined as those respondents who had not gambled online, but who may or may not have otherwise gambled) would be more likely to participate in online gambling if it were licensed and regulated by the state of Nevada.[274]

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[271] See *Id* Scharf and Corrin. Also see *Supra* at footnote 25 at p. 50. Also Griffiths notes that among other factors, increased access to gambling provided by online gambling might facilitate the development of gambling related issues. M. D. Griffiths, "Internet Gambling: Issues, Concerns and Recommendations," *Cyberpsychology & Behavior*, 6, No. 6 (2003): 557–568; cited by Sarah E. Nelson *et al.*, "Real Limits in the Virtual World: Self-Limiting Behavior of Internet Gamblers," *Journal of Gambling Studies,* 24 (2008): 463–477, DOI 10.1007/s10899-008-9106-8. Also The Committee on the Social and Economic Impact of Pathological Gambling notes that "More people are gambling, and they are wagering more. As a result, there is increased concern about pathological gambling." The Committee further notes that "With the increased availability of gambling and new gambling technologies, pathological gambling has the potential to become even more widespread." National Research Council, *Pathological Gambling: A Critical Review* (National Academy Press, Washington, DC, 2005), at p. 3.

[272] *National Gambling Impact Study Commission, Final Report,* 1999, at p. 5-4 to 5-6, http://govinfo.library.unt.edu/ngisc/reports/finrpt.html (last accessed on September 10, 2009).

[273] See *Supra* at footnote 69 at p. 62.

[274] See *Supra* at footnote 6 Bo Bernhard at p. 25, 46. Note $N = 1{,}000$. Also 96.3% of responders were non-online gamblers; that is, they stated that they had not gambled online in the last five years.

Mitigating Considerations: It can be argued that the lifting of the prohibition itself is unlikely to have any significant impact on would-be gamblers' willingness to gamble online, because gamblers in the United States are generally ignorant or completely confused about existing legal restrictions.[275] Support for this argument is found in the survey mentioned above, in which researchers discovered that 53.7% of responders were unclear regarding the legal status of online gambling. Approximately 17% thought online gambling was legal, and the remaining 29.5% thought it was illegal.[276] This result indicates general confusion among gamblers in the United States about current legal restrictions.[277] In addition, 87.9% of the responders noted that the current legal status of online gambling did not affect their desire to gamble online, whereas 4% indicated that their desire to gamble online was very much affected by its current legal status.

Moreover, the absence of any enforcement against online gamblers until very recently may have diluted the deterrent effect of legal restrictions on would-be gamblers' inclination to gamble, leading one to argue that complete removal of such restrictions in the future would not have a major impact on the behavior of would-be gamblers.[278]

b. *Introduction of Trustworthy Brands*

Potential Effect: Legalization may lead to increased comfort with gambling online, because U.S.-based sites, with trusted brands and subject to strict regulation, would offer a range of protections to gamblers that many offshore sites do not.[279] Moreover, greater competition in the sector, with gambling platforms offering better deals to would-be gamblers, might lead to increased volumes and greater incidence of problem gambling.

Researchers indicate that security concerns and legitimacy are two main reasons cited by gamblers for not gambling online.[280] Currently, Online Casino City, a guide to online gambling websites, lists 1,906 gambling websites from 70 different jurisdictions, 42 of which have sites

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[275] As noted in a June 5, 2009 interview with Keith Whyte, Executive Director of the National Council on Problem Gambling, Americans are generally ignorant of the legal status of online gambling, and many do not believe they will be prosecuted for gambling online.

[276] Researchers further noted that 54% of non-online gamblers were unclear about the current status of online gambling, whereas 16% deemed it legal and the remaining 29% deemed it illegal. [276] See *Supra* at footnote 6 Bo Bernhard at p. 26.

[277] Gaul notes that "even as bettors around the world gamble millions of dollars online, confusion reigns about the legal status of those bets and the companies that handle them." See *Supra* at footnote 83. Also, in a June 10, 2009 interview, Bo Bernhard, Director of Gambling Research at the UNLV College of Hotel Administration noted that the legal status of online gambling is "very unclear" in people's minds in the United States.

[278] See *Supra* at footnote 14.

[279] Section 2b discusses responsible gambling practices and safeguards that may be offered by regulated online gambling websites.

[280] See *Supra* at footnote 19, Sally Monaghan.

that allow players from the United States.[281] The majority of these websites are privately owned, and many are located in countries with no reporting requirements.[282]

In such situations, where consumers are uncertain and have limited experiences with providers, brand associations are known to be particularly influential.[283] In a recent survey, researchers at the University of Lethbridge found that the general reputation of the website was the most common reason identified by online gamblers for choosing to gamble at one Internet site over another.[284] Thus, the introduction of branded providers that are inherently perceived to be trustworthy might attract more gamblers to participate in online gambling.[285]

Mitigating Considerations: It can be argued that gamblers most likely to be influenced by the availability of trusted brand-name sites are those who gamble already, perhaps in the casino environment, and hence know the brands.[286] Although these gamblers may indeed shift their business, this shift would represent displacement, not overall growth. Further, the displacement would be from bricks-and-mortar to online gambling, which can offer more options and protections for problem gamblers than can land-based casinos.[287]

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281 As of September 14, 2009. See Online Casino City, *Online Gaming Site Owners*, http://online.casinocity.com/ownership. Also note, amongst these 1,906 sites are included 34 sites based in the United States, most of which involve skill games, free poker tournaments in which players can win real money, or state-sponsored lottery or sports betting.

282 Gaul notes that in a joint investigation, the *Washington Post* and CBS's *60 Minutes* found that "many Internet gambling sites operate in a shadowy world of little regulation and even less enforcement," See *Supra* at footnote 83.

283 Stevie Watson *et al.*, "The Legalization of Internet Gambling: A Consumer Protection Perspective," *Journal of Public Policy & Marketing,* 23, No. 2 (2004): 209–213, at p. 211.

284 Robert Wood and Robert Williams conducted two surveys. The first survey was a random digit dial telephone survey of 8,498 Canadian adults conducted from January 2006 to June 2007. The second survey was an online self-administered survey of 12,521 adults from 105 countries, conducted from June to December 2007. See Robert Wood and Robert Williams, *Internet Gambling in Comparative Perspective: Patterns, Problems, and Interventions,* University of Lethbridge, Presentation to the Alberta Gambling Research Institute Annual Conference, March 2009.

285 As noted in an August 4, 2009 interview with Simon Holliday, Director of H2 Gambling Capital (U.K.), the legalization of online gambling would probably increase the number of online gamblers. Also, the previously cited UNLV study revealed that 12% of non-online gamblers would be more likely to participate in online gambling if it were licensed and regulated by Nevada. Although some of these respondents may fear legal repercussions, some may be unwilling to gamble online due to a lack of credible, branded providers, because a large portion of respondents had doubts about the integrity of online gambling. See *Supra* at footnote 73.

286 MGM Mirage, a large U.S. bricks-and-mortar casino operator, set up an Internet gambling site based in the Isle of Man and marketed the site using MGM's brand name and credibility. See Richard McGowan, *The Gambling Debate* (Westport, CT: Greenwood Press, 2008), at p. 43.

287 Wiebe and Lipton note that "If players value such regulation, then the unregulated operators will be at a competitive disadvantage." Jamie Wiebe and Michael Lipton, *An Overview of Internet Gambling Regulations,* submitted to the Ontario Problem Gambling Research Centre, August 2008, at p. 15.

c. *Increased Accessibility*

Potential Effect: One of the most common critiques of online gambling is the increase in access and availability inherent in Internet-based gambling platforms.[288] Many believe that increased access to gambling and 24-hour-a-day availability may exacerbate problem gambling.[289] In addition, online gambling also facilitates (1) anonymity, allowing gamblers to participate without fear of stigma; (2) gambling under the influence; and (3) decreased perception of the value of money, thereby elevating the risks of problem gambling. Potential risks posed by the frequency and speed of gaming, variety of games, and smaller permissible bet size on the Internet are frequently cited.[290]

Mitigating Considerations: U.S. residents already have online gambling options available to them all day, everyday, and from anywhere. So the addition of U.S.-licensed sites would not alter that particular reality.[291] Furthermore, as discussed in Section 2b below, regulation can assuage these concerns. Responsible gaming features and safeguards, including links to problem gambling help-lines and websites, self-exclusion programs, and self-imposed time and money limits, are some common features that can be enforced to curb problem gambling. In fact, some have suggested that problem gamblers may benefit the most from the legalization of online gambling, because they would gain access to the tools required by the regulator.[292]

d. *Easier Flow of Funds if UIGEA Restrictions are Lifted*

Potential Effect: Absent UIGEA restriction, U.S. residents would be able to make deposits to and withdrawals from online sites with greater ease. The UIGEA was intended to stop the transfer of funds from U.S. gamblers to online gambling websites. Instead of criminalizing gambling itself, the UIGEA was intended to prevent U.S. residents from gambling by restricting the role of financial institutions in transmitting payments to and from gaming operators.

Mitigating Considerations: Currently, enough workarounds have been designed, and are actively promoted to consumers by offshore online gambling sites, to render the existing restrictions largely ineffective. U.S. gamblers primarily use services provided by offshore financial intermediaries unrelated to gambling sites, such as e-wallets, that allow customers to get around the restrictions placed by the UIGEA. An e-wallet is an online account in which money can be deposited and used in commercial transactions. The e-wallet draws on a consumer's bank or

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[288] See *Supra* at footnote 69 at p. 61. Also noted in August 7, 2009 interview with Jamie Wiebe, Director at the Centre for the Advancement of Best Practices of the Ontario Responsible Gambling Council.

[289] Michael Smeaton and Mark Griffiths, "Internet Gambling and Social Responsibility: An Exploratory Study," *CyberPsychology & Behavior*, 7, No. 1 (2004): 49–57, at p. 50.

[290] See *Supra* at footnote 69 at p. 61.

[291] See *Supra* at footnote 153 at p. 15.

[292] As noted in an August 27, 2009 interview with André Wilsenach, Chief Executive Officer of the Alderney Gambling Control Commission.

credit card and routes the funds to the merchant, in this case an online gambling website. The most widely used e-wallets facilitate billions of dollars in commerce annually and are based and regulated offshore.[293]

The UIGEA restrictions have not produced the intended deterrence to online gambling and may have unintentionally led to the surfeit of unregulated offshore intermediaries, which act as alternatives to regulated U.S.-domiciled financial institutions. Removal of these restrictions is therefore expected to have limited impact on the incidence of problem gambling.

In addition, as discussed in Section E, legalization would give regulators an opportunity to gain better oversight on such international money transfers when routed through regulated financial institutions. It would also provide consumers with the protections already available to credit card holders in the event of fraud, disputes, and complaints.

e. *Advertising*

Potential Effect: Currently, the U.S. Department of Justice (DOJ) has the authority to prohibit the advertising of illegal Internet gambling websites. In 2003, the DOJ issued letters to the National Association of Broadcasters and other media groups noting that allowing advertising for online gambling websites may be considered aiding or abetting illegal gambling operations.[294] Legalization of online gambling may, however, facilitate resumption of advertising in support of the online business.[295]

The high level of exposure to land- and river-based gambling and state lottery advertisements has contributed to gambling's normalization and perception as an ordinary and harmless activity.[296] Various marketing strategies, including pop-up promotions, free or practice games, and direct email campaigns, are already being used to promote online gambling.[297] Some advocates suggest that such advertising could lure would-be and existing gamblers to participate in online gambling, thereby leading to greater incidence of problem gambling.[298]

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[293] Todd notes that the UIGEA does not seem to have had an impact on online gambling in the United States. Aaron Todd, *NETeller Exit Impacts U.S. Internet Gambling Market*, onlineCasinoCity, Jan. 18, 2007, http://online.casinocity.com/news/news.cfm?ArticleId=70015 (last accessed on September 11, 2009); cited by Gerd Alexander, "The U.S. on Tilt: Why the Unlawful Internet Gambling Enforcement Act is a Bad Bet," *Duke Law & Technology Review*, 5 (2008), at ¶6.

[294] See *Supra* at footnote 60 at ¶11–12.

[295] It should be noted, however, that the FTC and the various state attorneys general would in all likelihood retain jurisdiction over advertising online and the FCC would retain jurisdiction over advertising on broadcast and cable media.

[296] See *Supra* at footnote 19 Sally Monaghan.

[297] See *Id.*

[298] See *Id.*

Mitigating Considerations: A note of caution is needed about the links that connect increased advertising for online gambling with increased problem gambling. First, the connection between increased advertising and aggregate growth of online gambling volume is likely and is supported by forecasts of increased online gambling post legalization.[299] However, no research has been done to establish how much of the increase in online gambling is displacement of already existing land-based gambling versus new gamblers or increased activity by existing gamblers. Second, the connection between increased online gambling and increased incidence of problem gambling is also not established. Early research indicates that, at least in mature markets such as the United Kingdom, access to additional gambling opportunities in general and the addition of online gambling opportunities in particular do not appear to increase the incidence of problem gambling.[300]

Some regulations have been enacted to limit the advertisement of gambling products across various jurisdictions. In the United Kingdom, the introduction of the Gambling Act brought new restrictions on gambling advertising and subjected it to regulation by the Department for Culture, Media and Sport (DCMS), the British Gambling Commission, and the Advertising Standards Agency, as well as its former regulatory bodies, the Broadcast Committee of Advertising Practice (BCAP) and the Committee of Advertising Practice (CAP).[301] The various regulations include provisions prohibiting advertising to minors or vulnerable adults, among others.

In addition to these rules, however, the gambling industry has issued a "voluntary" code for socially responsible advertising, which specifically requires that advertisements include the address of the United Kingdom's problem gambling help website and encourages operators to include responsible gambling messages in their advertisements.[302] The code also introduces a "watershed" time of 9 p.m., before which any newly permitted forms of gambling cannot be advertised, although the code does allow for the advertising of sports betting around televised

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[299] As noted in an August 4, 2009 interview with Simon Holliday, Director of H2 Gambling Capital (U.K.). Also, in a note to investors, the investment bank Goldman Sachs predicted a legalized online gambling market in the U.S. worth $12 billion (more than double the estimated size of the current market). See Jon Parker, "US to legalize online gambling; worth $12bn, Goldman Sachs predicts," *eGaming Review,* June 29, 2009, http://www.egrmagazine.com/news/industry/168682/us-to-legalise-online-gambling-worth-and3612bn-goldman-sachs-predicts.thtml (last accessed on August 26, 2009). Also, in an analysis provided to a payment processing firm, PricewaterhouseCoopers estimated the federal revenue effect of legalized online gambling to range from $13.0 billion (with a higher number of states opting out of the legislation) to $25.9 billion (with a lower number of states opting out) for the period 2010–2019. See PricewaterhouseCoopers, *Estimate of Federal Revenue Effect of Proposal to Regulate and Tax Online Gambling – Executive Summary,* prepared for UC Group, April 24, 2009, http://www.safeandsecureig.org/media/pwc09.pdf (last accessed on August 28, 2009).

[300] See *Supra* at footnote 293.

[301] Simon Fielder and Dominic Hodgkinson, *United Kingdom's Gambling Industry Adopts Voluntary Code on Advertising Standards,* Pillsbury Winthrop Shaw Pittman LLP, September 2007, http://www.pillsburylaw.com/siteFiles/Publications/AD40F0C315922BF5A969E8BF6379B2E4.pdf (last accessed on August 7, 2009).

[302] See *Id.*

sporting events.[303] In Australia, advertising restrictions are determined by the states/territories; most prohibit advertising to minors and the use of misleading statements, while some have no specific regulations.[304] The National Gaming Board of South Africa has set forth guidelines regarding advertising, prohibiting, among others, advertising to minors and advertising that may encourage excessive gambling.[305] The U.S. could impose whatever targeted restrictions on advertising deemed necessary or appropriate.

2. Potential Benefits of Legalization

The following sections describe two mechanisms through which regulation could reduce problem gambling. Regulators could implement (1) public policy measures designed to educate the public on the dangers of problem gambling and (2) efforts to provide resources to those affected by problem gambling.[306]

a. *Access to Funding to Increase Awareness of Problem Gambling*

If the United States decides to legalize and tax online gambling, significant revenues may accrue from the imposition of taxes and license fees.[307] Australia, Costa Rica, Great Britain, Aruba, and Antigua are some of the many countries that have recognized tax benefits from legalizing online gambling.[308]

The United States could use tax and license revenues to substantially boost publicly funded prevention, counseling, and treatment programs as well as research on gambling addiction.[309] Currently, statutes in some states require that information regarding problem gambling be provided to persons participating in any form of legalized gambling. At least three states require that telephone helplines be maintained for problem gamblers.

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[303] See *Id.*

[304] See Advertising Federation of Australia, *Gambling,* http://www.afa.org.au/public/content/ViewCategory.aspx?id=509 (last accessed on August 7, 2009).

[305] Mpande Advisors, *Report on the Regulation of Interactive Gambling,* prepared for the National Gambling Board of South Africa, October 2005, at p. 50 and 67.

[306] See *Supra* at footnote 153. Also see *Supra* at footnote 60 at ¶11–12.

[307] Researchers have estimated that at a flat tax rate of 6.25%, online gambling could generate more than $750 million annually. See *Supra* at footnote 69 Christopher Grohman at p. 68.

[308] See *Id.*

[309] See *Supra* at footnote 258 Michael Belletire at p. 12–13. Also see General Accounting Office, *Internet Gambling: An overview of the Issues,* GAO-03-89, December 2002; cited by Gerd Alexander, "The U.S. on Tilt: Why the Unlawful Internet Gambling Enforcement Act is a Bad Bet," *Duke Law & Technology Review,* 5 (2008), at ¶9.

Advocates for problem gamblers have been very vocal about the under-funding in existing budgets for prevention, counseling, and treatment services and observe that most health insurers currently do not cover these services.[310] Only 25 states provide any funding for problem gambling programs.[311] Availability of tax dollars from online gambling revenues and licensing fees could be used to substantially bolster problem-gambling awareness and treatment programs, and to provide educational supports for parents and higher-educational institutions dealing with underage gambling.

b. *Wider Implementation of Responsible Gambling Features*

Legalization of online gambling could lead to the introduction and wider implementation of regulations that give online gamblers tools for controlling their own gambling behaviors.[312]

Online gamblers today have access to a variety of online gambling options. However, research indicates the general lack of responsible gambling practices and safeguards offered by these online gambling websites. A 2004 exploratory study of 30 U.K.-based Internet gambling sites found that very few sites engaged in socially responsible practices.[313] Of the 30 sites, 26 had no reference to a problem gambling help resource; further, 20 sites showed no evidence of social responsibility and 29 sites did not seem to give an option to self-exclude from the site.

Various types of responsible gambling practices have been advocated, including links to problem gambling helplines and websites, self-exclusion programs, and self-imposed time and money limits. [314] Some common elements of regulatory structures across leading online gambling jurisdictions include (1) requiring operators to provide players with mechanisms to set their own

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[310] Franklin discusses lack of federal funding for treatment or awareness of problem gambling, lack of insurance parity for problem gamblers, and limited or lack of funding from most states in the United States. Joanna Franklin, *Problem Gambling in the U.S – From the Beginning into 2001*. Presentation available at Responsible Gambling Council, http://www.responsiblegambling.org/articles/Problem_and_Pathological_Gambling_A_view_from_the_States.pdf (last accessed on September 10, 2009). Also Winslow discusses the lack of state funding for problem gambling services in Colorado and other states in the United States. Kyle Winslow, "A Problem for Gamblers," *The American Prospect,* March 10, 2008, http://www.prospect.org/cs/articles?article=a_problem_for_gamblers (last accessed on September 10, 2009).

[311] As noted in a June 5, 2009 interview with Keith Whyte, Executive Director of the National Council on Problem Gambling.

[312] See *Supra* at footnote 153 at p. 15.

[313] See *Supra* at footnote 25.

[314] As noted in a June 10, 2009 interview with Howard Shaffer, Director of the Division on Addictions and Associate Professor of Psychology in the Department of Psychiatry at the Cambridge Health Alliance. Also, as noted in a June 10, 2009 interview with Bo Bernhard, Director of Gambling Research at the UNLV College of Hotel Administration, Nova Scotia recently introduced voluntary loss limits as a self-regulatory device in its land-based gaming operations. Also as noted in an August 5, 2009 interview with Phill Brear, Head of Gambling Regulation at the Gibraltar Regulatory Authority, gambling websites regulated by Gibraltar have responsible gaming features such as "cool-off" periods and self-exclusions mechanisms.

betting limits or limit the deposits they make to their online gambling accounts; (2) requiring site operators to allow gamblers to self-exclude from participating in gambling with the operator; (3) permitting family members to petition to exclude a gambler from a website; (4) banning extension of credit to players; (5) requiring operators to display prominent links to support and counseling services.[315] In addition to these, the European Gaming and Betting Association lists approximately 50 provisions related to mitigating problem gambling.[316] U.S. regulators could use this list as a menu from which to identify and evaluate various safeguards. The list includes requiring registration pages to offer self-diagnostic tests designed to help would-be gamblers understand their own attitudes and vulnerabilities, and requiring operators to impose speed-of-play, compulsory time-outs, or player-loss-rate caps.[317] Aristotle, Inc., mentioned previously, has produced the Integrity Self-Exclusion List (SEL), an international database of people who have chosen to exclude themselves from bricks-and-mortar and online gambling.[318] If an excluded gambler attempts to open an account, Integrity will not return an approval code from its verification system.[319] Finally, gambling sites can train staff to identify spending patterns that indicate problem gambling and to contact the gambler directly.[320]

In assessing the general effectiveness of responsible gaming features in the context of online gambling, one 2008 study by researchers at Harvard University demonstrated that responsible gaming safeguards can be effective in the Internet gambling environment. With self-limits, online gamblers reduced their frequency of play—both the number of days on which they placed bets and the number of bets they placed per betting day. The amount they wagered per bet did not change significantly, although the online gamblers did reduce the total amount they wagered.[321] In a large-scale survey of online gamblers, when asked about the usefulness of including

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[315] See *Supra* at footnote 287 at p. 10–12. Also Grohman notes that the United States could set up a protocol such that banks or other financial institutions must monitor deposits onto sites and report habitual or problem gamblers to proper authorities. In addition, he notes that the government could empower families to monitor problem gamblers by installing monitoring chips in computers. See *Supra* at footnote 69 Christopher Grohman at p. 67. Also see *Supra* at footnote 25. Also see *Supra* at footnote 153 at p. 15. Also see *Australia: Uniform Standards for the Regulation of Interactive Gaming,* The National Working Party on Interactive Gaming, Exposure Draft, April 5, 2001, at p. 22.

[316] *EGBA Standards Benchmark Study: Overview,* European Gaming & Betting Association, 2008, Table 2, at p. 11–13.

[317] See *Id.*

[318] Integrity, *Self-Exclusion List (Online Gaming),* Aristotle, Inc., http://integrity.aristotle.com/index2.php?option=com_content&do_pdf=1&id=52 (last accessed on August 11, 2009).

[319] See *Id.*

[320] As noted in an August 5, 2009 interview with Phill Brear, Head of Gambling Regulation at the Gibraltar Regulatory Authority.

[321] Sarah E. Nelson *et al.*, "Real Limits in the Virtual World: Self-Limiting Behavior of Internet Gamblers," *Journal of Gambling Studies*, 24 (2008): 463–477, http://www.divisiononaddictions.org/html/reprints/selflimits.pdf (last accessed on September 11, 2009), at p. 7.

responsible gambling features, such as self-imposed time limits, self-exclusion, regular financial statements, and regular self-assessments tests, online gamblers indicated that they would find it "quite useful." The Executive Director of the National Council on Problem Gambling, Keith Whyte, testified before the U.S. Congress as follows:

> The graphical and interactive structure of the internet provides a revolutionary opportunity to create informed consumers with access to a variety of information designed to encourage safe choices and discourage unsafe behavior....
>
> The technology also exists, unlike for other forms of gambling, to allow players and operators to set limits on time, wagers, deposits, etc...as well as to exclude themselves.[322]

D. Concluding Remarks

Legislative restrictions have failed to prevent U.S. gamblers from engaging in online gambling. Rather, those restrictions have led to additional business for Internet gambling operators beyond the regulatory reach of the United States. The current environment lacks responsible gaming features and safeguards offered to gamblers and limits publicly funded resources to educate the populace about problem gambling. We believe that regulators should be able to design sufficient protections to prevent any significant growth in problem gambling that results from legalization. Operators licensed within the United States should be required to offer a best-in-the-world range of services and resources for problem gamblers as well as to prevent underage gambling. Moreover, a proportion of the tax revenues and licensing fees derived from the U.S.-based industry could be used to substantially bolster the level of support for educational programs and services. According to André Wilsenach, head of the Alderney Gambling Control Commission, problem gamblers would receive "clear-cut" benefits from regulated online gambling, since land- and river-based gaming does not provide the tools that are possible in an online environment.[323]

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[322] Statement of Keith Whyte, in U.S. House of Representatives, Committee on Financial Services, *Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?* 110th Cong., 1st Session, June 8, 2007, at p. 120.

[323] From an August 27, 2009 interview with André Wilsenach.

APPENDIX A

Table 1 provides an overview of the 10 risks, providing for each:

- an indication of protections afforded under the current U.S. regulatory framework;
- an indication of the natural regulatory structure and strategy for control; and
- comments regarding relevant technologies and tactics, and the respective role of other parties.

TABLE 1: Major Categories of Risk Related to Online Gambling

	Category	Existing Protection	Natural Regulatory Structure & Strategy	Relevant Controls & Technologies
1.	**Gambling by minors**	No effective protection. Offshore sites range from well regulated to completely unregulated.	Industry's short-run incentives: ***supervisory***. Industry's long-run/strategic view: ***cooperative***.	(Strongest form) Positive id matching at player registration against existing databases of known adults. Range of weaker forms of age verification available at player registration. Provision of child-protective software for parents, to keep minors off their parents' accounts.
2.	**Consumers defrauded by site operators**	No effective protection. Offshore sites range from well regulated to completely unregulated.	***Supervisory:*** Enforcement focus aimed at disreputable operators. Exclusion of bad actors.	Vetting applicants and monitoring existing licensee behavior. Licensee oversight that includes software audits, mystery shopping, and betting pattern monitoring by regulator. Available complaint procedures: players report directly to regulators and have access to U.S. courts.
3.	**Players cheated by other players**	Detection mostly by other players. Remedies unavailable if sites deny the problem.	***Naturally cooperative:*** Public and industry's interests both served by preserving integrity of games.	Comprehensive data retention by sites. Routine operation of pattern recognition systems for anomaly detection. Complaint procedures available for players to report anomalies to operators and to regulators. Regulatory oversight of complaint investigation and disposition.
4.	**Involvement of organized crime**	No effective protection with respect to offshore activities.	***Supervisory:*** Enforcement focus aimed at disreputable operators. Exclusion of bad actors.	Vetting applicants and monitoring existing licensees/operators for · criminal backgrounds, · criminal associations, and · hidden ownership interests.
5.	**Money laundering by site operators**	Offshore operations subject to international cooperative enforcement efforts.	***Supervisory:*** Enforcement focus aimed at disreputable operators. Exclusion of bad actors.	Vetting applicants and monitoring existing licensees/operators for · criminal backgrounds, · criminal associations, and · hidden ownership interests.
6.	**Money laundering by players**	No effective protection.	Short-run incentives: ***supervisory.*** Long-run/strategic view: ***cooperative.***	Anti-money-laundering laws apply. Comprehensive data retention by sites. Details of every transaction recorded (not possible in casinos). Pattern recognition · by operators as part of a compliance operation, and · by regulators as part of oversight audit operation.

TABLE 1 (continued): Major Categories of Risk Related to Online Gambling

	Category	Existing Protection	Natural Regulatory Structure & Strategy	Relevant Controls & Technologies
7.	**Violation of jurisdictional restrictions or prohibitions**	No effective protection. States have no remedy with respect to offshore sites.	Short-run incentives: ***supervisory.*** Long-run/strategic view: ***cooperative.***	Right of government to prohibit or restrict · operators within state, and · services offered to residents by operators outside of state. Federal regulation of licensees that obliges them to respect list of state exclusions/restrictions. Residence validation at player registration. Geolocation monitoring for each player session (e.g., by ISP analysis). Regulatory audits of operators' software controls. Mystery shopping/testing by states exercising rights to restrict. Federal and state remedy against licensed operators through federal or state law.
8.	**Breaches of data confidentiality**	No effective protection. Offshore operators outside U.S. jurisdiction.	Short-run incentives: ***supervisory.*** Long-run/strategic view: ***cooperative.***	Licensees subject to all U.S.-based requirements regarding data confidentiality. Licensees subject to criminal sanctions and civil liability for breaches/abuses. Data-protection controls subject to audit.
9.	**Communications and computer security failures**	No effective protection. Offshore operators outside U.S. jurisdiction.	Short-run incentives: ***supervisory.*** Long-run/strategic view: ***cooperative.***	Principal responsibility for state-of-the-art security should rest with site operators. Civil liability for site operators with respect to any harm to consumers. Regulator's role in auditing site security software/systems.
10.	**Problem gambling behaviors**	No effective protection. Offshore sites range from well regulated to completely unregulated.	Short-run incentives: ***supervisory.*** Long-run/strategic view: ***cooperative.***	Site-imposed limitations & controls. Self-imposed exclusion options. Self-imposed limiting options. Taxes and license-fee revenue distribution can extend & enhance counseling & support services.

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Wood, Robert, and Robert Williams. *Internet Gambling in Comparative Perspective: Patterns, Problems, and Interventions.* University of Lethbridge. Presentation to the Alberta Gambling Research Institute Annual Conference, March 2009.

List of Individuals Interviewed

Name	Date of Interview
Parry Aftab Executive Director Wired Safety	05/27/2009
Bo Bernhard Director of Gambling Research UNLV College of Hotel Administration	06/10/2009
Michael Bolcerek Senior Vice-President of Business Development Aristotle	08/10/2009
Phill Brear Head of Gambling Regulation Gibraltar Regulatory Authority	08/05/2009
Peter Collins Professor of Public Policy Studies, Director of the Center for the Study of Gambling University of Salford (U.K.)	06/10/2009
Philip J. Cook Senior Associate Dean for Faculty and Research, ITT/ Terry Sanford Professor of Public Policy, Professor of Economics and Sociology Duke University	06/10/2009
Kelli Emerick Executive Director Secure ID Coalition	08/06/2009
Andrew Fritchie General Counsel PartyGaming PLC	08/21/2009
Glenn Gibson Manager, Technical and Systems Audit Tasmanian Gaming Commission (Australia)	08/05/2009

Damien Jarvis 08/05/2009
Assistant Director
Liquor and Gaming Branch
Tasmania Department of Treasury and Finance (Australia)

Matthew Hill 06/12/2009
Director of Strategy, Research and Analysis
British Gambling Commission (U.K.)

Simon Holliday 08/04/2009
Director
H2 Gambling Capital (U.K.)

Joseph Kelly 06/01/2009
Professor
SUNY Buffalo Business Law

Paul Mathews 08/03/2009
Former Senior Vice President
IGT Wagerworks

Sam McQuade 06/03/2009
Graduate Program Coordinator
College of Applied Science and Technology,
Rochester Institute of Technology

Katharina Riedl 08/13/2009
bwin (Austria)

Paul Morris 06/12/2009
Policy Development Manager
British Gambling Commission (U.K.)

Chris Pinion 08/10/2009
National Account Manager
LexisNexis Risk and Information Analytics

Sue Schneider 08/17/2009
Founder
Interactive Gaming News

John Sealy 08/31/2009
Manager, Information Systems and Technology Services
Licensing, Regulation and Alcohol Strategy
Northern Territory Department of Justice (Australia)

Howard Shaffer 06/10/2009
Director of Division on Addictions
Associate Professor of Psychology, Department of Psychiatry
The Cambridge Health Alliance, Harvard Medical School

Charles Wellford 06/17/2009
Professor of Criminology and Criminal Justice
University of Maryland, College Park

Keith S. Whyte 06/05/2009
Executive Director
National Council on Problem Gambling

Jamie Wiebe 08/07/2009
Director
Centre for the Advancement of Best Practices
Ontario Responsible Gambling Council (Canada)

André Wilsenach 08/27/2009
Chief Executive Officer
Alderney Gambling Control Commission

EXHIBIT B

CAN INTERNET GAMBLING BE EFFECTIVELY REGULATED TO PROTECT CONSUMERS AND THE PAYMENTS SYSTEM?

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

JUNE 8, 2007

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GARY G. MILLER, California
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PATRICK T. McHENRY, North Carolina
JOHN CAMPBELL, California
ADAM PUTNAM, Florida
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CAN INTERNET GAMBLING BE EFFECTIVELY REGULATED TO PROTECT CONSUMERS AND THE PAYMENTS SYSTEM?

Friday, June 8, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Present: Representatives Frank, Carson, Cleaver, Wexler; Bachus, Paul, and LaTourette.

The CHAIRMAN. Good morning. The hearing will come to order. First, let me apologize to the witnesses for the fact that only a couple of us are here. When I originally scheduled this hearing, we were under the impression that there would be votes this morning. On the other hand, your testimony will not be interrupted by our having to go off for an hour while you all sit here, so there are pluses and minuses to that. Staff members of various members are here, and they are often a very good way to get information to us.

This hearing is on the subject of the regulation of Internet gambling. Gambling in general is not the jurisdiction of this committee, and in fact, I had a conversation on Monday, I believe of this week, or Tuesday, rather, with John Conyers, the chairman of the Judiciary Committee, which has primary jurisdiction over gambling.

In the previous Congress, we did enact legislation to restrict the payment of Internet debts where credit cards were involved, and that's wholly within our jurisdiction. I voted against that bill, and I think it's important to be clear about what I think is really at issue here.

The bill was justified in part by people who said that we must prevent money laundering for the purposes of either terrorism or drugs, and that we must prevent young people from doing things that they shouldn't do. But my own conviction, having talked to a lot of members, and listening to the debate, is that the primary motivation came from people who think gambling is wrong.

Now, I have no quarrel with people who think that gambling is wrong. My quarrel is with people who, thinking that gambling is wrong, want to prevent other people from doing it.

This whole debate has driven me back to a book that I only vaguely remembered, and I have now become impassioned with: John Stuart Mill's, "On Liberty." I recommend it to people for the great philosophic text in our tradition.

The book makes the essential point that it is not the role of the government to send people with guns, under the threat of imprisonment, to make you better. We can give people information. We can, through various institutions in the society, give people instruction. But in the end, adults ought to be able to decide for themselves how they will spend the money that they earn themselves, as long as it does not have an effect on others.

Now, it is possible to argue that everything we do affects everybody else. People have said, "Well, you say it doesn't affect others, but if you gamble too much, then you're affecting others." Well, if you do anything too much, it affects others. The problem with that is it's a classic case of an argument that proves too much.

If you take that argument that, in fact, people have a right to your services, that people have a right for you to be healthy, it goes to extremes. People start telling each other what to eat, when to exercise; all of those things affect you.

Clearly, there is in the minds of most of us a distinction between those things we do that primarily affect ourselves and those who choose voluntarily to associate with us, and those things that we do that inevitably impact on others. That is a line that I think government would be well advised to respect, and this bill undoes that.

It is one of the rare cases where some of my conservative friends and some of my liberal friends come together. I have conservative friends who tell me gambling is wrong, and apparently I hear from some that there are biblical injunctions against it, although apparently there is an exception for bingo, which I have not yet been able to—I don't have a good enough textual expertise to find it, but I gather it is there. On the part of my liberal friends, to be honest, I think many of them think it's tacky. I think that they just don't think it's a nice thing to do, and therefore feel free to ban other people from doing it.

Some argue, well, we must protect the poor from spending their money unwisely. I reject that. If you want to help poor people, there are other ways to do it.

I suppose if you don't have enough money, there are a lot of things that I might advise you not to do: drink beer; go to baseball games; buy certain things; or spend too much on articles of clothing. Yes, there are a lot of pieces of advice we should give people. But I would not legally ban lower-income people from spending too much on their athletic shoes and their jeans, and I don't think we should do that here.

Now, I know the argument is, well, but there are abuses here. I believe we can deal with the abuses. Let me deal with one, and that is young people. There is a great danger in this society that we will substantially circumscribe the freedom that adults ought to have because we are afraid that some young people might abuse it.

It is incumbent upon us to try to differentiate in our laws between what adults can do and young people can do, and as far as Internet is concerned, I will say, from a lot of my conservative colleagues, I hear the mantra, "Never regulate the Internet."

And I guess what they really mean is, "Never regulate the Internet unless we find something offensive, and then we'll regulate it,"

because this is the most substantive interference with the freedom of the Internet that has ever been enacted into law.

People are entitled to be for this. They are not entitled to be for this and then say, "Oh, but we respect the integrity of the Internet to be free."

And let me just close by saying this: We do allow a number of things to go on through the Internet that should be age-restricted. You can buy wine over the Internet. You can buy cigarettes over the Internet. You can look at—in fact, the courts have said to us, to the Congress, "You have gone too far in terms of First Amendment rights in banning certain kinds of sexual-oriented material." Instead, they have said, "Differentiate according to age."

So we have been told by the courts, by the Supreme Court of the United States, that it is not appropriate simply to ban something entirely because young people might abuse it. Instead, we are under the obligation constitutionally to do the best we can to differentiate.

I think we know that there are ways that you can not totally prevent, but substantially diminish, age-inappropriate uses through the Internet. That ought to be done here.

But I again want to repeat, and we're also told, "Well, gambling is this possible front for terrorism." Well, everything is a possible—everything. But there is zero evidence that we have, in fact, had people playing poker so they can bomb buildings. I await that evidence. I hope it isn't there. If it is, I'll look at it. But I don't believe it is.

I think, just to close, what we have is people who don't like gambling and think that they have a right, through the government, to prevent other people from doing it. I regard that as a very grave crossing of the line that we in government ought to respect.

I now recognize the gentleman from Alabama.

Mr. BACHUS. I thank the chairman, and I appreciate the opportunity for us to discuss the legislation that we passed last year.

One of the last acts that this Congress passed last year was the Unlawful Internet Gambling Enforcement Act. It passed 317 to 93, and enforcement of the Act capped a multi-year effort to protect American families from the well-documented ill effects of illegal online gambling.

The new law attacks the problem of Internet gambling, illegal Internet gambling, through the payment systems, by prohibiting financial intermediaries from processing transactions involving unlawful gambling under applicable State and Federal laws, including the Federal Wire Act, and the Professional and Amateur Sports Protection Act.

It does not prohibit anything which is not already illegal. It simply enforces the law that has existed in this country for years.

As the record developed by this committee and the Judiciary Committee over the past several years has shown, gambling too often, illegal Internet gambling, results in addiction, bankruptcy, the destruction of families, and criminal activity. Internet gambling magnifies the destructiveness of gambling by bringing the casino into the home.

According to an extensive study conducted by the University of Connecticut Health Center, 74 percent of those who have used the

Internet to gamble have serious, chronic problems with addiction, and many of those have resorted to criminal activities to pay for their habit.

One of the witnesses who is with us this morning, Pastor Greg Hogan, will share with this committee the story of how Internet gambling addiction placed his high-achiever son on a path that ultimately led to prison.

The NBA, the NCAA, major league baseball, all of those testified before our committee as to the corrupting influence of illegal Internet gambling on athletes. Some claim that illegal Internet gambling is a victimless crime. The chairman has done that this morning.

In fact, the real, the very real victims of illegal Internet gambling, the ones I'm concerned about, are the ones he spoke of, the underage gamblers who, by the tens of thousands, are becoming compulsive, addictive gamblers.

They can't go in a casino. They can't go in debt legally. So they do it on the Internet, which is prohibited and illegal, but they do it anyway. They do it in their bedrooms. They do it in their dorm rooms. It is a mushrooming epidemic, leaving in its wake suicides, crime, and financial and family tragedies.

The Judiciary Committee, and our committee, had several instances of college students who committed suicide as a result of Internet gambling and the debts they drove up. When it comes to illegal Internet gambling—and I stress, we're talking about illegal Internet gambling. So those who are testifying in favor of this bill are actually talking about taking away prohibitions on what is already illegal.

If the activity was legal, then it would have been in our court to try to make it illegal, but this is not a debate over whether it's illegal or not. Every State in this union has a prohibition against this type of gambling.

When it comes to this type of gambling, illegal Internet gambling, there are three reasons in particular why it is dangerous.

Number one, the Harvard Medical School, the University of South Florida, and the American Psychiatric Association all conducted studies showing that the earlier one begins gambling, the more likely it is he or she will become an addicted, problem gambler. In fact, the Harvard study—and you are a graduate of Harvard, Mr. Chairman—showed that teenagers are 3 or 4 times more likely to become addicted than the older population.

Second, pre-teens, teens, and college students have unlimited access to the Internet, 24 hours a day, 7 days a week. Because of the repeated exposure they have to illegal Internet sites, gambling sites, they fall victim by the thousands. These are illegal sites operated, most of them offshore, or all of them offshore, I would assume.

So the people who are operating these sites are violating the laws of our country. I don't know any other way to say it, other than that they are criminals. If you violate the criminal laws of our country, does that make you a criminal? I think it does. In fact, a University of Connecticut study showed that as many as three in four pre-teens and teens who are exposed to Internet gambling become addicted.

Third, compulsive, problem gambling, particularly among young people, has been shown to result in the following: Increased withdrawal from normal activities; and turning to criminal activities to recoup financial losses.

The NCAA testified before the Judiciary Committee about the starting quarterback at Florida State University, who on an illegal Internet site ran up over $10,000 worth of debt, turned to burglary to try to solve this problem, was betting on games involving his own institution, and ended up in prison. He is only 1 of about 14 NCAA athletes who have been convicted in the past few years of illegal Internet gambling. A lot of people don't care about this. They make money on these games, they make money on these athletes, and so they aren't really concerned with whether the athletes end up in jail.

But this same study, the Connecticut study, showed that many of these teens turn to criminal activities to recoup their financial losses, they take drugs to deal with the depression, and as the Harvard study showed, the South Florida study, the American Psychiatric study, and 48 other studies by universities and health groups showed, their irresponsible behavior leads also to family and other relational problems.

A study by McGill University, and this is in the past 2 years—we didn't have the benefit of this study—found that nearly one-third of teen compulsive gamblers have attempted suicide.

The University of Pennsylvania has recently found that the number of young people addicted to gambling, largely due to what they found was an increased exposure to illegal Internet gambling, is growing by an alarming 20 percent between 2004 and late 2005.

They call this an epidemic which the country will deal with socially and economically for decades to come.

Thus, Congress's failure to act for many years, because of the resistance of many of the people pushing for today's bill, we are seeing the devastating consequences of efforts in this Congress for 2 or 3 years to stall our efforts.

The law we passed last year has already had a significant impact on the market for illegal gambling services, prompting the major players in the industry, many of which are publicly traded companies in the United Kingdom, to cease their U.S. operations immediately.

As reports in the Washington Post and others showed, they spent over $100 million resisting our effort to pass this bill. And yet, just as the new law is in the process of being implemented, through regulations that the Treasury and the Federal Reserve are expected to issue shortly, a concerted effort is already underway to undo it.

Chairman Frank has introduced legislation that we regulate rather than prevent gambling over the Internet. I don't question his motive, but the bill would establish the presumption in favor of legalized online casinos and sports betting—something that the NBA, major league baseball, the National Football League, and the NCAA worked for years to stop—and reward and legalize offshore Internet gambling sites that accept debts from Americans in violation of the U.S. law.

The licensing regime contemplated by the legislation is premised upon the ability of Internet gambling sites to detect and block attempts to gamble online by minors, compulsive gamblers, and individuals located in jurisdictions that legally prohibit gambling.

Let me say in conclusion, Mr. Chairman, that experts in the field of online protection and identity verification have openly questioned the effectiveness of technology currently available that attempts to verify age and identity in online settings, and advise the Judiciary Committee that only the prohibition we passed would work.

In summary, Mr. Chairman, there is no compelling reason to change the course that Congress wisely charted last year when it passed strong legislation to combat the scourge of Internet gambling.

Rather than spending our time trying to undermine the new law, we should be devoting our energies to rigorous implementation. America's youth, their families, and communities should expect no less.

Thank you, Mr. Chairman.

And let me say this—

The CHAIRMAN. We're over 10 minutes.

The gentleman from Florida.

Mr. WEXLER. Thank you, Mr. Chairman.

I will be brief. I just want to make a couple of quick points.

First, I very much want to associate myself with Chairman Frank's remarks and simply want to point out what I think are certain misunderstandings in terms of the current law.

If you were to listen only to those last year who advocated in support of the Unlawful Internet Enforcement Gambling Act and listen to the ranking member this morning, you might have the impression that there is no legal gambling on the Internet today in the United States. That's not true.

The law, the way it was crafted last year, in the current state of the law, if you want to bet on horse racing on the Internet today, you can do it with perfect legality. So if your thing is betting on horses, you can bet on the Internet, and we sanction it. If you want to participate in lotteries, in many of the States across the Nation, you can bet on lotteries all you want, on the Internet. Off-track betting is now on the Internet.

So the uneven state of the law simply says that if you're a horse racing fan, you can bet on the Internet, but if you're a poker player, you can't bet on the Internet. If you play Mah Jongg, and I represent a district that is probably the Mah Jongg capital of the world, if you play Mah Jongg, you can't bet on the Internet.

So this statement of gambling versus non-gambling is not, I don't think, reflective of the reality of the law the way we are today.

And if I can make one point as to personal responsibility, which I think gets to the heart of some of the objections, I have three kids. You could turn on HBO at 1:30 in the morning, and probably very simply watch movies I wouldn't want my 14-year-old child to watch. Does that mean we should shut down HBO? Of course not. What it means is, I or my wife ought to be wondering why my 14-year-old is up at 1:30 in the morning, and if he is, checking to see what he's watching on television to see if we permit it.

But it's not HBO's fault if he's watching something at 1:30 in the morning, and I'm not bothering to check on my 14-year-old. Likewise, to bet on gambling on almost all sites, and I understand there are some exceptions, you need a credit card. Well, how does a kid get a credit card? He or she gets a credit card usually because mom or dad or the caregiver or the guardian permits them to have a credit card. And if they're really industrious and they're going about getting these phone cards from Eastern Europe or whatever it is, again, parental responsibility.

So I find it somewhat ironic that those that often are so quick to argue parental responsibility, individual responsibility, when it comes to online gambling, all of a sudden parents have no responsibility at all, apparently, to monitor the conduct of their teenage children.

The real issue is, adults that want to gamble on games of skill in particular, like poker and Mah Jongg, why not? Why should we make it into an illegal behavior?

And with respect to adults gambling, they do it today legally with the Congress's blessing, with State legislatures' blessing, all across America, but they happen to be the preferred choice of gambling apparently, horse racing and lotteries, but if you want to bet on poker and Mah Jongg, and other games, dog racing, apparently that's somehow immoral.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas.

Dr. PAUL. Thank you, Mr. Chairman. I appreciate the opportunity to talk about this bill, since I am an original co-sponsor. I'm not sure that I can improve on John Stuart Mill, or your statement, because I endorse essentially what you said, but I do want to make a few comments about this.

It has already been mentioned, but I strongly believe there are two major reasons why this is a good bill. One, freedom of choice is important in a free society. Responsibility for improving one's behavior should be on the individual, the family, and the church and local community, not on the Federal Government. It hasn't worked before, and it probably won't ever work in the future.

Also, I strongly believe in supporting this type of legislation because I want to do my utmost to protect the Internet, in that this is a source of the spread of information. Even for good reasons, regulating the Internet can backfire on us and be used for other reasons.

I was particularly interested in the chairman's comments about the economic right to spend one's own money, and I strongly endorse that principle, but I would like to emphasize that I'd like to see the day when the individual has an economic right to spend all their money and not just the money left over after the government took their share. So I would make a distinction there that I would like to see that we, as individuals, have the right to spend all our money.

But I would like to identify with the ranking member's statement, as well, because he has made some very good points, and I agree with his concerns about the danger of gambling.

Obviously, the issue of gambling doesn't interest me that much, because I don't like it, and I taught my kids not to do it, but it's back to the problem of who is really responsible.

One thing, if we look at our history, prohibitions never worked. It was a total failure for alcohol, and we're currently failing with drugs, so if you come in and have another prohibition, it won't work. It will just drive it into the underground, and even in the electronic age, there are ways of doing that.

One thing that is interesting in this new age of prohibition is that in the original prohibition era, when we thought we had to prohibit the use of alcohol to improve one's behavior, we did it, and because of great concern for the Constitution, we amended the Constitution. Then we repealed it when we found out it didn't work.

Today, there's no concern. We just write laws of prohibition, whether it's gambling or drugs or whatever. And I think the way we do these things is every bit as important as the issue itself.

But I'm a strong supporter of this legislation, and over the years, I had opposed the efforts of H.R. 4411, but I strongly support H.R. 2046 to restore the rights of Americans to decide for themselves whether or not to gamble online.

I yield back.

The CHAIRMAN. The gentleman from Ohio.

Mr. LATOURETTE. Thank you, Mr. Chairman. I'll attempt to be brief.

I want to welcome all our witnesses here today, in particular Reverend Hogan, whose church I understand is in Congresswoman Sutton's district, but you live in Hudson, Ohio, so I guess I get to claim you, and welcome you.

And I think that, as I listen to the other opening remarks, I have to tell you, maybe after this hearing, the gentleman from Florida can tell me how you bet on Mah Jongg. I'm not familiar with that.

And the other observation about parental responsibility—

The CHAIRMAN. If the gentleman would yield, I think the interesting question is, from my experience, how do you teach Mah Jongg players to use the Internet?

[Laughter]

Mr. LATOURETTE. It has been probably 25 years since I played Mah Jongg, so I don't know.

But relative to the credit card issue, I understand the whole thing about HBO and bad movies, but I have two children, one 23 and one 19. I have more than two children, but those are the ones who are of age, and both of them have three credit cards, and neither one of them have a job. I was horrified to find that out, and it certainly wasn't done with my permission or consent,

A former member of this committee, who is now elevated, I guess we call it, elevated to the United States Senate, Senator Sanders, I was always willing to join with him on this notion of these unsolicited credit card solicitations that go to people without jobs who are not of age. And so I think it's pretty easy for a person without a parent's knowledge, who is in college, to have a credit card and engage in this activity.

I respect the chairman's principled opposition to the bill that we passed last year. I guess I'm saddened that before the regulations are written, we are attempting to adjust that.

But I do hope that today's hearing does address some of the serious concerns, that even if the chairman's idea is a good idea, that the technology exists to actually do what the chairman envisions.

And the only case that I'm aware of, that I've had the chance to review, was *ACLU* v. *Gonzales,* and I think in that case, the judge said that the stuff doesn't exist, and if it does exist, it doesn't work.

So I respect the chairman's observations about children and keeping them from gambling and age restrictions, but if we don't have the software or hardware or whatever ware we need to accomplish what he's attempting to accomplish, I have to remain opposed to this legislation.

And I yield back.

The CHAIRMAN. I thank the gentleman.

I'm going to recognize myself for additional time. There are a couple of points that I want to make.

First of all, with regard to credit cards, frankly, I'm somewhat surprised to hear my Republican colleagues complain about the excessively free use of credit cards. I didn't vote for the bill, the bankruptcy bill that gave the credit card companies all those advantages. Some of the people on the Democratic side of the aisle, our colleague from North Carolina, Mr. Watt, had tried to put some restrictions on credit card company solicitations to young people.

So I do think it is the case that many of my Republican colleagues, in particular, have in every other aspect supported the ability of the credit card companies to solicit, to have special protections in bankruptcy, and now to complain that some of the people who get the credit cards that you have made so freely available and so iron-clad in terms of their collectability, that some people are misusing them, seems to me impinge on the freedom of others.

And I am struck that what I heard from the ranking member and others is that some people will abuse this. The argument that you ban something entirely because some people will abuse it seems to me the wrong principle for society.

I'm also struck by the inconsistency—my conservative friends, in particular, usually say, "Listen, if you've committed a crime, you're responsible." This notion that society made me do it is generally mocked by Republicans when we talk about criminal behavior.

And now what we're told is, "Oh, you must stop everybody in America from doing this because a minority of them will be led into criminal behavior and it won't be their fault." Well, that is an abdication of the principle of personal responsibility.

And the other thing I would say is that in terms of age restriction, I assume we will soon have legislation to ban the sale of cigarettes and alcoholic beverages over the Internet. To my understanding, you can buy cigarettes and alcoholic beverages over the Internet. Those are age-restricted, and I think they're very important.

Actually, I am struck that we—and I may have misunderstood here. I thought we were talking about young people, though as the gentleman from Florida said, if your pre-teen has a credit card, for God's sakes, take it away. Don't come and tell adults that they can't do something because you can't keep your 9-year-old's hands off of your credit card. But we're talking apparently about adults,

about people in their 20's, and I think we should make whatever we can available.

I would also say this: If you are in your 20's, and you have this predilection to do something wrong, it's very hard for a free society to stop you. At some point, there are other ways you can do it.

But I am struck again that what we are told here is not that this is inherently something wrong. You know, most things that I want to ban are just wrong. You should never take someone else's money. You should never assault someone. You should never start a fire. You should never cheat someone. But the argument that you make something illegal because a minority are going to abuse it is a problem,.

And the last thing I would say is this, in terms of the consistency issue. Many of my Republican friends have again talked about the importance of free trade and living up to our international free trade obligations, and we have been told that we can't do certain things because we did adhere to the World Trade Organization—I voted no, but we did—and we have to live up to those obligations.

We have been found in violation of our World Trade Organization obligations under this bill, and people are basically saying, "Well, who cares? The people who complain about us are little, so we can ignore them." But, you know, people are entitled to one side or other of the argument, but not to both.

Mr. LATOURETTE. Does the gentleman have any more time left?

The CHAIRMAN. Yes. You have 2 minutes left on your side.

Mr. LATOURETTE. Thank you. I'll try and just use about 30 seconds of it.

I hope the chairman was using the royal "you" because when we had the discussions on credit cards and everything else, I did in fact join with Sanders and Watt and so forth and so on.

I happen to not think that this unbridled solicitation of minors and people who aren't financially responsible should have credit cards, one, I thought it was a bad idea then, and I continue to think it's a bad idea now.

And so—

The CHAIRMAN. I acknowledge that, but I was talking about, I thought I was explicit, the great majority of the Republican party. The bankruptcy bill was passed by—

Mr. BACHUS. Will the gentleman yield?

The CHAIRMAN. I yield to the gentleman.

Mr. BACHUS. How much time do we have left on this?

The CHAIRMAN. On your side, none, but go ahead.

Mr. BACHUS. Okay.

[Laughter]

Mr. BACHUS. That concludes my remarks. No.

Let me just again say that the chairman has used the words "make illegal," "ban," "prohibit," and "stop." What we did late last year did none of those things.

Illegal Internet gambling was illegal, prohibited in all 50 States except in one or two rare cases, and in those cases, we didn't—the law didn't operate.

So yes, we have the right to decide what we're going to make legal and illegal, and we did that in this country, and that's why the—

The CHAIRMAN. I would ask the gentleman, what's the purpose of the law? If it was already illegal, what did you need this law for?

Mr. BACHUS. I mean, we didn't decide that—

The CHAIRMAN. But why did you want this law, then, if it was already illegal?

Mr. BACHUS. The law is an enforcement mechanism because even though there was a prohibition, it was a criminal activity to engage in it, people did it in offshore sites, and we weren't able to shut them down.

And I will agree with you, the WTO has come in and said it's a violation of the WTO and our international trade agreement for us to try to stop illegal Internet gambling in our own homes, which, boy, is—

The CHAIRMAN. No, let me—

Mr. BACHUS.—the testimony of the WTO and—

The CHAIRMAN. No, what the WTO said is what the gentleman from Florida pointed out, that it's hypocritical and inconsistent to allow your own gambling if it takes place at a racetrack in America or a dog track in America and ban it when it takes place in a foreign country.

What the WTO found us guilty of was blatant hypocrisy and violating the fundamental principle of the WTO, namely, that you cannot give yourself economic rights that you then deny to other countries.

Mr. BACHUS. I think we let other countries come in if they want to come in and gamble at our racetracks—

The CHAIRMAN. You might, but again, you misstated the WTO's principle. The WTO, if we had banned all gambling in America, then I don't think you would have had this WTO case.

But what they hit on was that we allow gambling in America, you can gamble on a racetrack in America, or a dog track in America, or State lotteries, or a whole lot of other things, but you can't—you know, And I guess, look, I suppose the next thing we'll see is that young people are buying too many scratch tickets. I don't know how you stop them doing that.

Mr. BACHUS. Well, of course, your scheme—you know, this legislation today, still the WTO has indicated they're still going to challenge what you do because it restricts access to our U.S. market.

The CHAIRMAN. Yes. And I would like to, if we had jurisdiction, I would restrict that, as well, but our committee doesn't have jurisdiction over that.

Mr. BACHUS. In fact, they have indicated that it's going to be easier to challenge, the WTO challenge, if this legislation passes.

The CHAIRMAN. Oh, I don't believe that's the case. We've already been found in violation. How can it be easier?

Mr. BACHUS. Well, you have arbitrary opt outs—

The CHAIRMAN. But it's already—

Mr. BACHUS.—and carve outs, which they prohibit.

The CHAIRMAN. You mean for the sports teams, the leagues? Yes, we did give those arbiters of absolute moral superiority, the professional athletic leagues, in a concession to reality, the right to opt out.

Well, let's get to the witnesses. The gentleman from Texas is going to introduce the first witness.

Dr. PAUL. Thank you, Mr. Chairman.

Chairman Frank, Ranking Member Bachus, I am pleased to welcome Radley Balko, senior editor of Reason Magazine, one of my favorite publications, to the hearing.

Mr. Balko is one of the most perceptive critics of government policies that prevent individuals from engaging in what the government considers immoral or unhealthy behavior. Mr. Balko's defense of civil liberties has appeared in a wide range of publications, including the Wall Street Journal, the Washington Post, and foxnews.com.

His writings on the militarization of law enforcement were cited by Justice Stephen Breyer's dissent in the *Hudson* v. *Michigan* case.

I'm sure my colleagues will benefit from Mr. Balko's thought on how banning Internet gambling is inconsistent with constitutional government and a free society.

Welcome.

The CHAIRMAN. Mr. Balko, go ahead. I know you went to some considerable trouble to get here, and we appreciate that.

STATEMENT OF RADLEY BALKO, SENIOR EDITOR, REASON MAGAZINE

Mr. BALKO. Thank you, Mr. Chairman.

Mr. Chairman, and distinguished members of the committee, my name is Radley Balko, and I am a senior editor with Reason Magazine. I am also a former policy analyst at the Cato Institute.

I have spent a good deal of my time writing and researching civil liberties issues, including the problems associated with the prohibition of victimless crimes. I'd also like to commend Chairman Frank for his work defending individual freedom, and I thank the committee for inviting me today.

The Unlawful Internet Gaming Act was passed under rather dubious circumstances. It passed the U.S. Senate on the last day of Congress, late at night, with no Floor debate, after being attached to an unrelated port security bill. My problem with how the bill passed, however, is beside the point. Let's get to the crux of this issue, Mr. Chairman.

What Americans do in their own homes, with their own money, on their own time, is none of the Federal Government's business. Take online poker, by far the most popular form of online gambling. Poker has enjoyed a surge in popularity over the last several years. The game is about as mainstream and uniquely American as baseball.

Poker evolved from similar card games in the early 1800's, then flourished in popularity on Mississippi's river boats, winning over such iconic American aficionados as Mark Twain. Today, most daily newspapers have a poker column, including the New York Times. The game saturates cable television. And until recently, even members of the Supreme Court had a monthly poker game.

Online poker is merely a new evolution of the game, similar to the way Civil War poker games introduced the straight, and gave us variations like draw and stud poker. The Internet merely removes the geographic barrier preventing those who love the game

from finding opponents of similar skill who are willing to wager similar amounts of money.

No one is hurt when two or more consenting adults sit down for a game of poker, be it online or in person. Why any of this should be of concern to the Federal Government is rather perplexing.

I respect the fact that many Americans and many Members of Congress may have moral objections to gambling, online or otherwise. To them, I'd say simply, well, don't gamble, then.

But in a Nation where Las Vegas is one of our fastest-growing cities and most popular tourist destinations, where Indian casinos are commonplace, where horse racing is a national pastime, where nearly every State in the union derives public funds from State lotteries, singling out Internet gambling for prohibition seems arbitrary, and, frankly, hypocritical.

Yes, it's possible that a parent could bet away their family's savings or their child's education fund in an online poker game. They could also fritter that money away on eBay or on booze or fancy cars or exotic travel. But these are personal decisions, and if a free society means anything, it means we should have the freedom to make bad choices in addition to good ones.

The ban on Internet gambling punishes the millions of Americans who are wagering online responsibly due to anecdotal evidence of a few who may do so irresponsibly. It's an affront to personal responsibility and symptomatic of a government that treats its citizens like children. A government based on the principle of liberty doesn't police the personal lives of its citizens for bad habits at any level, much less the Federal level.

Supporters of a ban on Internet gambling say that the industry is unregulated, that underage people are more likely to gamble online, and that it supports money laundering and similar criminal enterprises. These are all problems wrought not by the decision of a consenting adult to gamble, but by the Government's decision to prohibit it.

Were Congress to give its blessing to legalized online gambling, I suggest you'd soon see brand names like Harrah's, MGM, and Trump immediately enter the market. Reputable offshore brands like FullTilt Poker and PartyPoker would almost certainly incorporate in the United States and subject themselves to U.S. market regulation and Government oversight, including age restrictions.

Customers want to know that they're playing a fair game, that their bankrolls are secure, and that their privacy is protected. Companies that set up shop in the United States with the blessing and encouragement of the U.S. Government will almost certainly dominate the market. Winning could be taxed. Market forces and, if necessary, the Federal Government, could regulate and monitor gaming sites for fairness and transparency.

Most importantly, if online gambling were decriminalized, the Federal Government could get out of the trivial business of breaking up online poker games and Federal law enforcement officials and prosecutors could expend taxpayer-funded resources on more appropriate endeavors, like pursuing Internet or interstate fraud, theft, and protecting the country from terrorism.

In closing, the Unlawful Internet Gaming Act is a significant and disturbing and disturbing encroachment on individual liberty. I'd

This deposit provides immediate access to funds in the event of a valid consumer dispute. Further, too, this rolling reserve provides protection against the risk of money laundering.

Mr. Chairman, and members of the committee, I thank you for the opportunity to provide this testimony. I trust that our experience gives you helpful insight as to how a regulated environment can work, and why we believe prohibition does not.

Thank you.

[The prepared statement of Mr. Kitchen can be found on page 59 of the appendix.]

The CHAIRMAN. Thank you.

By the way, I should have said that without objection, any written material that any of the witnesses wish to submit will be made a part of the record.

Next, we have Mr. Jon Prideaux, who is an independent payments consultant.

Mr. Prideaux.

STATEMENT OF JON PRIDEAUX, CHIEF EXECUTIVE, ASTERION PAYMENTS

Mr. PRIDEAUX. Thank you very much, Mr. Chairman, and members of the committee. Thank you very much for the honor and the privilege of giving my testimony to you today.

As you said, my name is Jon Prideaux, I am an independent payments consultant, and I have nearly 2 decades of experience in the payments industry in Europe. Most of this was with Visa, though I should emphasize to the committee that I'm not speaking on behalf of Visa today.

I've worked together with banks and as a consultant with payment systems providers and also with marketing companies. I must tell you that I have never consulted for any Internet gambling company and I have no plans to do so.

Gambling in Europe, and in the U.K. in particular, is widely available, both on the main street and also online. Internet gambling, as has been mentioned, is offered by multi-billion dollar companies listed on public exchanges that are well-regulated and their shares are widely held and traded.

To place a bet and to withdraw one's winnings for an Internet gaming transaction is a multi-stage process. In each of these stages, there is independent validation and checking. By definition, Mr. Chairman, in a regulated world, Internet gamblers cannot be anonymous.

In this electronic medium, they must go through multiple "know your customer" stages in order to establish an account, and will necessarily leave an audit trail of their actions when they play.

So what are the control processes that are in place in Europe?

There is an important role for the State. In the U.K., the National Gambling Commission has the job of ensuring that the operator plays fair and also that the vulnerable are protected.

And in addition, the Financial Services Authority, or FSA, the agency in the U.K. which performs an oversight role similar to that of the Federal Reserve, is charged with protecting the integrity of the payment system, is charged with ensuring protection of consumers, and also with minimizing financial crime.

My own particular expertise, Mr. Chairman, is in the regulation and compliance programs operated by payment schemes. Visa, and to the best of my knowledge, Master Card and the other card companies, operate such regulatory and compliance programs and regimes directed at various different stages of the payment process.

The first process is directed at the accurate flagging and identification of Internet gaming transactions. Controls also apply at the moment at which transactions are authorized. When they're cleared through the system, monitoring can be done for unusual patterns, as can also be done when credits or payouts are made.

And in addition, as an important safeguard, there is a possibility to monitor the level of disputes or chargebacks.

So these are the controls, this multi-leg process. What results do they give, Mr. Chairman?

Well, in my experience in Europe, regulated Internet gambling transactions are less likely to give rise to a dispute than e-commerce in general. Certainly, regulated Internet gambling is significantly less dispute prone than other digital sales, such as music downloading or Internet service provider subscriptions.

During my many years as the chairman of Visa Europe's compliance committee, I can tell you, Mr. Chairman, that I did become aware from time to time of many different complaints that consumers had about various aspects of the Visa system.

But during this same period, Mr. Chairman, I can tell you that I did not receive a complaint, nor was I aware of any complaint relating to Visa of problem gambling, nor was I aware of complaints relating to operators cheating their customers on regulated sites, and neither did our anti-money laundering procedures cause us to make any suspicious transaction reports in the regulated sector.

I conclude, therefore, Mr. Chairman, that Internet gambling can and should be regulated effectively.

The arrival of the Internet, Mr. Chairman, has changed many industries. The gambling industry is no different. The genie cannot be put back in the bottle. Internet gambling is a fact. We must deal with it.

This change of access to gambling has certainly brought with it new challenges, but, Mr. Chairman, it also brings with it new tools for management and for control, and a modernized regulatory regime will surely lead to better outcomes for all concerned.

It is a matter of incentives, I would say. A prohibition regime provides incentives for operators to go underground. In a regulated regime, the incentive is to act responsibly. Surely, Mr. Chairman, that's what we all want.

Thank you for your time.

[The prepared statement of Mr. Prideaux can be found on page 71 of the appendix.]

The CHAIRMAN. Thank you.

And to introduce the next witness, I'll call on the ranking member.

Mr. BACHUS. Thank you.

Jeff Schmidt is a recognized expert, author, and speaker on the topics of information security and infrastructure protection.

He worked with MicroSoft Corporation in the Windows production security department. He was one of the CIOs of the Ohio State

University, chief information officer. He was the founder and elected director of the InfoGuard National Members Alliance, which was the private sector component of the FBI's InfoGuard program. He's an entrepreneur who has started several successful ventures in the information security space. He actually worked with the FBI to start the InfoGuard program in 1998, and received his MBA from Fisher College of Business at Ohio State University.

I welcome him.

STATEMENT OF JEFF SCHMIDT, CHIEF EXECUTIVE OFFICER, AUTHIS

Mr. SCHMIDT. Thank you very much, Mr. Chairman, and committee members. I appreciate the biographical information. I can now scratch that off of my list here.

I have been in the information security space for the last 15 years, and have focused specifically on identity and authentication-related issues for the last 3 years.

I come to you today with the luxury of not having an opinion about Internet gambling. That's not what I'm here to talk about. I'm a security practitioner, and it's my job to give you a candid review of the state-of-the-art with respect to two specific technologies and techniques that we've been talking a lot about today, namely, identity and age verification, as well as geographic location or IP geo-location.

My written submitted testimony contains several pages of excruciating detail on these particular technologies and techniques and again, a candid explanation of the state-of-the-art.

I'm going to skip to the highlights. These technologies are not reliable in their current form today. Technologies that attempt to identify a person's age as well as identify their geographic location will fail on the order of 20 percent.

These numbers come from the vendors of these technologies themselves. They come from independent parties that have researched these particular techniques. And they come from my own research and my company's own research.

Again, 20 percent, I don't know if that's good, bad, or indifferent for the application that we're talking about today. It is my job to make sure that the committee is fully informed about this reality when considering the policy decisions that are in front of us.

The policy decisions are again, fortunately for me, well above my pay grade. So the best way to demonstrate this is with a couple of very simple demonstrations.

On this piece of paper I have written down my user name and my password, as do 70 percent of all Americans in this country. Mr. Hogan. Now, Mr. Hogan is Jeff Schmidt. Online, anywhere else, if that were an age verified credential, Mr. Hogan would now be my age. It really is that simple, and recent data has confirmed that.

First of all, *ACLU* v. *Gonzales,* with respect to CAPA, did a lengthy discussion about age verification and identity verification technologies, and found them to be unreliable.

Also, I would remind the committee that the largest and most quickly growing complaint to the FTC has consistently been around identity fraud and identity theft-related issues.

It really is, that is the sad state of affairs right now. We will see failure rates. Another way to think about what the failure rates might be is to consider a very simple and very common age verification problem, the problem that we see when credentialing a youth at a bar.

According to research done by the University of Wisconsin, the University of Arizona, and the FBI, use of forged, faked, or borrowed IDs for the purchase of cigarettes and alcohol exceeds 20 to 25 percent. Online age verification is a much harder problem. You're not in person, you're not inspecting a government-issued ID. Therefore, it is safe for us to assume that failure rates will be higher in the online scenario.

The second technology that we've discussed is IP geo-location. The way that the Internet is constructed, it is extremely difficult to determine the geographical location with any sort of precision or reliability.

Again, a very simple demonstration. Mr. Chairman, Boston is one of my very, very favorite cities. I was there yesterday. I used this Verizon card to access the Internet. I used the same card again this morning to access the Internet from my hotel here in the District.

And in both cases, I received different answers from all the major IP geo-location providers. One had me in Dallas, Texas; one had me in Reston, Virginia; and one had me in Minneapolis. In no case did they agree or in no case did they actually put me in the accurate locations.

Now, I understand that the use of these wireless cards is somewhat of a curve ball. However, this is the emerging technology, and this technology is standard equipment in almost every new laptop that is being built today.

My other personal research around geo-location technologies has demonstrated failure rates for non-curve ball types of applications in the 20 to 30 percent range, as well.

So again, it's critical to understand that you will see very high failure rates and it is critical to factor that in when making these important policy decisions.

Thank you.

[The prepared statement of Mr. Schmidt can be found on page 81 of the appendix.]

The CHAIRMAN. Thank you.

And to introduce our next witness, the gentleman from Ohio.

Mr. LATOURETTE. Thank you very much, Mr. Chairman. I did welcome this witness earlier, but Gregory Hogan, Sr., is the pastor of the First Baptist Church in Barberton, Ohio, which is in Representative Betty Sutton's district.

He has a Bachelor's Degree in Education from Tennessee Temple University. He is married with 4 children, and he is here to talk about the experience of his family and one of his children.

And so welcome, Reverend Hogan. We look forward to hearing from you.

STATEMENT OF REVEREND GREGORY J. HOGAN, SR.

Rev. HOGAN. Thank you very much.

Chairman Frank, Ranking Member Bachus, my own Congressman, Mr. LaTourette, and members of the House Financial Services Committee, thank you for inviting me here today.

As a parent, we dread a call that often comes to us. That call came to me on December 9, 2005. On the other end of the line was my son. It was not his cell phone number that showed up on my wife's phone, but one we did not recognize.

He immediately started crying, and he said, "I've done something terribly wrong. I'm in jail for robbing a bank." Time stopped. My wife couldn't even drive across the street, and I do not remember today how we got home from the restaurant that evening. But my son was under arrest for doing something that was inconceivable for him.

What could have put my son in a state of mind to do that act? He was president of the sophomore class at Lehigh University. He was second-tier cellist in their orchestra. The high school psychologist who worked with him for 4 years called him a "straight arrow." And no one who knew Gregory could believe that he had done such an act.

How could this young man who appeared twice at Carnegie Hall in New York City think that he could rob a bank? The answer has to do with illegal Internet gambling.

It all began when a non-student came into his room, walked over to his computer and said, "Hey, look how much money I made on the Internet." He keystroked a few things into my son's computer, and up on the screen popped $120,000. He downloaded the program so my son could gamble through his preferred site.

And then for 14 months, we began to watch our son's descent into the black hole of addiction to Internet gambling, especially poker. It began when a few overdraft charges showed up at our house, and our first conversation was on wasting money and avoiding spending money frivolously.

It included a battle with depression, daily notices from the banks about overdrafts, and I had to live at a home that I did not like. I had to take out all the computers in our house. I had to lock them up. I had to make sure that my wallet was beside my bedside every night and all my financial papers were in the safe.

Whenever Greg was around, I had to secure our family finances, and the TV was always turned to Texas Hold 'em. After interviews with a certified gambling therapist, with members of GA, and begging colleges to provide a counselor for him, we sent Greg back to Lehigh University for his sophomore year.

With him he had taken, without our knowledge, $2,000 in savings bonds from our family safe, and he began to gamble again. Greg's student account at the bank in Bethlehem, Pennsylvania, did not allow Internet payments, so he found an intermediary site to continue his gambling.

I installed Gamblock, an anti-gambling program, on his personal computer, and so he began gambling at the Lehigh University library, up to 12 hours a day. I asked the university to block his access to the computer, and I was told that nothing could be done.

By December of 2005, he had been shut out of all the sites because of bad bank transactions. His fraternity brothers were asking for their money back so they could buy Christmas gifts for their families. Greg's grades were slipping. And he was descending into the pit of addiction. He became two different people.

The weekend before his arrest, he ran a volleyball tournament to raise money for the local Boys and Girls Club. He had to make one more bet. So, with the bravado of a bluffing gambler, dressed as a typical college sophomore, Greg walked into a bank, waited in line, passed a note to a teller, and walked out with the money in his backpack.

He was arrested that evening, as he came into the college arts center on his way to orchestra practice. Greg has pleaded guilty to a first-degree felony, and is now serving 22 months to 10 years in Pennsylvania.

After Greg's arrest, we sent him to a gambling rehab center, CORE, in Shreveport, Louisiana. He came home and said, "Dad, you never told me gambling was evil." You can't imagine a Baptist pastor not saying gambling is evil, but I never had talked that way to my children. He realized how evil it was, emotionally and intellectually, and how it was damaging so many lives.

This time next year, instead of watching my son receive his diploma from Lehigh University as president of his class, I'll be waiting proudly outside the gates of prison to see my son released. I will count myself fortunate, because many dads have stood by the graves of their sons who took more drastic steps to end their addiction to Internet gambling, such as suicide.

Why tell my personal story for a piece of Federal legislation? Well, Greg's story is being repeated in so many young lives. According to the AMA, the APA, up to 5 percent of all college students will become compulsive gamblers when exposed to Internet gambling. Are we willing to see up to 16 million new gambling addicts in our Nation?

Greg's story is one that recounts loss. I have met many people who have $30,000 to $50,000 in online gambling debts. Many people drop out of college. They drop out of life. They drop out of society, to pursue online gambling.

The World Series of Poker that's going on this week may be glamorous, but the life of an addicted gambler on the Internet is not. It is just a series of broken hopes, promises, dreams, and lives.

The question I ask this committee today is the same that the apostle Paul asked the Romans: "Shall we continue to do good, or shall we continue to do evil that good may prevail?" The answer to that, obviously, is no.

Thank you, Mr. Chairman.

[The prepared statement of Reverend Hogan can be found on page 53 of the appendix.]

The CHAIRMAN. Next, Mr. Michael Colopy from Aristotle International, who manages communications for Aristotle.

And I know you are the first non lawyer, the Wall Street Journal noted, to be a general partner in a U.S. law firm. I don't know if you're the last, but you're the first.

Go ahead.

STATEMENT OF MICHAEL COLOPY, SENIOR VICE PRESIDENT, COMMUNICATIONS, ARISTOTLE, INC.

Mr. COLOPY. Thank you, Mr. Chairman. I just want to add to your comment about John Stuart Mill. Your predecessor, and my family friend, Bob Drinan, said years ago, referring to how some of these debates develop, that policy is often formed by the voices that are heard rather than the realities that exist.

He said, if Rene Descartes were alive today, he wouldn't say, "Cogito ergo sum," he would say, "Dico ergo sum"—"I speak, therefore I am." And so, reluctantly drawn by that dictum, I'm here today.

The CHAIRMAN. My predecessor, Father Drinan, was much more adept at Latin than I, I should acknowledge.

Mr. COLOPY. Moving right along, there are so many things that, in his day and now, have to be elucidated by these hearings, and that is why Aristotle, the company that is the leading provider of verification technology for most elected officials of the United States, and is also now the industry leader in online age and ID verification, insisted that I respond to your request and be here today.

So I'm going to make a few generic remarks, and I want to address some things that are said here today and that are put about by PR and interested parties in confusing an issue that must be seen clearly for policy to be framed in a coherent and an effective manner.

Number one, let's look at what society wants to do, which presumably is to do the right thing—protect our most vulnerable members, mitigate risk of fraud and abuse and so on.

And then the second question is, what is the market, what is the free enterprise system doing to address these issues?

Those are two fundamental questions.

First off, we have to point out the fact that while time flies, technology rockets forward, that technologies that were discussed in just the last Congress are now almost obsolete.

I know, for example, that there was a report aired in November 2005, which I believe we have, right? Let's take a look at it. This is from "60 Minutes," November 2005.

[A videotape was played.]

Mr. COLOPY. Mr. Chairman, many of the points you made resonate with this report, but as I said, that was in November of 2005.

"60 Minutes" re-aired it in November of 2006, because members here and elsewhere were saying they weren't aware that there were any technologies available that could age verify and identity verify.

The court record that was referred to earlier is already being noted as an example of judicial opinion that is way behind the times.

Right now, the company that I represent here today, Aristotle, and others, are doing tens of millions of high-risk verifications all the time. All of the major motion picture studios that show R-rated trailers use the verification system to keep kids out.

Tobacco sales. In the State of Virginia, it's on the books that you have to have online age verification. We have not had a single sale get through the system.

to be clear that the age verification issue seems to me to be secondary, in that the sad tales we've heard tend to be young adults.

And whether age verification is good or not good isn't going to resolve the problem of people who are 18 or beyond, and then you do get to the philosophical question, do you prohibit some adults from doing something because a small number of adults are going to abuse it?

But with regard to age verification, I want to ask Mr. Schmidt one question. You said that 20 percent was the failure rate, but you then suggested that it would be much higher by comparison because you said the FBI statistics are that in person failure rates for alcohol and cigarettes are higher than 25 percent, and therefore it's probably higher online.

How does that square with your citation of the 20 percent figure?

Mr. SCHMIDT. Mr. Chairman, the 20 percent number was a general number for both cases.

I think you can make a case very strongly that age and ID verification would fail to that level or greater—

The CHAIRMAN. Well, no, I guess—

Mr. SCHMIDT.—comparison.

The CHAIRMAN.—no, if it's 25 percent for in person and it averages out to 20 percent, online must be below 20 percent, because how do you get—if you start with 25 percent and you wind up with 20, somebody has to be below 20.

But I don't want to bog down too much here. I do think we're not talking age verification.

But I want to ask you this, in the figures that you gave, you said that it is probably about 25 percent. That's based on alcohol and cigarettes.

Can I ask, do members of the panel think we should ban the sale of alcohol and cigarettes online?

Mr. Schmidt, what would you think the incidence is of underage people buying wine or cigarettes online?

Mr. SCHMIDT. I'm not aware of any direct research about incidents—

The CHAIRMAN. But you would expect it to be well above 20 percent?

Mr. SCHMIDT. Well, it's a little different, because there's a delivery of a physical product, that would increase the rates of success, that, you know, a bottle a wine or a pack of cigarettes that showed up. I would expect—

The CHAIRMAN. You don't think that children—

Mr. SCHMIDT.—lower.

The CHAIRMAN. You don't think that 15-year-olds clever enough to get by this couldn't find a place to have the mail delivered?

Mr. SCHMIDT. I would expect it to be lower, probably not dramatically lower, but—

The CHAIRMAN. Well, but I do want to make that point, that my point is this.

You know, we have real reasons and reasons that are advanced. I think the real reason for this legislation is that people don't like gambling, and they don't think other people ought to gamble. I think there is a moral disapproval of gambling.

And I don't gamble. For one thing, I have a short attention span, and you can't gamble if you're thinking about something else. You're going to lose your pants. And that's why I don't gamble.

But I don't do a lot of things, and I certainly do not think the world should be restricted to things I like to do.

But to the extent that it is age, here is the great inconsistency. I have had people who were strong advocates of this bill, but they're also strong advocates of selling wine over the Internet.

And, you know, it seems to me, just a clear contradiction with regard to that, and how people can be for this and talk about underage, and continue to support the sale of tobacco and wine, just seems to me to show that's not the real reason.

But let me ask philosophically, because this—and Reverend Hogan, and I sympathize and admire—the story you told is of an extremely dedicated parent, the lengths you went to to try and be supportive and protective of your son.

But would you, if you could, restrict other forms of legal gambling? People can bet on horses. They can go to lotteries. And we have certainly had addicts.

I have been in public life for 40 years. I've heard stories of addictions to gambling when we considered a lottery in the Massachusetts legislature in the 1970's. People said, "Don't do that, there are addicted gamblers." Casinos, we talked about casino gambling in Massachusetts. Again, all in-person gambling. And so the problem of addiction, a sad problem, certainly pre-existed the Internet and continues today.

Would you personally propose—you said, you know, that gambling is evil, or your son said—would you restrict other forms of gambling that are now legal in the United States?

Rev. HOGAN. Thank you, Mr. Chairman.

In 2005, the Media Awareness Network said that 23 percent of male students in grades 10 and 11 reported visiting a gambling site, so there is a lot of underage gambling going on, and I have known families who do that.

In my own personal life, as some people—personally, myself, I would recommend that no one gamble, because—

The CHAIRMAN. So would I, by the way. But the question is, there is a difference between what we individually would do and what we would recommend to others, and what we would use the law enforcement mechanism to enforce.

Would you, given the prevalence of addiction in other parts of gambling, not just you, or the fact of it, would you legally ban other forms of gambling that are now legal in the United States, non-Internet gambling?

Rev. HOGAN. I was relieved last year when the Congress passed the Internet gambling bill, because it reinforced the Wire Act of 1961. I was relieved because I knew that my son was doing an illegal activity, and yet it seemed like I was powerless to stop him from doing it.

We have a principle, I believe, in the government, that we allow the States to decide these questions, and now you're trying to make the Federal Government decide the question.

The CHAIRMAN. I guess I would differ with you on this, and I understand, and I admire the lengths to which you went to work with your son.

But the argument is not one of federalism, in substance, it is if gambling is wrong and that you get into addiction, and I guess again, it is—I am not very confident that if you were able to ban all Internet gambling, that addictive gambling would go away.

Addictive gambling preceded that, and wouldn't go away, and if we ban Internet gambling, or increase the effectiveness of the ban on Internet gambling, because there is addiction, then I don't understand, again, we let cigarettes and tobacco be sold on the Internet.

Why don't we shut down all forms of gambling? Because it is certainly the case that there is a wide range of addiction, gambling addiction, other than that.

But my time has expired. The gentleman from Alabama.

I'm sorry. I don't mean to—

Rev. HOGAN. I'm sorry. Thank you, Mr. Chairman.

I'm an American Baptist pastor, and the American Baptist denomination has passed a resolution against gambling—

The CHAIRMAN. In all forms, legal gambling?

Rev. HOGAN.—warning people against gambling that really is not a profitable aspect of State government.

I used to be employed by a public school district. Our public school district received very little money from the State lottery, but the lottery was perceived as the panacea for paying for public schools.

And I just don't see where gambling is a necessary—

The CHAIRMAN. I appreciate the consistency, and I think that's an honest and consistent answer.

But I don't see one for saying, let's restrict Internet gambling more, but allow it to go elsewhere.

The gentleman from Alabama.

Mr. BACHUS. Thank you, Mr. Chairman.

Mr. Balko, in your testimony, one of the brands that you singled out for praise was FullTilt Poker?

Mr. BALKO. Well, it is one of the more reputable poker—

Mr. BACHUS. One of the more reputable firms.

Have you looked at their Web site?

Mr. BALKO. Yes, I have.

Mr. BACHUS. Did you read—you know, they have the biographies of some of the players, and you've seen those, haven't you?

Mr. BALKO. I'm familiar with several of the biographies of the top poker players, yes.

Mr. BACHUS. Are you familiar with Ross Boatman's biography on their Web site?

Mr. BALKO. No, I'm not.

Mr. BACHUS. Let me tell you about him.

Ross was 10 years old when he played poker for the first time. His brother Barney, who is a little older than Ross, was playing with some friends, and after much pleading, they let him sit in.

His gambling career really didn't get started until a couple of years later, though, when he was 12 years old. Ross was too young and didn't have the money to play with those guys—I guess they're

talking about his 14-year-old brother—but they let him sit and watch, and he learned plenty.

I guess the verification system didn't work.

Mr. BALKO. I believe that was well before the age of Internet gambling, Congressman.

Mr. BACHUS. Okay. Was it? I wonder why it's still on the site today.

Mr. BALKO. Well, I think—well, first of all, if I understand the biography correctly, he didn't actually wager, he was allowed to sit and watch.

Mr. BACHUS. Oh, just sit and watch. Okay.

At 18—this is Howard—deferred college for a year, moved to New York to pursue his passion.

He discovered poker. He was immediately hooked. For the next 2 years, he played poker relentlessly, clocking 70 to 80 hours a week. He went home broke 9 nights out of 10. Well, they're pretty honest about that.

Alan attended UCLA where he planned on pursuing an engineering degree. While he enjoyed his study, he discovered playing poker. Soon, the success he experienced led him to leave school and pursue poker full-time. It's a move he hasn't regretted. It worked out well for him.

Mr. BALKO. Can I respond, Congressman?

Mr. BACHUS. What?

Mr. BALKO. Can I respond very quickly?

Mr. BACHUS. Yes.

Mr. BALKO. The second part of the question, I guess, all occurred after he was 18, and in this country, I think we recognize 18 as the age of consent to contract.

Mr. BACHUS. You know, at 18, in every State in the union, and I have a letter from attorneys general that I'll introduce at this time, where they wrote us last year, illegal Internet gambling that he was doing is prohibited in all 50 States.

I'd like to introduce that for the record.

The CHAIRMAN. Reserving the right to object, I guess.

Mr. BACHUS. Let me—Mr. Kitchen, you process Internet gambling payments, your company?

Mr. KITCHEN. We process transactions in all industry sectors, yes.

Mr. BACHUS. Okay. So you actually make a lot of money processing the payments of these illegal Internet gambling sites?

Mr. KITCHEN. We don't process for any illegal companies, and I'm not sure that the—

Mr. BACHUS. They're legal companies, and you can—you're aware that they're engaging, they're allowing people in the United States, where it's illegal—are you aware that it's illegal to gamble over the Internet in the—

Mr. KITCHEN. I am aware that companies that we process for do not take U.S. bets.

Mr. BACHUS. Okay. Are you aware that the companies that you process payments for, that a lot of those payments are people who are gambling here in our country?

Mr. KITCHEN. Will you repeat that, please, sir?

Mr. BACHUS. Are you aware that the companies, that some of the companies that you're processing their payments, you say they're legal. They're legal in the U.K. But are you aware that they are gambling sites that are—people in the United States are gambling on those sites?

Mr. KITCHEN. The companies that we process for do not take bets from U.S. consumers.

Mr. BACHUS. Okay. How about the ones that did before the law passed last year?

Mr. KITCHEN. Well, I joined the firm as previously managing director—joined before the ban, and at that point my company was doing none of that.

Mr. BACHUS. So you don't have any financial interest in any of these, in any Internet gambling sites?

Mr. KITCHEN. Absolutely not. We are a processing company, and we process transactions—

Mr. BACHUS. And you don't do business with Internet gambling sites?

Mr. KITCHEN. We do business with Internet gambling sites which are legalized and regulated in the United Kingdom.

Mr. BACHUS. Okay.

I'd also, Mr. Chairman, like to introduce a letter from the National Coalition Against Gambling Expansion, and they actually pointed out again, reminded me in their letter of June the 6th that it was Mr. Abramoff who lobbied for 10 years against the bill we passed last year on Internet gambling.

I'd like to introduce it for the record.

The CHAIRMAN. Without objection.

Mr. BACHUS. And finally, I'd like to introduce a letter which I received last week from the NFL, major league baseball, the NBA, the NHL, and the NCAA.

And I'll say this to all members of the panel. Are you all aware that this Congress in 1992 bipartisanly and overwhelmingly, with a vote in the Senate of 88 to 5, passed the Professional and Amateur Sports Protection Act which prohibits Internet gambling of sporting events online? So it wasn't actually our bill last year.

Mr. Kitchen, were you aware of that Act? Are you familiar with that Act?

Mr. KITCHEN. I've been asked to comment on the effectiveness of regulation of the Internet. I'm not aware of the—

Mr. BACHUS. Okay.

Mr. KITCHEN. No, I'm not.

Mr. BACHUS. I'll just—let me introduce this.

It also points out that—well, their very strong opposition to this bill today, which they believe will allow, if passed, that sports betting will likely proliferate and the integrity of American athletes would be compromised.

Now, that's the NFL, major league baseball, the NBA, the National Hockey League, and the NCAA.

The CHAIRMAN. Was that about steroids?

Mr. BACHUS. I'm sorry?

The CHAIRMAN. Was that about steroids?

Mr. BACHUS. About what?

The CHAIRMAN. Was that about steroids?

Mr. BACHUS. I couldn't hear you.

The CHAIRMAN. Was that about steroids, this letter?

Mr. BACHUS. No, but I'll try to get you a letter on that, if you like.

[Laughter]

The CHAIRMAN. The gentleman from Ohio.

Mr. LATOURETTE. Thank you, Mr. Chairman.

Mr. Chairman, I'm glad that you talked in your questioning about it's not just underage, and I think that Mr. Hogan, Reverend Hogan's story does point to the fact that it's a problem that goes to these people who are maybe away from home for the first time.

And I mean, I probably shouldn't tell this story in public, but even though I'm from Ohio, I went to the University of Michigan, and the reason that I went to the University of Michigan is, at the time, Michigan had a drinking age that was 18, and Ohio was still 21. It was not a good reason to pick an educational path, but I benefitted from my degree.

But I think Reverend Hogan's story is not unusual, in someone being away from home for the first time, with a credit card, in a dorm room or apparently even after he loads software onto his computer at the library, and you can do it all night.

And so I appreciate this hearing, and I appreciate your principled stance.

I have enjoyed this hearing, because it's very rare, we often have people coming in with different opinions, but unless I'm wrong, we now have people have different facts, and have a severe disagreement.

So Mr. Colopy, I understood you, and I think also Mr. Kitchen, to talk about effective rates of the, let's take the IP locator technology of 99 percent or some such thing, and Mr. Schmidt's testimony is a 20 percent failure rate.

So Mr. Colopy, I'll put it as directly as I can, being from the midwest. I mean, you think that Mr. Schmidt is full of baloney with his observations?

Mr. COLOPY. I only insist on what the evidence shows. What Mr. Schmidt referred to is no evidence; what we do daily is evidence.

You know, arguments and PR have no beta test. Data and companies that use them do. They perform or they're not used. They're effective or they're not paid for.

No company takes on age verification, the extra burden of a check, unless it has a direct material impact on benefits to that company, meaning to their consumers.

So what I'm talking about are facts, and as I mentioned earlier, in the research that's been bandied about about this topic, efforts to actually look at real-time online age and identity verification were not accepted.

No one has never asked us for any information on what we do that opposes this. That is significant, because public relations is often damaged by data.

What we're talking about is hard data, what's happening today, what the marketplace is doing.

Whether you're liberal, moderate, or conservative, in our society, we have this combination of humane principles and a market economy.

In both cases, the movement of the market under those humane principles is toward real-time, effective, robust, reliable age verification and identity verification.

Mr. LATOURETTE. Let me ask, and then I'll go to you, Mr. Schmidt.

I have trouble turning my computer on, so I don't know a lot of the different things, but there is something called spooling or spoofing, and when Mr. Schmidt was talking about using his phone card, in my small world, when we said spoofing, when I was growing up, it meant playing a joke on your parents, but apparently now it's a computer term.

Are you indicating that Mr. Schmidt's experience with whatever he used, and I'll ask him about that again, where he got three different answers on where he was and none of them were Boston and Washington, is nothing more than a story that he's telling?

Mr. COLOPY. Again, I can't comment on data I haven't seen or a fact base that's put before me. I've never seen any of that information. In prior events like this, there's been no hard data presented.

The hard data that I see all the time is what the Aristotle operation shows.

Now, the other important point here is that in doing work, for example, for the New York State lottery—no offense, Mr. Chairman, but we actually assist them in complying with agreements they have with other States.

I don't mean an offense to what you said, but to bring up that lottery question again, this is a contentious issue, and as the reverend said, people have different views about it.

But, as an operational matter, which is the only thing I'm talking about, as an operational matter, it's fundamentally important that the State of New York know that the purchaser of that ticket is within the State of New York.

It's also fundamentally important for banking operations, both internationally and nationally, to know where somebody is when they're attempting to execute a transaction.

What was said earlier about how unreliable it is does not square with the facts of 2007, but it probably is relevant to the facts of 2001.

I'm suggesting that technology in the service of social good in the private sector is here, it's available, it's effective, and we should be using it.

Mr. LATOURETTE. I appreciate that, and just by way of a commercial, I use your software and have never been fined by the FSA, so I appreciate it very much.

Mr.—

The CHAIRMAN. If the gentleman would yield, for a representative from Ohio, that's a significant—

[Laughter]

Mr. LATOURETTE. Well, Mr. Schmidt, let me ask you the same question, because I listened to your testimony, and I listened to your story about the IP locator and your experience.

And so is it a fair representation that you and Mr. Colopy don't agree on this issue, and I guess are you willing to stand up for

yourself, because basically he says that you have—well, I'm not going to put words in his mouth. You heard him.

So what do you have to say?

Mr. SCHMIDT. I believe it was full of baloney.

Mr. LATOURETTE. No, no, no, that was my question. He did not say you're full of baloney. I asked him if you were full of baloney and he would not respond in that kind.

Mr. SCHMIDT. First of all, as an Ohioan who went to Michigan, I'm having a little trouble over here, as a Buckeye myself.

Mr. LATOURETTE. I got it.

Mr. SCHMIDT. I, in addition, rely on the facts and the data, and the leading provider of IP go-location data says that their data is 99 percent accurate to the country, 85 percent accurate to the city, and 80 percent—I'm sorry—85 percent accurate to the State, and 80 percent accurate to the city.

That's the leading provider, in their own—so in our research, and we use, my company uses geo-location data as one of many factors to determine information.

It cannot be solely relied on, because it is unreliable, but it is perfectly valid for, you know, one of many factors.

We found reliability in the 70 to 80 percent range, in general. Again, that's from factual operational experience.

Now, two comments.

First of all, the experience that I had with the wireless card that I mentioned with respect to D.C. and Boston, that was with no attempts on my part to actively circumvent the system.

That's a standard issue piece of technology from the carrier, not unlike the technology that's embedded in many laptops these days, with no active attempt by the user to circumvent it. IP geo-location is absolutely trivial for a user to actively circumvent.

So in addition to its inherent unreliability, with no active attempt to subvert the system, it is absolutely trivial to subvert through a whole host of technical measures, none of which are terribly difficult.

And moreover, anybody with an engineering and technical understanding of how the Internet works would not disagree with my statements here. It simply was not designed to allow geographic location.

It was designed to survive failures, it was designed to allow, you know, an infinite number of paths between any two points, and there are a whole host of reasons why, technically and engineering-wise, it is just not reliable technology.

Mr. LATOURETTE. Mr. Chairman, I know my light is on. Mr. Colopy stuck his hand up, and I think he wants to respond to that.

The CHAIRMAN. Go ahead.

Mr. COLOPY. I think it's an important point to make that, just like an automobile does not run alone on its transmission or on its cylinders, it needs brakes, tailpipe, and the works, we're talking about a system that, to be effective as age an identity verification, has many component parts.

These systems, by the way, have several levels of tolerance, which are set according to the risk confronted. What they call it is, process matched to risk. Therefore, it is a complex mix, algorithm

if you will, of capabilities that are adjusted in the cases in which they are used.

It is not appropriate to make any general statement about all of these cases and give a statistical number without looking at the context and the set of data you're talking about.

Again, the data tells the story. The data tells the story in the marketplace every day, in the tens of millions, where a lot is at risk. That is what we do.

Mr. LATOURETTE. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Missouri has joined us.

Mr. CLEAVER. Thank you, Mr. Chairman. I apologize. I had another committee hearing.

Thank you for this meeting on gambling.

We had a very lively debate last year when we considered legislation to address unlawful Internet gambling, and I'm always in a struggle with these kinds of issues.

I served as the Mayor of Kansas City for 8 years, and during that 8-year period, we enacted riverboat gaming, which I did not support as the Mayor. However, I wasn't elected to serve as the pope of Kansas City, so I signed it into law.

I normally believe that Congress should not be involved in any way, shape, or form with regard to regulating morals as a policy or as a practice, so I always struggle when these kinds of issues surface.

But where there is a longstanding public policy interest in regulating activities that do harm our society, such as illegal gambling, then there is an appropriate Federal legislative role.

I'd like to thank all of you for coming. I apologize for not hearing your comments, but I do have your comments.

And Mr. Prideaux—hopefully I pronounced that—

Mr. PRIDEAUX. Prideaux, in fact.

Mr. CLEAVER. Prideaux—you mentioned that the U.K. is starting to regulate online gambling.

I wonder how many people are gambling on the regulated sites versus the ones in countries such as Antigua, that have fewer regulations, and is there any data available that the U.K.'s experience with regulating has actually reduced the problem with regard to gambling behaviors?

Mr. PRIDEAUX. I wish I had precise data, but the weight of evidence essentially is that gamblers are attracted towards regulated sites, for a number of reasons.

The first thing is, that gamblers are attracted towards regulated sites because they know that they're going to be treated fairly.

I mean, if you're operating in an underground prohibition environment, where there are sites who are not subject to regulation, then gamblers have less confidence in the fairness of the games that they're being offered, and they have less confidence in the payment scheme they're operating. So, there is a huge commercial incentive for sites to operate within a regulated regime.

I think it's also the case, Congressman, that there is evidence that within a regulated regime, better safeguards can be put in place to protect vulnerable people playing on sites.

And so you do have this kind of self-reinforcing process, whereby consumers come to sites that are regulated, and that tends to capture, as it were, the overwhelming preponderance of the market.

Mr. CLEAVER. Thank you.

You know, talking about this conflict I have anytime something like this comes up, the Bible actually supports gambling, which is a bit troubling theologically, but I think, Reverend, you would agree that there are some rather bold examples of gambling in the Bible. But my struggle continues, anyway.

Mr. Balko, you have an interesting blog, theagitator.com.

You recently wrote, "On Friday, I'll be testifying before the House Banking Committee in support of Representative Barney Frank's bill to repeal the Internet gambling ban. I'll be taking the it's-none-of-the government's-damn-business position, though I'll probably refrain from using the word damn."

I've been your surrogate.

[Laughter]

Mr. CLEAVER. If I read this blog correctly, you understand H.R. 2046 to be a bill that will legalize many forms of currently illegal gambling and expand the U.S. market for Internet gambling.

Mr. BALKO. Yes.

Mr. CLEAVER. Yes. Okay.

Mr. BALKO. Yes.

Mr. CLEAVER. And so the chairman has invited you here to testify, so I think that your understanding is instructive.

By contrast, some persons advocating this bill have claimed that it is designed to be a more effective system for enforcing U.S. gambling laws.

If this argument were true, and the net effect of us passing this bill would be less Internet gambling, would you still support this bill?

Mr. BALKO. I'm not sure that this bill would result in less Internet gambling.

I think, had this bill passed before the Unlawful Internet Gambling Act passed, I think you may have been correct, but I think what this bill does is it gives Web site operators a path to legitimacy and a way to establish legitimacy with consumers, and it also allows consumers of Internet gambling sites to have a reputable site where they can wager, knowing that their money is secure, that they're playing on a fair site, that if something does happen, they have some recourse.

You know, also, the law that was passed last year didn't really stop Internet gambling. It put a significant dent in it, but it still goes on, and it's still fairly easy to place a wager online.

The difference now is that the companies that are facilitating the wagers are less reputable, and there are less avenues for recourse if a consumer is defrauded.

So I think what it's actually done is, like a lot of prohibitions, it's forced a lot of this stuff underground, and it's removed some of the market regulation, in addition to a lot of the government regulations that were in place.

Mr. CLEAVER. Thank you, Mr. Chairman.

The CHAIRMAN. I'm just going to give myself a second round.

First of all, I'm sorry the ranking member isn't here, because I want to take very strong exception to what I think was an unusual breach of appropriateness on his part by noting that this bill had been opposed, the one that was passed by Jack Abramoff. That kind of "McCarthyite" guilt by association has no place in this discussion. I did note that my colleague seemed a little abashed as he was reading it.

But bad people support good things and good people support bad things, and this is a position I've long held, wholly unrelated to Mr. Abramoff, and I would not think it would behoove members of the Republican Party to start tallying up who more often found themselves on the side of Mr Abramoff. It's an irrelevancy.

Mr. Balko.

Mr. BALKO. I'd actually like to respond to that, because Mr. Abramoff's name was invoked in the original bill to ban Internet gambling by the proponents of the bill several times, and in fact, if you look at the bill that Mr. Abramoff was pushing, it was actually a prohibition on Internet gambling with carveouts for the clients that Mr. Abramoff was representing, including State lotteries. That's exactly the bill that we have now.

So Mr. Abramoff actually was pushing for the bill that we have—

The CHAIRMAN. Thank you for that correction, and obviously, it doesn't affect the merits one way or the other.

I do want to get back, first of all, I want to say on geography, to me that's an irrelevancy.

Mr. Colopy has inspired me to "Latinize" a little bit more, and I think one important set of Latin phrases here is the distinction between "mala prohibita" and "mala per se"—something evil only because it is banned and something which is evil in and of itself.

Gambling to me is clearly "mala prohibita," and underage gambling, gambling by 12-year-olds and 13-year-olds, I would say was "per se." That's a bad thing.

Gambling by someone who happens to live in one State rather than another is simply because of prohibition, so I would distinguish. I am much more concerned about our ability to do age distinctions. Geographic distinctions, I cannot understand why any rational human being would care whether you put the bet down in one State or another.

And you say what about federalism? We're talking about national laws. And again, we have been told over and over again by many people that the Internet, after all, doesn't know interstate versus intrastate commerce. The Internet is transcendent of State boundaries, so I would put aside the geographic location. I think that is irrelevant.

The age one is relevant, but again, I would say, and I just want to reiterate as we talk, I think even if we had a 100 percent foolproof age cut, that opposition to this—the sides wouldn't change.

That is, I believe the motivation for trying to further restrict the ability of people to gamble on the Internet is based on a moral disapproval of gambling, a fear about addiction, but all of the examples we've heard about addiction have been from older people, who are of age.

The last thing I just would want to agree with Mr. Prideaux about, and this—my basic motivation here is, I spend a lot of time

here, as a Member of Congress, trying to protect people from other people who would treat them unfairly, certainly people who would physically abuse them and steal their property, people who would unduly pollute the atmosphere in which we all have to live, people who would be economically exploitative in ways in which you have to come together.

I have no energy left to protect people from themselves. Adults have to do that without me. And I think once the government does that, once we accept the principle that we have the right to protect people from things to which they might become addicted, our lives would become very much poorer in terms of the richness of things we could do.

I think it is a terrible mistake to say that government has an obligation to protect adults from making poor choices in matters that affect them.

And addiction, there are addictions to gambling, there are addictions to sex, there are addictions to video games. We've heard about kids who spend much too much time on video games, or young adults. There are addictions to alcohol, to tobacco.

We should give people the information with which they can be told that this is bad for them. We should—I'm prepared to provide funding through various medical programs to recognize inability to fight addiction. But banning something because adults will misuse it in a minority, when it is not otherwise harmful, is a grave error.

The last thing I would say with regard to Mr. Prideaux, I would agree with him that intelligently regulating something may—in that it does take away from the illegal site, and the best example is, it has been the experience, I believe, in Massachusetts, and much elsewhere, 30 years ago, before you had State lotteries, what was called the numbers racket was very prevalent. People would bet on what number was going to come out. Maybe it was a parimutuel handle, etc.

I know that has substantially diminished. The existence of legal lotteries has essentially, in a way that no law enforcement and no rules could ever have done, substantially diminished the numbers racket in America, because people do prefer, most rational people, a legal status.

And, you know, people can be upset about the State treasurers, they can be upset about the State lottery, but I know of no State treasurer who has ever broken a kneecap, or refused to pay when someone hit it.

With that, I have no further questions. Does anybody in the panel—the gentleman from Ohio.

Mr. LATOURETTE. Thank you very much, Mr. Chairman.

Just a piece of housekeeping.

The ranking member has asked that I ask unanimous consent to submit a letter dated today to you and he from Focus on the Family, and I would ask that it be included in the record.

The CHAIRMAN. It's a letter to me from Focus on the Family? I will treasure that. I get so few of them.

[Laughter]

The CHAIRMAN. I thank you. I thank the gentleman.

Mr. LATOURETTE. It is, in fact, addressed to you and to Mr. Bachus.

The CHAIRMAN. Could I just ask the gentleman, is it signed, "Yours truly," or "With great affection?"

Mr. LATOURETTE. Let me just see.

The CHAIRMAN. What is that?

Mr. LATOURETTE. "Sincerely."

The CHAIRMAN. Oh. Well, all right. That's good.

Mr. LATOURETTE. If we're doing a second round, does that mean I can have 5 minutes?

The CHAIRMAN. Yes. But let me recognize the gentlewoman from Indiana first.

Mr. LATOURETTE. Okay.

The CHAIRMAN. And then I'll give the gentleman a second round. She came in afterwards. The gentlewoman from Indiana.

Ms. CARSON. Thank you very much, Mr. Chairman, and members of the committee.

I come from Indianapolis, Indiana, probably the State that has more gambling casinos than any other State in the United States.

I have a question in terms of consistency.

The race, the Kentucky Derby held in Louisville, Kentucky, you could bet on it from anywhere in Indiana, by computer.

According to the question, what's the difference between Internet gambling and being able to gamble on the horses?

Could one of you refined gentlemen answer that question for me, please?

You're not going to answer?

Mr. KITCHEN. I'm not sure there is a difference.

Ms. CARSON. I'm not, either. That's why I'm confused.

[Laughter]

Mr. KITCHEN. I think we all are.

Rev. HOGAN. Madam Congresswoman, to me, as the chairman said to me, last November in Ohio, we had an issue on the ballot which basically would allow slot machines in Ohio. The vast majority of Ohioans said no to that.

And the vast majority of Ohioans also said yes to the election of Mr. Brown to the Senate, which gives your party—helps them quite a bit to have a majority in the Senate.

Ms. CARSON. How do you know what party I'm with?

Rev. HOGAN. You're on that side of the room.

[Laughter]

Rev. HOGAN. But coming down to this issue, I think the issue of this bill is that in Ohio, we said no, but West Virginia said yes, and I have friends who drive down to West Virginia. I don't think we should put roadblocks over the West Virginia border saying you can't go play slot machines in West Virginia.

But the issue is, with the Internet gambling, the situation has been, we do not want to see bets put across State lines. I know that they made an exception for horse racing, and now we're not going to discuss the wisdom in that, but still, right now, we're actually expanding that, so why should we have more of it?

And the issue is now it is illegal, it has been illegal since 1961 before Al Gore invented the Internet, and it's going to—and we want to continue to keep it at that standing there.

So that's why I'm saying, I would love to see every individual locality continue being consistent, the Federal Government being

consistent, and allowing the locals to decide what they want to do, and we've all said Internet gambling is illegal in all 50 States, or at least the majority of them.

Thank you.

Ms. CARSON. Thank you.

I know I have heard objections to this for family reasons, because they feel like they'll gamble all their money before they bring the paycheck home to their spouses, but they do that now. It doesn't require Internet gambling to make some irresponsible person not accommodate his or her responsibilities first for the family.

But I'm still confused on how you can bet at a racetrack—you go up, they put your numbers in by computer, give you a receipt, and in this situation, beginning with this legislation, you can do it over the Internet, either by credit card or whatever kind of card you use.

And I guess the bottom line, and I don't want to belabor the point, is why are we debating this? People gamble because they want to gamble.

As long as it's consensual adults gambling, whether they're being responsible or not responsible—wouldn't it be wonderful if we could legislate responsibility among human beings of age? We can't do it.

So while I think I voted for restrictions the last time—and I don't feel hypocritical, either—I just think more time has passed, and you understand better what it is that you're trying to do.

We have changed a lot of laws, reversed a lot, and I don't know what the chairman is going to do with this one, but if he wants to repeal what we did, I'm going to vote to repeal it, because it just doesn't make any sense, to me. But I'm not the brightest star in the galaxy, either, so I have to have some help.

I've enjoyed the testimony. Believe it or not, I've read it. And I thank you very much.

The CHAIRMAN. I thank the gentlewoman for her support, and I would caution the witnesses, if they haven't already figured this out, that it is when the gentlewoman from Indiana is at her most self-deprecatory, that I would be very careful, if I were you.

[Laughter]

The CHAIRMAN. The gentleman from Ohio.

Mr. LATOURETTE. Thank you very much, Mr. Chairman.

And Reverend, most of the folks who live in the northern part of the district where I am, in Lake County, go to Niagara Falls instead of West Virginia, but now they can't get passports, so there will probably be more of them going down to West Virginia.

And I want to associate myself with the remarks of the chairman on Mr. Abramoff. A lot of the stuff that goes around reminds me of gang reporting, the way they used to in the 1920's and the 1930's, and I really think it's disgusting, and as I said on the Floor the other night, even though I didn't get a lot of converts to join me, I really think that we're engaged in a race to the bottom on some of these things. People who do bad things should be punished, and they have.

But Mr. Prideaux, I want to focus on Page 8 of your testimony, and get to the compulsive gambler. I think we've talked about the technology, we've talked about the underage problem, but the compulsive person.

And you talk about velocity controls, and maybe somebody else talked about velocity controls.

I know, even though it pisses me off, sometimes I go to an ATM and it only lets me take out $200 of my own money, then charges me $2.50 for the privilege of giving me my own money back, but they won't give me $300, they'll give me $200.

And so it seems to me that may be a way to deal with the compulsion problem, and I'm not aware of any constitutional right to be able to not only bet online, but bet a lot of money online.

Can you describe for me what you mean about the velocity controls and how that's utilized in your experience relative to online gambling?

Mr. PRIDEAUX. Yes. Thank you, Congressman.

In essence, though, I mean, if I could just interpret your question a little broadly, and talk about velocity controls in general—and clearly, some can be applied by the payment scheme, I think as you have said, particularly for credit cards, where gaming transactions are considered quasi-cash.

The risk profile that issuers take is to not extend the whole of a credit line for quasi-cash style transactions, and certainly that's one mechanism as far as the payment scheme that can operate, that can provide some safeguards to the problem of compulsive gambling.

At the same time, I mentioned in my testimony that there was a multi-layered approach from this. I think there are a number of other important aspects to talk about.

The first one, of course, is that of the operator themselves acting in their self-interest, and the majority of reputable regulated sites will establish limits for new players to the extent that they can play, and indeed, they will also make available to players the ability for that individual to self-limit, a sort of a cooling off period.

And of course, the regulators themselves, if they felt it was appropriate, could enforce some of these mechanisms.

I think the point that I want to make is that we talked about how the Internet was transforming businesses, and clearly it transforms the Internet. And they also have access based controls, being substituted by these controls here, to address compulsive gambling.

None of the features that I've described have really been available in the face-to-face gaming environment. This is a good example of a place where the problem of compulsive gambling which exists today can be better controlled in a regulated environment for Internet gambling as opposed to gambling in the face-to-face environment.

Mr. LATOURETTE. Thank you.

And just my last question relative to the bill that the chairman has put forward, I understood from your testimony that in the United Kingdom, the Gambling Commission regulates the gambling activities, while the Financial Services Authority has no particular responsibility for gambling.

As I understand the chairman's bill, the Treasury Department takes responsibility for the financial transactions, which it obviously knows, but it doesn't know much about gambling, I would assume.

Have you looked at the chairman's bill, and have you had the chance to compare his proposed regulatory scheme to the one that exists in the United Kingdom that you are familiar with?

Mr. PRIDEAUX. I must profess that I'm not an expert in the regulatory apparatus of the United States, but to the extent that I have looked at the bill, it does seem to me that the same twin regulatory structures of the financial system on the one hand and of the gambling perspective on the other do seem to be features of the chairman's bill.

Mr. LATOURETTE. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. If the gentleman would yield—because there was a concern raised when the bill was passed about money laundering, terrorism, etc. That's why we did assign the FinCen operation there.

I thank the members for participating on a Friday. Frankly, I like Friday hearings. The fewer members you have, the more you can get in.

I thank the witnesses. It is a topic on which reasonable people can differ. I think, on the whole, we have done that today.

Before we adjourn, I am going to ask for a blanket unanimous consent to insert various statements into the record. I have one from our colleague, Congresswoman Berkeley, from the United Methodist Church, and one from the National Coalition on Gaming, basically agreeing with the point Mr. Prideaux made about how to do this, and I know that on the Republican side, there are also a number of statements, o we'll get unanimous consent to put those statements into the record.

And with that, the hearing is adjourned.

[Whereupon, at 12:02 p.m., the hearing was adjourned.]

APPENDIX

June 8, 2007

Financial Services Committee
Hearing "Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?"
Opening Statement of Congresswoman Julia Carson
June 8, 2007

I thank Chairman Frank and Ranking Member Bachus for holding this hearing today. I believe it is an important, proactive approach in considering Congress' role in the expansive industry of internet gambling.

Last year, I opposed legislation banning certain types of gambling on the internet because I felt that it was an inappropriate intrusion by the federal government on the personal choices of an individual. I also believed it was the wrong position to take on the issue.

I am a cosponsor of Chairman Frank's bill because I believe it is a practical and responsible approach to regulating an industry that has existed without effective regulation. This bill also comprehensively addresses the concerns we all share about compulsive gambling, underage gambling and fraud and money laundering issues. The federal regulatory framework this bill creates provides safeguards against those behaviors.

Those operators seeking a license under the proposed exemption to the Unlawful Internet Gambling Enforcement Act would have to undergo significant scrutiny and would be subject to intense regulation. Those operators who obtain licenses would have to respect state and tribal laws and sports leagues decisions on whether or not to authorize gambling.

I feel this is the responsible and practical approach the industry and one that is respectful of one's personal decisions. I encourage further discourse on this issue which deserves serious consideration and I look forward to your testimony today.

Financial Services Committee
Hearing "Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?"
Congresswoman Julia Carson's Statement for the Record
June 8, 2007

When I spoke earlier I mentioned that I had voted in favor the Unlawful Internet Gambling Enforcement Act passed in the 109th Congress, when in fact I opposed it. I am strongly in favor of Chairman Frank's legislation that would provide for an exemption to that ban. Thank you.

Rep. Emanuel Cleaver, II
House Financial Services Subcommittee on Housing Hearing
"Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payment System?"
Friday, June 8, 2007

Comments

Mr. Chairman and Ranking Member, thank you for scheduling today's hearing on internet gambling. I recall our Committee's lively debate last year as we considered legislation to address unlawful internet gambling. We grappled with the desire of some to impose their values on others against our fundamental rights of free speech, association, and the "pursuit of liberty" as individuals chose their pursuits. Notwithstanding my real job, as an ordained minister, I do not believe Congress should attempt to legislate morals as a policy or as a practice.

However, where there is a long-standing public policy interest in regulating activities that can harm our society, such as illegal gambling, then there is an appropriate federal legislative role to provide an effective enforcement mechanism. That is why I voted last year to support passage of the Unlawful Internet Gambling Enforcemet Act, which represented 10 year's worth of hard work to finally reach a compromise among a multitude of competing interests that was able to pass both chambers and be signed into law. Therefore, I hope we carefully and cautiously weigh all the competing interests and issues before we make any changes to law we just enacted last year.

I thank the witnesses for sharing their time and insights with us today and I look forward to your testimony.

House Committee on Financial Services
United States Congress

"Can Internet Gambling Be Effectively Regulated to Protect Consumers and the Payments System?"

Testimony of

Radley Balko
Senior Editor
Reason Magazine

June 8, 2007

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Mr. Chairman, distinguished members of the committee: My name is Radley Balko. I'm a senior editor with Reason magazine and a former policy analyst for the Cato Institute. I've spent a good deal of my time writing on civil liberties issues, including the problems associated with the prohibition of victimless crimes. I want to commend Chairman Frank for his work defending the freedom of adults to gamble online and I thank the committee for inviting me to testify today.

The Unlawful Internet Gaming Act was passed under rather dubious circumstances. It passed the U.S. Senate on the last day of Congress, late at night, with no floor debate, after being attached to an unrelated port security bill.

My problems with how the bill passed, however, are beside the point. Let's get down to the crux of this issue, Mr. Chairman: What Americans do in their own homes with their own money on their own time is none of the federal government's business. Take online poker, by far the most popular form of online gambling.

Poker has enjoyed a surge in popularity over the last several years. The game is about as mainstream and uniquely American as baseball. Poker evolved from similar card games in the early 1800s, then flourished in popularity on Mississippi's riverboats, winning over such iconic American aficionados as Mark Twain.

Today, most daily newspapers have a poker column, including *The New York Times*. The game saturates cable television. Until recently, even the Supreme Court had a monthly poker game.

Online poker is merely a new evolution of the game, similar to the way Civil War poker games introduced the straight, and gave us variations like draw and stud poker. The Internet merely removes the geographic barrier preventing those who love the game from finding opponents of similar skill who are willing to wager similar amounts of money.

No one is hurt when two or more consenting adults sit down for a game of poker, be it online or in person. Why any of this should be of concern to the federal government is rather perplexing. I respect the fact that many Americans—and many members of Congress—may have moral objections to gambling, online or otherwise. To them, I'd say, simply, "don't gamble, then."

But in a nation where Las Vegas is one of our fastest growing cities and most popular tourist destinations, where Indian casinos are commonplace, where horse racing is a national past time, and where nearly every state in the union derives public funds from state lotteries, singling out Internet gambling for prohibition seems arbitrary and, frankly, hypocritical.

Yes, it's possible a parent could bet away their family's savings, or their child's education fund in an online poker game. They could also fritter that money away on eBay. Or on booze. Or fancy cars and exotic travel.

These are all personal decisions, of course. And if a free society means anything, it means we should have the freedom to make bad choices, in addition to good ones. The ban on Internet gambling punishes the millions of Americans who were wagering online responsibly due to anecdotal evidence of a few who may do so irresponsibly. It's an affront to personal responsibility, and symptomatic of a Nanny Statist government that treats its citizens like children. A government based on the principle of liberty doesn't police the personal lives of its citizens for bad habits, at *any* level, much less at the federal level.

Supporters of a ban on Internet gambling say the industry is unregulated, that money wagered and lost leaves the United States, and that all of these offshore gaming sites are ripe for money laundering and similar criminal enterprises.

But these are all problems wrought not by consenting adults' decision to gamble, but by the government's decision to prohibit gambling.

Were Congress to give its blessing to legalized online gambling, I'd suggest you'd soon see brand names like Harrah's, MGM, and Trump immediately enter the market.

Reputable offshore brands like FullTilt poker and PartyPoker would almost certainly incorporate in the U.S. and subject themselves to U.S. market regulation and government oversight.

These companies want to win the trust of their customers. And they want to operate in a business environment that respects the freedom of contract and adheres to the rule of law.

Customers want to know that they're playing a fair game, that their bankrolls are secure, and that their privacy is protected. Companies that set up shop in the U.S. with the blessing and encouragement of the U.S. government will almost certainly dominate the market. Winnings could be taxed. Market forces and—if necessary—the federal government could regulate and monitor gaming sites for fairness and transparency.

Most importantly, if online gambling were decriminalized, the federal government could get out of the trivial business of breaking up online poker games, and federal law enforcement officials and federal prosecutors could expend scarce taxpayer-funded resources on more appropriate endeavors, like pursuing interstate fraud, theft, and protecting the country from terrorism.

In closing, the Unlawful Internet Gaming Act is a significant and disturbing encroachment on individual liberty. I'd urge the committee to correct this overreach, and let Americans do as they please within the privacy their own homes.

ARISTOTLE

Statement of

Michael Colopy
ARISTOTLE Inc.

Regarding

Effective Age and ID Verification Online

Before the House Committee on Financial Services

Hearing on H.R. 2046, the Internet Gambling Regulation and Enforcement Act of 2007

June 8, 2007

Mr. Chairman and Members of the Committee, good morning. Age and ID verification online first emerged several years ago as a solution of choice for many industries concerned about their social responsibilities to the broader society, especially where their marketing and sales efforts might reach underage teens or expose children to risk. Even three years can be a generation in the lifecycle of technology. The Internet has brought an acceleration of technological remedies that are far more effective today than they were at the start of the last Congress: state-of-the-art online verification illustrates this pattern.

The Sixty Minutes report you just viewed is a relevant illustration of how in the instance of online gaming robust technology can be used by responsible private enterprise to perform a social good. As recently as last fall, some Members of this body professed to be unaware of the online age verification and ID methods the CBS report appropriately demonstrated, giving this as their reason to support the online gaming ban. Yet, the tech savvy son of the producer of Sixty Minutes could not enter the gaming site that uses an effective verification service but easily penetrated those that do not deploy it. Time may fly but technology rockets forward. That report was first aired in November of 2005: the robust system that kept the boy out of the gambling site is even more effective today.

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I am here as a stand-in for John Phillips, the CEO of Aristotle Inc. whose age and ID verification system, INTEGRITY, is the backend of the effective system in the unscripted test you just saw. Commenting on what Aristotle does for its many clients is not our custom but we were persuaded to come because it is necessary to correct central misimpressions, particularly where they pertain to child protection. Without wading into deep technical water or proprietary matters, I hope we can address most of them here today.

America is a society guided by humane principles: we are also a free enterprise economy. In the context of today's hearing, therefore, there are two considerations that should guide this exploration: First, what is necessary to provide reasonable protection to society's most vulnerable members, reduce fraud and mitigate risk, and, Second, how is the market choosing to address the first question?

Over the last ten years, law enforcement and consumer protection agencies as well as industry self-regulatory bodies have recognized the need for rapid online identity verification for Patriot Act and anti-money laundering compliance, fraud prevention and for risk mitigation involving age-restricted products such as tobacco, alcohol, pharmaceuticals, video games and mature content from many sources.

Alongside the steep rise in public concern, online age and ID verification has matured as a needed solution such that any merchant may do online what is routinely done at stores every day across America. In fact, as ever more efficient technologies and reliable databases have been developed, online transactions have become in many instances faster and less risky than the visual driver's license scan that suffices for alcohol or cigarette purchases in America's neighborhoods.

Government agencies that monitor commerce have been notably slower than the market in recognizing what has been happening but that too is changing. The Federal Trade Commission and other agencies have urged that reliable state-of-the-art methodologies available on the market be deployed to protect children from accessing promotions intended only for adults. In its 2003 report to Congress on the marketing of beverage alcohol products, the FTC pointed to the emergence of online methods, and Aristotle's service in particular, as addressing this public need. *(See FTC Report to Congress:* ***Alcohol Marketing and Advertising*** *September 2003).*

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Aristotle's INTEGRITY verification technology is one logical response to the acute need of marketers for reliable, robust and commercially reasonable protective screening that also addresses important privacy and security concerns. Depending primarily on public records data rather than on personal financial information, INTEGRITY comprises several levels of authentication in a methodology that matches process to risk. The INTEGRITY system is now a major component of the private sector's accommodation of mounting public pressure for a technological solution that was both socially responsible and commerce friendly.

According to Forbes Magazine, Aristotle's INTEGRITY verification service is the market leader in online identity and age verification. INTEGRITY is utilized today by global Fortune 1000 enterprises that are required by law or best-practices professional codes of conduct to identify individuals requesting permission to enter a facility, a website, open an account or conduct certain transactions online.

Institutions relying on INTEGRITY include more than 350 of the nation's largest financial services companies, government agencies and airport security authorities, wineries, distillers, makers of premium cigars, video game publishers and the major motion picture studios.

It is utilized to comply with the multi-state Tobacco Master Settlement Agreement provisions that prohibit marketing to minors. The service exceeds the strict standards of such laws for online age-verification as California's Business and Professions Code §22963, and Virginia Code §18.2-246.8, governing online tobacco sales. Since adoption, not one INTEGRITY service client has ever been found to have improperly marketed a tobacco product to a minor. Blocking underage teens from purchasing tobacco online is believed by most citizens to be an important social value. (The Campaign for Tobacco-Free Kids (http://tobaccofreekids.org/Script/DisplayPressRelease.php3?Display=425) presents the urgency of this issue on its website.)

Hollywood has also seen the wisdom of the new approach to marketing. The major motion picture studios use INTEGRITY to comply with the Motion Picture Association of America (MPAA) guidelines for restricting minors' online access to studio promotions with "R" rated content. In fact over ninety percent of all visitors to studio sites with restricted ads are age verified through Integrity.

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Vendors in the beverage alcohol business use INTEGRITY as well. In the new era of direct wine shipments, for example, online age verification has become an essential component for compliance and responsible marketing across the United States. Without a verification service such as INTEGRITY, Members of Congress and the general public would not be able legally to purchase fine cigars, wines, lottery tickets or R-rated movies by mail, by telephone or online.

Another social mandate is in the area of gambling. In addition to the risk mitigation and child protection benefits of age and identity verification, this service benefits those individuals who acknowledge that they are problem gamblers and wish to avoid relapse. A self-exclusion list program (SEL) is being developed in association with the National Council on Problem Gambling through which individuals will be able to put their own names on a confidential self-exclusion list of those who do not wish to be solicited or allowed to open an account with a casino.

As with all data in the INTEGRITY system, the list is strictly confidential, and the names would not be disclosed to anyone. Individuals could remove their names from the list after a set minimum period.

In the United Kingdom, INTEGRITY is widely used by licensed casino operators to comply with the strict UK requirements for age verification online.

In their determination to "do the right thing" and comply with the law while marketing responsibly under best practices standards, a large and growing number of enterprises across the broad spectrum of American commerce have adopted online age and ID verification. The market has spoken: industries of all stripes are moving quickly to make effective age and ID verification increasingly the norm.

In its simplest terms, the case for this child protection measure has never been more apparent or urgent. Age and ID verification is efficient, effective, reliable and available nearly everywhere.

Thank you. I look forward to responding to your questions.

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A Father's Journey...

My journey with my son through the nightmare of Internet Gambling

Testimony given to
The Financial Services Committee
U.S. House of Representatives
June 8, 2007

By
Rev. Gregory J. Hogan, Sr.
Hudson, Ohio

My Background:
I am the Pastor of First Baptist Church, Barberton, Ohio. I have a BS degree in education from Tennessee Temple University in Chattanooga, Tennessee. I am married to Dr. Karen W. Hogan RN, ND, and we have 4 children. Our second child, Gregory, Jr. is currently in prison for a robbery he committed to feed his online gambling addiction.

Testimony:
I am just a dad. I am the dad with you in the Memorial Day parade in our hometown. I am the coach leading my son's U-8 soccer team, or walking in my scout uniform with the Boy Scout troop, or riding in the truck with my church youth group. After the parade and the speeches, I come to the front of the crowd to have the honor of shaking the hand of my congressman. I am the dad that bows his head at the invocation, and prays to our God in heaven for you, my congressman, a blessing for your hard work, strength to your family as you serve here in Washington, and wisdom from on high to deal with hard choices that you must make. I am just a dad.

I do not consider myself an expert on Internet Gambling. For in reality, I am a dad. I am a dad that uses the Internet everyday for a variety of reasons. I appreciate its power to find information that I need, help me communicate with my colleagues, and keep me informed on what's happening in the world. But as a dad, I realize that the Internet can also bring in the worst of what is out there into the laps of my children at the speed of light. But I am sure that each of you who are parents, grandparents, aunts or uncles, also fear the traps that are so cunningly laid for our children on the Internet.

I am here today for this very reason--I am a dad; a dad that has had to witness the devastation that Internet Gambling has brought upon the life of my son and our family. Many times in my sermons, I have had to watch my children's faces as I told a story of something that happened in our home. I could not resist because this story so aptly illustrated the point I was making. The words, "let me tell you about my son" would

often bring a groan and rolling eyes from my family's pew. But please today, let me tell you about my son.

I am extremely proud of my son, Gregory Jr. Greg has always been full of life and zeal to share it with others. He loved to read even as a 4 year old. He would read my old history textbooks from my days as a teacher becoming fascinated with the Civil War. He loved being on his soccer team and in his music lessons. He began to study piano when he was only 5. He soon became very proficient for his age, and even won two medals in the International Piano Competition. He was able to perform twice in the winners' recital at Carnegie Hall in New York City.
He also seriously studied cello. He wanted to attend arguably the most academically challenging school in Ohio. He achieved that goal, and while there he lettered in two sports, achieved the highest recognition for volunteerism, he was active in Bible studies, the Gay Straight Alliance, mock trial, and was the first student in the school's 105 year history to solo on two different instruments. He was elected a Prefect over his house in the leadership system.

Greg set his goal to be admitted to Lehigh University, a top-50 ranked university. He was accepted on early decision with a $23,000 a year grant. I was so proud and relieved, because I couldn't afford Lehigh on a minister's salary.

I was so proud the day we dropped Greg off at school, we stood on the side of the hill looking over the campus, I prayed a prayer of blessing, and before I left, he said to me, "Dad, I am going to run for president of my class." Two months later he added that to his long list of accomplishments. At the end of the year, he was re-elected president for the sophomore class.

A few weeks after the beginning a school, a non-student walked into Greg's room and said, "Look how much money I made playing poker on the Internet." He walked over to Greg's computer, and in few keystrokes, the program had downloaded, and the screen showed a balance in this guy's account of $120,000. That was more money than Greg could imagine. That evening, Greg opened his account and played his first hands of Texas Hold'em. He could not have driven down to Atlantic City and walked up to a card table, he could not even have gone to the convenience store and bought a lottery ticket because of his age, but on the Internet he could gamble in his own dorm room.

I soon became aware of Greg's gambling. We still had a joint checking account that he had opened when he worked at the pizza parlor during high school. Just before Thanksgiving, I opened the checking account statement, and saw a couple of suspicious charges. They were $50 each made to "Pokerstars." I did a google search of the name, and was immediately connected to an Internet poker site.

When Greg came home for Thanksgiving break, he and I talked. I first approached it as a waste of money, I told him not to waste his money on something that was not beneficial,

and he made the first in a series of promises to me, "Dad, I'll not do it again." This was the first in a multitude of broken promises and lies about his gambling.

By Christmas vacation, he was placing up to $400 a day in his poker account. We discussed the fact that he would soon not have enough money for books and his social needs at school the next semester. "I've stopped," was his only refrain.

It was not my son that spent winter break with us his freshman year. Greg had changed from a person that was very outgoing, very active, very concerned about his personal hygiene, enjoyed being with his friends, and even enjoyed working, to a depressive blob that would watch Texas Hold'em on TV all hours of the night, not change out of his pajamas or get a shower for three days.

We were very concerned. We contacted the university and arranged for Greg to have counseling. We sent him back for his second semester, with very little money left in his account, and a prayer that things would work out.

Greg gambled very little his second semester, mainly because he had such limited funds. We thought things were working well. He contacted the CEO of a large financial institution in the Cleveland area for a job. He was given a summer job, and told by another president of the corporation, that all of the future managers start out here. If Greg did well, he had a future with this corporation.

He opened his own checking account to receive the direct deposit of his paycheck. Shortly after he arrived home, he was updating his face page on the Internet, and a banner ad promised him money if he would sign up for a poker account today. That ad appeared on a site used by hundreds of thousands of high school and college students.

With his first paycheck, he began to gamble in earnest. By July 4th weekend, the overdraft notices were coming every day. We stopped believing in his desire to stop, and realized that he was involved in something that was beyond his control. I removed all the computers from my house, we found a certified gambling therapist for Greg, and we began to attend Gamblers Anonymous. I paid off his overdraft charges, because if his account were to be closed, he would lose his job and his future.

Gambling is about short cuts. It is about short cutting your dreams and accomplishments in life. Greg has told me he dreamed of buying himself a Jeep Wrangler, of buying me a new car, and of paying for his college so he would not be a burden to his mother and me. Since then, I have heard the story of many other teens that say their descent on the path of Internet Gambling began by thinking it was a shortcut to their dreams.

Nobility is often a characteristic of a gambler's dreams. It allows him to do something that would hurt us in the long run, to give us something good in the future. There are no

shortcuts to our dreams and those things that are worth having, come from hard work and doing good to others.

We sent Greg back to Lehigh for his sophomore year. He moved into his fraternity house, and promised us he would go to Gambler's Anonymous in Bethlehem. He did see his counselor on campus, but never attended a GA meeting. Soon the charges began to hit his account again. I immediately called Lehigh and was told that nothing could be done to limit my son's access to online gambling.

I went to Lehigh for Greg's installation as class president, and attended the Trustees dinner with him that evening. He went around collecting business cards from men and women that were telling him to call them for internships and summer jobs after his junior year. While I was there, I installed "Gamblock"® on Greg's computer, we closed his bank account back home. His account at college would not allow international payments from their debit card, so once again I thought I had stopped Greg from gambling. He found an intermediary site that would take money from his account and send it oversees. He began to gamble from a computer in the school library for up to 12 hours a day. He was not gambling alone.

Statistics provided by National Council on Problem Gambling reveal that 4 percent of the adult population living within 50 miles of a casino will become addictive gamblers. Among the college population, 7 percent that gamble on line will become addicted.

Between his binge gambling, binge drinking to forget the losses of gambling, his active social life as the president of his class, and a demanding academic load, Greg went into full tilt. He had taken money from his parents, his siblings, he had taken his savings bonds from the family safe, and borrowed money from friends, all with the idea that he would make it big, pay everyone back, and treat those that he loved to some nice gifts. The only thing we wanted was the old Greg that we all loved and enjoyed being around.

When he returned to school after thanksgiving, he was out of money and out of luck. Because of the overdraft charges, he was shut out of the poker sites. His fraternity brothers started asking for their money back to buy Christmas gifts for their families. The black hole of his addiction kept dragging him deeper and deeper. He just had to make one more bet.

So with the bravado of a bluffing gambler dressed as a typical college sophomore, Greg walked into a bank, passed a note, and walked out with over $2,000 in his backpack. He returned to his dorm, threw the back pack on the bed and went out for pizza with his friends. When he returned to campus, the police were waiting for him as he came to orchestra practice that night.

Greg pled guilty to a first degree felony and is now serving a sentence of 22 months to 10 years in the Pennsylvania corrections system. After his arrest we did send him to an

inpatient treatment center and had him go through some serious counseling to deal with his addiction.

Because of Internet Gambling, Greg's dreams of becoming a judge or working on Wall Street have been destroyed. Because Greg fell victim to Internet Gambling's illusions of quick riches and a shortcut to his dreams, his dreams are in ashes today. Each day my wife, myself, and our three other children have to experience what it is to be a victim of Internet Gambling. Each of us has experienced sleep disturbances, panic in social settings, depression, and sought out counseling and medical help.

If it was not for internet gambling, next May I would be proudly waiting to see President of the Senior Class Greg Hogan graduating from Lehigh University. He would be preparing for graduate school or his first job in the financial industry. Instead, I will be waiting for him outside of the prison gate, and he will be preparing to live life handicapped by a felony on his record.

As a private citizen, I oppose any effort to legalize or even give credibility to Internet Gambling. Here are some facts:

- Suicide rates are 200 times higher than the national average for compulsive gamblers and 150 times higher for their spouses. (February 7-13, 2002 issue of Metro, Silicon Valley's Weekly Newspaper.)
- Problem gamblers between the ages of 18 and 25 lose an average of $30,000 each year and rack up $20,000 to $25,000 in credit card debt, according to the California Council on Problem Gambling. In a health advisory issued by the American Psychiatric Association early this year (2001), 10 percent to 15 percent of young people reported having experienced one or more significant problems relating to gambling.
- Bill Lockyer (former California state attorney general and now state treasurer) says there are 600,000 kids with gambling problems.

St. Paul challenges us in his epistle to the Romans, "And why not say, "Let us do evil that good may come"?" Every argument for the legalization or expansion of gambling from a governmental official, to me, has a common thread, "We can do so much good with the money we get from gambling." Has our government which was created to protect the common good become just as addicted to gambling as my son was when he walked into that bank?

I am asking this committee to refuse to pass this bill. Congress has historically expressed its opposition to Internet Gambling. A majority in both parties passed the Ports Bill last September with the Internet enforcement provisions in it. It was a great day when I heard that bill had passed. It was an answer to my prayers that other families would not have to suffer as my family has. Please refuse this bill, because if we open the door to any type of Internet Gambling, we are allowing our college and high school students to play

"Russian Roulette." We know that 7 percent of them will lose. That is not very good odds. How much is it worth to throw away so many thousands of our children?

I am just a dad. I am proud of my 4 children. I am proud of my son, Greg. When I stand outside of that prison and see him walk through those gates, I will be so happy, so proud. I will also think of the other dads that I have met on our odyssey through the nightmare of online gambling. Some dads do not know where their children are today, and other dads have had to bury them because Internet Gambling left them only with the choice of suicide.

Thank you, Mr. Chairman and Congressman Bachus, for the opportunity to testify today.

Testimony of Gerald Kitchen, Chief Executive, SecureTrading Group Limited
June 6, 2007

Submitted for the Record Concerning
Legislative Hearing on H.R.2046, the "Internet Gambling Regulation and Enforcement Act of 2007"

Held Before the Financial Services Committee
United States House of Representatives
On Friday, June 8, 2007, at 10:00 a.m.

Mr. Chairman and Members of the Financial Services Committee, I am Gerald Kitchen, Chief Executive of SecureTrading Group Ltd, a UK Limited Company which operates a Financial Payments business that specializes in the secure processing and settlement of Internet payments.

I appreciate the opportunity to submit written testimony to you concerning our experiences with the secure processing of Internet payments with respect to high-risk transactions, specifically Internet gambling transactions.

I. INTRODUCTION

First, I would like to provide some information about SecureTrading Group Ltd and Baker Tilly. SecureTrading Group Ltd is a UK Limited Company which has operated a Financial Payments business that specializes in the secure processing and settlement of Internet financial transactions since 1997. SecureTrading Group Ltd is not an online gambling company but rather a payment service provider that, with the support of back office services provided by Baker Tilly ("BT"), processes a wide variety of financial transactions (including legal online gambling transactions) for some of the largest financial institutions in the world.

BT is an independent member of Baker Tilly International, a global network which has 126 member firms in 93 countries with an aggregate worldwide annual fee income of over $2.2 billion, making Baker Tilly International the 8th largest accounting network in the world, by fees.

The card payment processing industry has evolved over many years to put in place a globally cooperative and integrated infrastructure that seeks to optimally and seamlessly mitigate risks and maximise the service experience for cardholders. The participants in this infrastructure include card schemes (VISA and MasterCard), card issuing banks, merchant acquirers, merchants and payment service providers like SecureTrading Group Ltd.

Further to this, the SGBT system provides an oversight and integration role in ensuring compliance and adherence to the various requirements related to risk mitigation and regulation across the payments processing industry.

Working together SecureTrading Group Ltd and BT have developed a transaction system for e-commerce sectors which is specifically designed to provide security, protect against fraud, prevent money laundering, and limit other abuses in areas of e-commerce that are perceived to pose special risks, such as in travel reservations and Internet gambling transactions.[1] In this document I have referred to the system as "the SGBT system".

I am submitting this testimony today to address concerns raised about Internet gambling and to provide information about how many of the same concerns are already being addressed in other nations through the application of specific processes and technology.

II. H.R.2046 AND ITS GOALS

The legislation introduced by Congressman Frank (D-MA) seeks to modernize existing U.S. law by implementing a licensing and enforcement regime for Internet gambling. The licensing and enforcement regime for Internet gambling in the United States will provide appropriate protection against underage gambling, compulsive gambling, money laundering, and fraud for those citizens who choose to gamble online. The bill specifically permits individual states, tribes and sporting leagues to opt out of such an arrangement thus protecting rights that currently exist.

Several concerns have been raised about the activity that might be permitted under the bill. Specifically, concerns have been raised that allowing any legal Internet gambling would invite a number of social harms – such as underage gambling, compulsive gambling, involvement of organized crime, money laundering and fraud.

I would like to address each of these points, but first let me state unequivocally that I do not, nor does SecureTrading Group Ltd, take a position regarding the legality or illegality of gambling or Internet gambling. SecureTrading Group Ltd does, however commend the efforts of Congressman Frank and supports the introduction of H.R.2046 that establishes high standards of consumer protection and security of financial transactions. From the text of the Internet Gambling Regulation and Enforcement Act of 2007 *certain* financial transactions are likely to be permitted. To the extent that this is the case, I respectfully offer to the Committee that there is, today, the technological and process capability in place to permit those *legal* transactions to occur – with protections in place to prohibit underage or compulsive gambling, organized crime, money laundering and fraud. I have spent a career developing such protections, not just for Internet gambling but for *all* financial transactions. I hope this testimony will provide useful information regarding the technology and process landscape and respond to the concerns raised.

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[1] Other areas of higher risks of payment fraud, and related abuses include airline travel bookings, adult entertainment, and consumer purchases of digital goods. The SecureTrading Group Ltd's systems and solutions handle a variety of forms of consumer transactions, but as a matter of choice and policy do not include the adult entertainment sector.

III. THE SGBT SERVICE FOR HIGH RISK E-COMMERCE SECTORS

Many of the risks that have been articulated relating to online gambling potentially apply to Internet financial transactions more broadly. For example, these transactions involve risks not present in face-to-face business because the card holder and the merchant are not normally together when the transaction occurs. Without safeguards in place, the lack of face-to-face communication has the potential to increase the risk of fraud in any Internet payment by comparison to its counterpart in the physical world. Some e-commerce sectors, such as gambling and entertainment, raise additional public interest concerns that further enhance the need for making these payments both secure and capable of preventing fraud and other abuses. The degree of risk is greatly reduced by reliance upon the stringent controls and oversight of the existing financial institutions.

The SGBT system provides payment and related financial services to Internet merchants to protect both the merchants and the consumers who purchase goods and services from these merchants. In the payment card transaction chain, it operates between the merchant and the acquiring bank and performs the functions of an online payment service provider. The SGBT system carries out the full Internet payment process for the merchant, using SecureTrading's software. However, unlike traditional online payment processors, the SGBT system adds a significant number of security features to ensure that the consumers, merchants and banks are protected from fraud.

The SGBT system works as follows:

- First, SecureTrading Group Ltd sets up a "rolling reserve" escrow account for each merchant in which a percentage of the merchant's revenue is kept for six months. This is done to ensure that chargebacks or refund requests from disputed transactions can be settled against the escrow account. Valid requests for chargebacks and refund requests relating to disputed transactions are accepted as a matter of course. Such claims automatically result in a full repayment to the principal card holder. Depending on the chargeback record of a merchant the "rolling reserve" can be decreased over time. It is therefore in the interest of the merchant to take all possible steps to avoid unauthorised use of payment cards. This aspect of the SGBT system has been highly successful in dramatically reducing the level of chargebacks typically experienced by internet merchants. Our industry comparisons show that merchants utilising the SGBT processing systems are experiencing lower levels of chargebacks than industry norms.[2]

[2] Internet merchants can be the victim of attacks by professional payment card fraud rings, which may cause occasional peaks in the number of chargebacks. For the purposes of this paper this was not regarded as part of "normal transaction traffic."

- The SGBT system monitors the occurrence of suspicious chargebacks and refunds on a payment card (in particular those linked to possible unauthorised use). Should suspicious activity such as excessive levels of chargebacks or refunds occur, SecureTrading Group Ltd immediately stops accepting further transactions from that payment card.[3]
- The SGBT system does not "aggregate" e-commerce transactions, putting them together into a single pool of funds that is then moved through the payments system. Transactions are kept in separate accounts for each merchant and, as needed, for each URL[4]. This ensures funds are retained at a merchant level to ensure all cardholder claims for chargebacks and refund requests are honoured in a timely manner.
- The SGBT system monitors and compares IP address,[5] country of card holder and country of issuing bank as further protection against fraud and ensuring regulatory compliance at a location level.
- The SGBT system constantly monitors the frequency and value of transactions per payment card. The SGBT system ensures that a sudden increase in frequency of use or value of transactions on a payment card is immediately investigated.
- The SGBT system uses secure software which allows it to trace back every single transaction down to the second. In other words, the SGBT system creates an audit trail for every transaction.
- The SGBT system makes continuous use of the services of BT, which extracts all transactions on a daily basis and manages the "rolling reserve."
- All funds are received into bank accounts controlled exclusively by BT. All trading and reserve accounts are reconciled on a daily basis by BT.
- BT calculates all relevant deductions, being the transaction based costs. The same methodology would be used to calculate any taxation to be deducted. These funds are then identified separately from Merchant funds, before paying over to the relevant authorities or recipient 3rd parties.
- BT notifies Merchants daily of the transactions processed by the SGBT system.
- BT retains a full audit trail of all transactions it processes, detailing all information received by BT and the eventual trail through to payment to the relevant parties.
- All of the SGBT system data (including all transaction records) are stored safely on state-of-the-art high security servers both by SecureTrading Group Ltd and by BT.[6]

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3 Chargebacks or refunds can be objectively justifiable in e-commerce. For instance, it is possible that a consumer inadvertently "clicks twice." In such cases, the money spent inadvertently will be returned but there is no objective reason to refuse to transact with this consumer in the future.

4 A "URL" is a web link ("URL" stands for Uniform Resource Locator).

5 "IP address" stands for Internet Protocol address. Every computer connected to the Internet is assigned a unique number known as an Internet Protocol (IP) address. Since these numbers are usually assigned in country-based blocks, an IP address can often be used to identify the geographic location from which a computer is connecting to the Internet.

6 All card data is encrypted and managed in accordance with the requirements of the Payment Card Industry Data Security Standard (PCI DSS)

- To protect against the risk of money laundering, SecureTrading Group Ltd high risk e-commerce clients are contractually obliged to:
    - Fully disclose the identity of company directors and beneficial shareholders and report any changes.
    - Take all reasonable steps to verify the identity of a consumer (e.g. by collecting a copy of a drivers licence or passport or by using online identification services such as Verid or URU).

  SGBT ensures adherence to this by undertaking regular audits of these processes. When a merchant is found in breach of its contractual obligations in this regard, the merchant's "rolling reserve" escrow account is increased in case of future claims. Should this practice continue, processing services will be terminated.
- In the specific case of Internet gambling merchants, SecureTrading Group Ltd limits the payment of winnings to the card holder (by a bank draft check in the card holder's name or through a transfer to his bank account), and screens names of payees against applicable sanctions lists. As a result, no money is at risk of being paid to individuals or organisations listed on the lists of persons, groups and entities subject to financial sanctions published by the European Union (EU)[7] and the "Specially Designated Nationals list" published by U.S. Department of the Treasury.[8] SGBT ensures adherence by undertaking regular audits of these processes.
- In the specific case of Internet gambling merchants, SecureTrading Group Ltd only deals with merchants who are licensed under applicable local laws and who are in good financial and legal standing, based on banking and legal references.
- Likewise, if a merchant fails to cure any breach of the contractual anti-money laundering obligations or is determined to no longer be in good legal standing, or financially sound, SecureTrading Group Ltd will terminate all services to that merchant.

The SGBT system has been extensively reviewed by several major United Kingdom based clearing banks, including Barclays, Lloyds and Royal Bank of Scotland, as well as European banks and legal practices including Herbert Smith LLP and Alston & Bird LLP.

Thus, the SGBT system has already in place systems that effectively counter fraud and money laundering pertaining to Internet gambling, as well as other forms of potentially higher-risk online consumer transactions. The same sets of processes can be used to combat underage gambling and compulsive gambling, by defining criteria that require age verification or which impose limits on the basis of required personal identifications, to enforce such limitations as may be imposed by any jurisdiction's particular regulatory regime. I address this process further in my testimony below.

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7 Available at http://europa.eu.int/comm/external_relations/cfsp/sanctions/list/consol-list.htm

8 Available at http://www.ustreas.gov/offices/enforcement/ofac/sdn/

IV. SPECIFIC CONCERNS ROUTINELY RAISED BY INTERNET GAMBLING

As previously stated, there are generally five main areas of public interest concern with respect to Internet gambling transactions – underage gambling, compulsive gambling, involvement of organized crime, money laundering and fraud. These areas of public concern are not unique to the United States – they are concerns faced by a multitude of jurisdictions. Many jurisdictions, including the United Kingdom, have legalized Internet gambling. They have not done so by turning a blind eye to these concerns. Rather they have instituted a regulatory regime whose purpose is to ensure that technology and processes are employed to protect consumers and financial institutions. As other nations have found, these risks can be countered and contained, if those institutions operating Internet gambling payment gateways choose to adopt, or are required to adopt, technological systems and processes specifically designed to address each of these problems, systems and processes such as those provided by the SGBT system. The strength of this system is complemented by the strength of the controls and vigilant oversight of the financial institutions.

- **The role of the operator.**

An important consideration is that all consumers wishing to participate in this activity need to establish a player account with a licensed operator. During the registration process the player's identity must be verified. Stringent "Know Your Customer" (KYC) requirements need to be satisfied to confirm the identity, age and residence of the player. When a registered player logs on to participate in the activity their identity is again verified using a unique identifier generated during the registration process. Additionally, the location of the participant is also checked. Only one account is permitted per player and no payments are made without full verification of the identity of the player.

There is also an onus on the operator to comply with best practices as they relate to responsible gambling measures. These practices include setting player bet limits (individual bet and capped cumulative loss), permitting a player to exclude them self from participating in play, whether at that site or on a broader industry level, and providing players with access to information about their activity.

- **Technology and processes exist to restrict customers by location**

The SBGT system allows for the exclusion of customers based on their location in the event that a jurisdiction chooses to opt out.

The individual's location can be identified using IP Geolocation technology. This involves matching the customer's IP address to a specific state and in some cases a specific city or town. This technology is provided by a number of 3rd parties including Quova. The accuracy of the Quova system has been independently verified by PricewaterhouseCoopers as 99.9% accurate on a country level and 95% accurate on a state level.

This accuracy can be further enhanced by considering IP location together with both the registration information provided by the customer, the address to which a payment card is registered and the location of the bank that has issued the payment card.

- **Technology and processes exist to address the risk of underage gambling.**

The SGBT system incorporates a number of barriers to prevent abuse by underage persons. The first barrier is at the merchant's website, which must have appropriate age verification mechanisms in place to qualify for services from SecureTrading Group Ltd. The next barrier is provided by the card issuance rules in place for financial institutions. Finally, underage persons are denied winnings because the SGBT system only permits payment of winnings to the registered account and card holder.

A key part of addressing the underage gambling risk is the KYC checks undertaken at the point of consumer registration with the merchant.

KYC requires that the organisation know whom it is in fact dealing with. In order to satisfy this requirement, the customer is asked for a range of information, including Name, Address, Date of Birth, Telephone Number and information not easily available such as Social Security or Passport Number. This information is then compared to multiple databases to confirm the accuracy and validity. If the customer fails this validation they are unable to open an account. These services are today provided across many industries. Service providers include Experian, Aristotle and GB Group.

Additional KYC checks performed include checking that the registered address of the telephone number matches the details supplied, and that the customer is in fact able to answer the telephone and confirm these details.

Credit card companies typically do not issue credit cards to minors. Nevertheless, minors may validly have access to debit or sponsored cards. In these cases, the Issuer will be aware of the cardholder's age and is able to decline the transactions flagged as internet gambling at the time of authorization.

An additional control ensuring use by the legitimate cardholder is provided by the financial institutions and the card schemes through a requirement, at an increasing number of sites, to enter a password before completing an online transaction (Verified by Visa and MasterCard Secure Code systems).

A final impediment to underage usage goes to the heart of the system designed by SGBT: The underage consumer cannot receive any winnings, as they are not the authorized owner of the card.

SecureTrading Group Ltd acknowledges that enforcement and compliance with regulations cannot be perfect and requires continuous improvement and enhancement. While SecureTrading Group Ltd is confident that the rules in place are sufficiently rigorous to prevent underage consumers accessing the system, should an investigation prove that an underage consumer has circumvented the rigorous controls in place, the principal card holder will be refunded.

- **Technology and processes exist to address the risk of compulsive gambling.**

The issue of compulsive gambling remains a significant challenge. The solutions are complex and require all participants in this industry to work together in a cooperative way with a combination of education, technology and oversight (parental and / or government). The approach required to effectively combat this requires transparency and involvement from various stakeholders.

The SGBT system offers a number of opportunities to address compulsive gambling on the Internet that are as good as, if not better than, those available for bricks and mortar gambling.

First, payment card holders can be offered the possibility to restrict their ability to gamble on the Internet by way of applying to be excluded via a self-exclusion program. Land-based casinos in the United States already maintain self-exclusion programs but the effect of such a program is normally limited to one casino. When self-exclusion from Internet gambling is put into effect via the payments system, it becomes impossible for the person concerned to participate in *any* gambling on the Internet that uses traditional card payments through the payment processor. Furthermore, individuals may fix limits on the amounts they can spend on Internet gambling. Increasing such limits is typically subject to cooling off periods after which the individual would need to reconfirm that he or she effectively wants to increase the spending limit. The ideal solution is for a global self-exclusion database to be established and access made available to all financial transaction processors and licensed operators, providing for a broader blocking capability.

Second, the SGBT system can prohibit individuals from registering more than one payment card to pay for Internet gambling transactions. This would prevent individuals from running up excessive debts by using multiple cards. Similarly players are restricted to only the one account with a licensed operator.

Third, it is relatively simple for the SGBT system to detect an unusual increase in an individual's spending on Internet gambling. This makes it possible to monitor compulsive gambling much more closely than in the case of traditional forms of gambling where the casinos, lotteries and racetracks normally do not know the identity, or the spending pattern, of most of their customers.

Fourth, as mentioned above the customer's identity is verified using 3rd party KYC systems. Once the information has been validated, it can be checked against various databases of compulsive gambling. In the event that a customer is found to be present in these databases, the registration can be rejected or the customer investigated.

- **Technology and processes exist to address the risk of abuse of Internet gambling by organized crime.**

It is envisaged that the licensing process under FinCEN (Financial Crimes Enforcement Network) would require that licence applicants satisfy the same stringent due diligence and suitability requirements as with land-based gambling licensing processes. These relate particularly to criminal record checks. Additionally, the SGBT system maintains an audit trail of all transactions conducted using the SGBT system. Prior to paying any winnings, the SGBT system can be used to screen the payee against the EU's lists of persons, groups and entities subject to financial sanctions and the United States' list of "Specially Designated Nationals." Additionally, the SGBT processes involve screening the beneficial shareholders of the Internet gambling companies that use its services on a best endeavours basis. These checks could be extended to various information resources including OFAC and the Sanction lists.

Using technology and processes such as those provided by the SGBT system, makes Internet gambling a much less attractive vehicle for organized crime than the anonymous, cash-intensive world of traditional gambling with casinos, lotteries and racetracks or other high turnover cash businesses or businesses lacking transparency in their financial systems. Internet gambling transactions processed by the SGBT system can be tracked by authorized regulators and law enforcement in connection with their criminal investigations. As a part of this process, SecureTrading Group Ltd has instigated links with the United Kingdom Serious Organised Crime Agency (SOCA).

- **Technology and processes exist to address the risk of abuse for money laundering.**

It is envisaged that FinCEN would not permit licensed operators to accept cash deposits into player accounts. Similarly, SecureTrading Group Ltd does not accept cash payments from consumers or Internet gambling businesses. All transactions are recorded with all parties having satisfied stringent KYC checks. All parties are clearly identified. As a result, the SGBT system virtually eliminates the attractiveness of using Internet gambling transactions for money laundering. As the U.S. General Accounting Office has reported:

> "Banking and gaming[9] regulatory officials did not view Internet gambling as being particularly susceptible to money laundering, especially when credit cards, which create a transaction record and are subject to relatively low transaction limits, were used for payment. Likewise, credit card and gaming industry officials did not believe Internet gambling posed any particular risks in terms of money laundering. (...)

[9] The term "gaming" used by the GAO in its report is retained here. The term "gaming" is generally used in the UK to refer to what in the U.S. is ordinarily referred to as "gambling." In deference to this U.S. forum, my testimony uses the term "gambling" throughout.

"In general, gaming industry officials did not believe that Internet gambling was any more or less susceptible to money laundering than other electronic commerce businesses and noted that the financial industry – which is responsible for the payments system – is better suited to monitoring for related suspicious activity in the area than the gaming industry itself."[10]

The United Kingdom, which spent considerable time and effort studying the feasibility of regulating Internet gambling with a regulatory framework subsequently included in their Gambling Act 2005, takes the view that "there appears to be a paucity of proof" that money laundering through Internet gambling sites is "a significant problem" and that "[i]t is safe to say that gambling transactions completed online can be more secure than cash business conducted in traditional gambling outlets."[11] Compliance with anti-money laundering guidelines and license conditions, use of controls within the financial industry and the adaptation of best practices utilizing technology will ensure the threat of money laundering via Internet gambling is greatly reduced, if not removed.

- **Technology and processes exist to address the risk that Internet gambling operators might defraud consumers.**

An underlying premise of any regulatory regime such as that proposed by Congressman Frank in H.R.2046 is that stringent due diligence and financial viability checks will be satisfied prior to any license being issued. As an extension of this, SecureTrading Group will only provide clearing and settlement solutions to operators who have been licensed under this regime. Notwithstanding this strict licensing regime, SecureTrading Group has technology and processes in place, which will largely mitigate any likely fraud against consumers by operators.

There are two potential avenues for consumers to be defrauded by operators:

Financial - from the perspective of a fraudulent payment card transaction posted by an operator, a consumer has the recourse of charging back the transaction. The "rolling reserve" escrow arrangement in place with Baker Tilly will result in the funds being available to refund the consumer. This virtually eliminates the incentive for merchants working with SecureTrading Group Ltd to defraud their customers. In the sector of Internet gambling, SecureTrading Group Ltd has and will only deal with properly licensed, reputable, and authorized gambling operators.

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[10] *See*, United States General Accounting Office, "Internet Gambling. An Overview of the Issues", December 2002, GAO-03-89, p 37 (available at http://www.gao.gov/new.items/d0389.pdf).

[11] *See*, United Kingdom Department for Culture, Media & Sport, "The Future Regulation of Remote Gambling: a DCMS Position Paper", April 2003, para. 69-70 (available at http://www.culture.gov.uk/global/publications/archive_2003/gamb_position_paper.htm).

"Rigged" Games – licensed operators in leading regulatory jurisdictions, both land and Internet based, are required to satisfy the regulator that games offered to consumers are fair and operate honestly. One example of an independent standards authority for the online gaming industry and which oversees fair gaming, player protection and responsible operator conduct, is the non-profit organization eCOGRA (www.ecogra.org) with its Generally Accepted Practices (eGAP). It is a requirement of any leading regulated jurisdiction, land and Internet based, that games and related financial transactions are fair, money is safe and secure, and that those involved in the conduct of gambling operations are suitable persons. It is anticipated that such compliance requirements would be an integral component of a regime envisaged under FinCEN.

V. POLICY ISSUES

As stated above, SecureTrading Group Ltd endorses the regulatory regime proposed under H.R.2046, the Internet Gambling Regulation and Enforcement Act of 2007. The non-discriminatory licensing process coupled with relevant opt out provisions for states, tribes and sporting leagues, promotes a commonsense control structure at the same time providing the government with an opportunity to generate additional revenue. SecureTrading Group Ltd believes the obligations under the bill relating to consumer protection - underage, problem gambling, absence of crime, money laundering and fraud specifically, in the context of the opt out provisions – can readily be combated by the use of technological tools, addressing concerns with online gambling previously discussed.

In the view of SecureTrading Group Ltd the most serious of all the concerns in an unregulated environment is the possibility of organized criminal activity involving online gambling, such as money laundering and fraud. However, as discussed previously, H.R. 2046 proposes a regulatory regime that will address these concerns via stringent due diligence and suitability checks and ongoing monitoring, at the same time providing consumers with the necessary protections.

SecureTrading Group Ltd recognizes that banks and operators of payment cards are already subject to sufficient federal requirements to combat money laundering, and when applicable, to state requirements to combat fraud. But other types of current and developing Internet payment methods being driven underground by prohibition efforts may not be under any existing federal or state obligations to apply these types of protections.

For this reason, SecureTrading Group Ltd supports H.R. 2046 and the use of technologies, processes and regulatory oversight to combat organized crime, money laundering and other fraudulent activities. Technologies and processes do exist today and are being used to accomplish these goals. Furthermore, if Congress requires use of such technologies to protect the public interest, the market will inevitably create further products designed to address these risks for any businesses that wish to handle any such lawful transactions.

Testimony of Jon Prideaux

Independent Payments Consultant

June 6, 2007

Submitted for the Record Concerning

Legislative Hearing on H.R.2046

"Internet Gambling Regulation and Enforcement Act of 2007"

Held Before the Financial Services Committee

United States House of Representatives

On Friday, June 8, 2007, at 10:00 a.m.

1. Introduction

Mr. Chairman and Members of the Financial Services Committee, I am Jon Prideaux. I operate as an independent consultant to the payments industry. I have worked with a range of clients including banks, processors, payment service providers - including SecureTrading Group Ltd who are also testifying at this hearing - and marketing companies. I have not provided any consultancy services to any Internet gambling company and have no plans to do so.

From 1989 to 2006, I worked for Visa in Europe. My responsibilities included the setting of rules globally for the operation of the scheme, as well as being responsible for their enforcement in Europe.

I am grateful for the opportunity to submit written testimony to you concerning my experiences with regulating Internet gambling transactions and ensuring that, to the best extent possible, the freedom of individuals to spend their money as they wish is balanced by concerns to protect the more vulnerable members in society.

2. My Qualifications

For 17 years I was a senior executive at Visa in Europe. I am the immediate past Executive Vice President, Marketing of Visa Europe and member of the Executive Management Committee, responsible to the non-executive Board for the running of the organisation. I led Visa Europe's Internet business as the founder of Virtual Visa, Visa Europe's Internet Division.

I served on Visa's global Product Development Council, which has responsibility for establishing rules and compliance programs for the operation of the Visa system, under delegated authority of the Board. From 1999 to 2006, I was also Chairman of the Visa Europe's Compliance Committee, which had the mission of enforcing the rules and implementing Compliance programs.

I should emphasise that my testimony is in a personal capacity. I am not representing Visa. Nevertheless in my career, I have gathered a great deal of experience about the operation of payment in Internet businesses in general, and Internet gaming businesses in particular. I have also had broad exposure to devising and implementing regulatory structures. I have seen the types of businesses that have generally satisfied customers. I have also seen the types of business models and practices that give rise to customer complaints.

I feel that I am well qualified to provide evidence to the committee about the feasibility of operating Internet gambling in a regulated environment.

3. Gambling and Internet Gambling in the UK and Europe

My evidence will concentrate on the environment for gambling in Europe as a whole and the UK in particular. I shall attempt to answer the question "Can Internet Gambling be Effectively Regulated to Protect Consumers and the Payments System?" It is, Mr. Chairman, my contention that the evidence from Europe shows that it can.

Gambling is a legal, regulated business in the UK and in a number of other European countries. People in the UK wishing to place a bet can go to a race course or dog track and do so directly. They can also go to more than 5,000 licensed betting shops located in the high streets of practically every town in the country. More than 30,000 shops throughout the country sell tickets for the National Lottery. There are also several dozen legal casinos. In addition, Internet gambling is also permitted today and is likely to grow even further following the introduction of the Gambling Act 2005 under which all forms of Internet gambling licenses can be issued.

All these forms of gambling are regulated and taxed by the UK Government. Additionally, the European Court has recently re-affirmed the right of gaming operators to trade freely throughout the European Union.

Gaming operators are some of the largest companies in the country. For example, Ladbrokes, who operate both a physical and an Internet business, have a market capitalization of more than£2.5 billion. William Hill, another large operator, have a market value of more than £2 billion. Both companies are listed on the London Stock Exchange and are members of the FT/SE 250 stock market index. The stocks are widely held and widely traded.

In addition to the largest players there are dozens of other operators, some listed on smaller exchanges such as AIM. These companies specialize in different types of gaming such as sports betting, offering casino games, poker or also operate as betting exchanges.

The total volume wagered is considerable with several billion pounds staked annually.

The UK Government has an explicit strategy to try to make the UK a jurisdiction of choice for Internet gambling companies. In addition there is a strategy to use land-based casinos as a vehicle for regeneration of deprived urban areas.

It would be wrong to say that some of the developments in the UK were completely without controversy, but – essentially – the controversy relates to the location of casinos, rather than to any concerns about the wide availability of gaming opportunities to consumers.

4. Typical Transaction Cycle

Before describing the operation of the regulatory processes, I thought that it might be worthwhile to describe the typical Internet gambling transaction cycle so that the relevant steps can be explained as well as the best places in the cycle for different regulatory processes to be applied.

1. The process starts when a player registers at an Internet site. This is a crucial step. It is the part in the process when the customer must have his identity checked and also when Know Your Customer (KYC) checks are undertaken by the gaming operator. In order to complete registration, the company will often require to see copies of identity documents as well as confirming the customer's identity through the use of various electronic databases and tools. Checks are also applied to ensure that the customer has a good credit rating and does not appear on any blacklist, for example, those designed to prevent Money Laundering or Terrorist Funding. Additionally checks can be undertaken against an industry level blacklist at this stage, for example, to check if the player is on an exclusion list.

2. The next step is for the customer to register a payment device against his account. In order to demonstrate that the customer does in fact have access to the account that he presents for payment, a typical practice is for a micro-credit to be made. The consumer is asked to confirm the exact amount of the micro credit. If he correctly matches the payment, the instrument is registered and can be used to fund the account. All customers who have access to payment instruments from authorized financial institutions must themselves have been through a separate KYC process to obtain it.

3. Once the payment device is registered, the customer can then use it to make a deposit into an account at the Internet gambling site. In Europe, many gambling sites have implemented 3-D Secure. This technology is branded "Verified by Visa" by Visa and "MasterCard SecureCode" by MasterCard. It requires the customer to enter a password in order to complete the transaction.

4. Once deposited into the account, the consumer can use the funds on deposit to place bets or make wagers. The gambling site will require the customer to enter a password each time they sign in to the site, before they can place a bet.

5. Once the bet is placed the result will be known at varying times depending on the game being played: for casino games the result is practically instantaneous while for event betting, the result may not be known for some time. Once the result is known any winnings are credited to the account with only one account permitted per player at a site. The account balance can be used either to make further bets or be withdrawn.

6. The withdrawal of the winnings or any unused deposits will be paid e.g. by cheque or electronically into a bank account (which has been through a registration process as described above) or paid back on to a card – but only in the name of the player. In the case of Visa, following advice and guidance from the UK Police, a system of refunding winnings to the original card account was introduced. This is seen by UK law enforcement as best anti-fraud practice – a fraudster is hardly likely to want to benefit his victim!

It is worth reflecting that at all stages of the process, precisely because the Internet gambling environment takes place in the electronic environment, the degree of control that can be applied far exceeds that which can be applied in the face to face environment where cash is the normal currency. Internet gamblers cannot be anonymous and all the activity that they undertake can be regulated and controlled through a variety of different processes.

5. Multi Layered Regulatory and Control Process

The process of placing a bet ensures that a multi-layered regulatory and control process is brought to bear on the Internet gambling industry.

The player has his identity checked by both the specialist gambling company, under the supervision of the gambling regulatory authorities; further any payment instrument that they might use to fund their gambling has been issued by an authorized financial institution operating under the oversight of the Financial Regulator, finally the payment scheme can also institute various controls to ensure that the payment instrument is used in an appropriate manner.

Together these controls can operate at the time of registration as well as in real time, when funding attempts are made and also at payout.

a) Gambling Regulation

There is an important role for government regulation. It is the responsibility of the government to establish an overall gambling policy and to put in place a licensing regime with appropriate sanctions to ensure that it is upheld. In the UK, licensing and enforcement is the responsibility of the Gambling Commission. Their responsibilities are to ensure that gambling is only operated by fit and proper persons in a fair and open way. Regulation ensures that players get a fair deal and are not cheated. This is considered to be a particular problem in an unregulated market, where disreputable operators – perhaps associated with organized crime - can establish gambling operations.

As well as protecting the vast majority of players who enjoy and can control their gambling, the Gambling Commission is also charged with protecting the vulnerable: they are specifically charged with ensuring that under age and other vulnerable persons are protected from being harmed or exploited, as well as making available assistance to persons who are or who may be affected by problems relating to gambling. The Commission has wide ranging powers to disbar individuals from operating a gaming business as well as to withdraw the license for companies who transgress the rules. Under certain conditions criminal sanctions can also apply.

It is clear that H.R.2046 gives to FinCEN equivalent powers that would enable it to carry out a similar function were the Bill to be passed.

b) Regulation by the Financial Regulator

All Financial Institutions in the UK are under the regulation of the Financial Services Authority (FSA). The FSA has a number of objectives:

- Market confidence
- Public Awareness
- Consumer Protection
- Reduction of Financial Crime

Their controls ensure that persons using bank accounts, credit or debit cards are properly authorized and operate within a regime which seeks to ensure there is an orderly market for the granting of credit, including an awareness of a consumer's ability to pay, is maintained. The FSA has no particular responsibility for gambling, but its generic controls against financial crime and in favor of consumer protection are certainly relevant in the sector.

In the U.S. the Securities and Exchange Commission (SEC) performs a broadly similar role.

c) Regulation by the Payment Scheme

My main experience is with devising and implementing regulations by Visa. The responsibility of the payment scheme is to ensure that laws are respected, that law enforcement requests are facilitated and that the reputation of the scheme is maintained. Notwithstanding the legal position, it is in the interests of the payment scheme to ensure that both buyers and sellers using its products are satisfied that they are being fairly treated and that they have suitable redress in the event of problems.

All Member Banks in the Visa system agree to be bound by its regulations, which provide wide ranging powers to its Board to pass specific regulatory programs and also have generic powers which allow sanctions to be applied for willful breaches of the rules. These sanctions range from fines, through disbarment from certain aspects of the business through to outright expulsion from the system.

The architecture and operation of a payment scheme such as Visa allows considerable scope for intervention at various stages of the payment process.

i. Identification

With respect to Internet gambling, the first priority of Visa was to ensure accurate identification of such transactions. A rule requires all transactions to be accurately flagged with the correct Merchant Category Code (MCC). For Internet Gambling, all transactions are required to be flagged with MCC "7995". The use of this code is defined under the aegis of the International Standard Organization (ISO).

To ensure compliance with the flagging requirement there is a compliance program. Without revealing too many details, it involves a significant sample of test transactions being undertaken at gaming sites and the tracing of those transactions through the system. Where Internet gambling sites are detected not using the 7995 code, the first recourse is to the Acquiring Bank, the bank that has the relationship with the merchant.

When first detected, Acquirers are notified and required to correct the coding error. Subsequently, regular audit transactions are undertaken in order to ensure that the miscoding has been rectified. If not, an escalating schedule of fines is applied.

ii. Authorization

The second prong of the payment scheme regulatory approach is delivered through the authorization process: when the player attempts to load money into his account, a series of checks can be undertaken in order to determine whether to approve or deny the transaction.

The approval can utilize a number of different factors. At Visa, controls were implemented to allow Issuers in particular jurisdictions to deny all Internet gambling transactions should they wish, or be required to by local law. Authorization also can be based on various other controls:

- Velocity controls can deny authorization if too many transactions occur in a defined period of time, offering a mechanism to address compulsive gamblers.
- Value based controls can deny a transaction if the amount spent exceeds the consumer's available credit or funds in their checking account.
- Additionally the location of the merchant is also available to the Issuer, who can update their system to deny transactions from a particular risky country.

These controls can be applied either by individual banks, or alternatively, at a scheme level across all transactions.

iii. Clearing

Approved transactions are cleared through the Visa system: this process allows further checks to be undertaken. Suspicious patterns of transactions can be analyzed for suspected money laundering activities. As and when a suspect transaction is identified, procedures exist for them to be reported to the relevant authorities. Monitoring for suspicious transactions is the responsibility of both the banks involved in the transaction and also the payment scheme itself.

iv. Chargebacks

Once transactions have been cleared through the system, they are posted to the consumer's account. Should he dispute the transaction, he can utilize a process known as "chargeback". A chargeback can be made for specified reasons and sets out a measure of the level of disputes generated by particular merchants.

Visa has defined a program to monitor the level of chargeback occurring and which defines warning levels and penalty levels for merchants generating excessive levels of chargebacks. These programs apply to all merchant types, not only those engaged in Internet gambling.

When the program's penalty thresholds are reached, not only does the Acquiring Bank lose the value of the transaction, but also further penalty fees, on a per-chargeback basis, are applied; the higher the level of dispute, the higher the level of penalty fees. In my experience, merchants with high dispute rates have suffered penalty fees in excess of $1 million, on a number of occasions. Penalty fees at this level tend to rapidly produce a dramatic improvement in performance.

v. Credit monitoring

Visa also has a program to monitor credits being sent through the system. Checks are undertaken to ensure that payouts relate to bets and that the use of the Original Credit transactions are controlled.

vi. Other Sanctions

In addition to the defined programs defined above, organizations that persistently breach the programs can be subject to specific sanctions. Merchants and their principals have had their acceptance privileges permanently withdrawn. In theory, Member banks can also be expelled from the system, although this power, while threatened, has not had to be exercised.

In should also be noted that individual banks are quite at liberty to have stricter policies, within the global framework defined by the scheme.

6. Outcome

The results of these programs were as follows:

Billions of pounds sterling have been processed annually for many years, with hundreds of thousands of satisfied players.

It is often said that Internet gambling constitutes a high risk sector; I have to say that in my experience, this is not the case. Dispute rates for regulated Internet gambling operators are low, at around 0.10%. This means that, on average, gambling transactions are *less* disputed than average Internet transactions. Internet gambling generates fewer disputes than online music retailing, less than software retailing and around the same level as purchases of airline tickets. The sectors with significantly higher levels of disputes include pornography and ISP subscriptions.

In my experience as the Chairman of Visa Europe's Compliance Committee, I did not receive any complaints relating to problem gambling, or any complaints relating to the cheating of players by Internet gambling sites. During the same period, I had many complaints with respect to other sectors.

It should also be recorded that Visa monitoring did not result in any suspicious transaction reports in regard to money laundering from any Internet gambling site operating in a regulated environment.

7. Conclusion

On the basis of my experience I can unequivocally state that Internet gambling can be regulated, and that abuses can be effectively regulated and controlled.

No one can argue that there will never be any issues with Internet gambling; it is a sad fact that some people, in a free consumer society, overspend and get into debt. Many people spend too much money on drink, on clothes, on shoes and a whole range of other items. Other people can lose money on the stock market, in property deals or through other bad investments. Most people in such a position work through their issues and work hard to repay their losses. Other, more vulnerable, people get to feel that there's no way out for them. Some of them resort to criminal activity or self harm.

The question is not whether the law can prevent gambling from happening. It's perfectly clear that it cannot. The question is whether vulnerable people would be better off if gambling was regulated or whether it was underground.

There is no doubt that in a regulated environment, there are tools to ensure that only fit and proper persons operate the gaming sites. In a regulated environment, controls can be put in place to address problem gambling. In a regulated environment, the taxes raised can be invested in education programs to help people who might have problems. In a regulated environment, blacklists can be established to ensure that players cannot play at any regulated site.

Without regulation, none of these things can be guaranteed.

In a real sense, we owe it to people who have experienced problems with Internet gambling in the past to introduce a regulated environment where the proper protection can be provided to the vulnerable.

8. Closing remarks

I am available to provide further information to the Chairman and other Members of this Committee, as well as to other Members of Congress, regarding my experience with Internet gambling and its control by a payment scheme.

Mr. Chairman, I thank you and the Committee for its time and appreciate the opportunity to submit my remarks for the record.

Testimony to the House Committee on Financial Services
Examining the Security Implications of Proposed Online Gambling Regulation

Jeff Schmidt
CEO, Authis
Friday, June 08, 2007

Chairman Frank, Ranking Member Bachus, and members of the Committee:

Thank you for the opportunity to speak to you today. My name is Jeff Schmidt and I am the Chief Executive Officer of Authis, a provider of identity and security-related products and services to the financial industry. I am a recognized expert on issues related to online identification and authentication, and have published numerous books, articles, and papers on information security related topics. I am also a founder, former Director, and current Officer of the InfraGard National Members Alliance, the private sector component of the FBI's InfraGard Program

My most recent scholarly article entitled *Online Child Safety: A Security Professional's Take,* discusses the issues of Internet-scale identification, authentication, and age verification. It was published in the Spring edition of The Gardian, the InfraGard National Members Alliance's peer-reviewed security journal.

I speak only for myself today and not for any of the organizations with which I am affiliated or for any colleague.

In my testimony today I would like to focus on two topics integral to the proposed legislation: the notion of "age verification" of persons remotely over The Internet, and the ability to determine the geographic location of an individual using The Internet.

Mr. Chairman, it is critical to understand that age verification and determination of geographical location simply cannot be done reliably over The Internet. As no security measure is infallible, good security practitioners always consider a-priori what happens in the inevitable situations when security measures fail. I appear here today to discuss the factors that contribute to the unreliability of these particular security measures. The facts are that these two particular security measures are inherently unreliable, can be trivially circumvented, and will fail at high rates. This reality must be taken into account when considering this proposed legislation.

Age Verification Is Not Reliable
Authentication is the difficult problem of verifying that persons are who they claim to be. Authentication is hard, expensive, and requires a delicate balance between cost, security and usability. Today, mass consumer Internet authentication is problematic: security is weak and irritated users are forced to maintain long lists of usernames and passwords. I would ask the distinguished Committee Members: how many usernames and passwords do you have?

At the root of nearly all "information age" security problems is the inability to reliably authenticate users (and computers) over The Internet. Identity Theft/Fraud, Phishing/Pharming, and even SPAM are all authentication problems at their root.

Authentication comes in many shapes and sizes. Some authentication techniques, such as photographs, physical descriptions, and secret handshakes, are only useful in-person. Moreover, some do a better job than others - we call this authentication strength. For example, when online, a simple username/password provides very weak authentication, while Smart Cards, tokens, or biometric measures provide a much stronger authentication. Reliable authentication at Internet scale is particularly problematic.

Academically, "age verification" is the act of attaching an attribute "age" (or "date of birth") to an identifier. In other words, we attach an age ("45") to an identifier ("Joe"). Once we've made that association, if we successfully identify and authenticate Joe, we'll also know his age. We need the age information to be highly resistant to forgery, and we need authentication strong enough to make it sufficiently difficult for motivated persons to impersonate others.

"Age Verification" must be split into two separate problems I call the Initial Subscription Problem and the Subsequent Visit Problem. The first time (initial subscription) we see a person identifying himself as "Joe" how do we determine his age? In other words, how do we reliably associate the correct "age" attribute with this person? Then, on subsequent visits, how do we reliably identify and authenticate that the person claiming to be "Joe" is the same one we subscribed?

When attempting to age verify adults online, the Initial Subscription can be reasonably performed in many cases with public records. However, the security of the Subsequent Visits, authenticated only by a password, is in doubt: reliably matching the age verified identity to some person thousands of miles away on the Internet is fraught with peril. Again, this is the root of the "Identity Theft/Fraud" problem we face today in nearly all aspects of online commerce.

We know from experience that usernames and passwords are unreliable for Internet scale authentication. We also know from experience that clever and motivated minors will always find ways to circumvent any age verification system – from impersonating parents and siblings to sharing or stealing age verified identities. We also know that criminals harvest, use, and resell usernames and passwords.

Underscoring the fundamental problems with age verification at Internet scale, the attorneys general of 21 states recently lashed out at Anheuser-Bush's Bud.tv age verification method, claiming it does little to keep minors from accessing the site.

When considering the proposed legislation, it is critical to consider that Internet age verification can not be done reliably and as such one must conclude that motivated minors will in fact easily and regularly circumvent the system.

Determination of Geographic Location of an Internet User Is Not Reliable
The Internet is a massive conglomeration of interconnected networks. Engineered by the DoD during the Cold War, a primary design goal was multi-path redundancy such that point to point communications could be maintained even if parts of the network were destroyed. These requirements lead to a highly decentralized network with literally an infinite number of paths between any two distant points. It is impossible to know in advance which path "through The Internet" traffic may take – and the actual path often changes transparently mid-communication due to numerous factors.

Internet Protocol (IP) addresses, like phone numbers, identify devices in the network. However, unlike the telephone system, most users connect to the Internet using dynamic IP addresses – a different address is transparently issued to their computer on each use and re-issued to others when communication ceases.

Moreover, the Internet is awash with technical measures including overt and transparent proxies, firewalls, filters and filtering services, Network Address Translators, private address spaces, point-to-point links, tunnels, and Virtual Private Networks (VPNs) which further obfuscate the true source and destination of communications. These technical measures are widely deployed and critical for the proper operation of The Internet.

For engineering reasons, Internet Service Providers (ISPs) often maintain large pools of IP addresses which are issued dynamically according to demand and technical factors. The same IP address may at one moment be in use by a user in Texas and then a moment later be assigned to a user in Ohio. The current explosion of wireless technologies including commercial and private Wi-Fi "hotspots" and "Mobile Broadband" technology (high speed Internet connectivity through the wireless cellular system) has greatly impacted the methodology carriers use to assign IP addresses even further detracting from the ability to reliably ascertain geographic location.

Additionally, users can very easily use various tactics including "anonymizers", proxies, and zombies to conceal or impersonate their location. In most cases, the use of these measures violates no law.

Based on all of these facts and absent supplemental data from a location-specific technology such as The Global Positioning System (GPS), reliable determination of the geographic location of individuals/devices on The Internet is simply not possible. While several vendors have built databases which attempt to match individual IP addresses to geographic locations, this data is most reliable at a "macro" level (i.e. identifying the country of origin) and not generally reliable at a fine-grained jurisdictional level. Data contained within these databases is highly dynamic and often inaccurate, lacks the granularity required to reliably identify jurisdictions, and can be misdirected both by technical measures inherent in the networks and by motivated users wishing to conceal or impersonate their location.

When considering the proposed legislation, it is critical to consider that physical geographic location of an Internet user can not be done reliably.

AOGA

Antigua Online Gaming Association

www.aoga.ag

Statement of the Antiguan Online Gaming Association Regarding United States Compliance with its Commitment to Permit Cross-Border Remote Gaming Services Under the General Agreement on Trade in Services (GATS)

Testimony Submitted for the House Committee on Financial Services Hearing to Consider the Internet Gambling Regulation and Enforcement Act of 2007 (IGREA)

6 June 2007

This statement is submitted by the Antiguan Online Gaming Association (AOGA) for the consideration of the House Committee on Financial Services as it deliberates regarding the proposed legislation known as the Internet Gambling Regulation and Enforcement Act of 2007 (IRGEA). The key purpose of this statement is to respectfully request the Committee, as it develops and hones the IRGREA, to recognize the existing treaty commitments of the United States under the General Agreement on Trade in Services (GATS) to allow Antiguan remote gaming operators access to the United States gambling market.

The World Trade Organization (WTO) has ruled that the United States remains out of compliance with its GATS commitments to permit Antiguan remote gaming operators access to the United States market. While the IRGEA, as proposed, does not bring the United States into compliance with its GATS commitments, the IRGEA presents an opportunity for Congress to realign United States gambling policy with the realities of the 21st century, and at the same time, prove to its international trading partners that the United States supports and adheres to the dispute resolution process of the WTO.

A. The AOGA

The Antigua Online Gaming Association (AOGA) is a nonprofit and nonpartisan trade organization consisting of select remote gambling operators who are licensed and regulated by the Government of Antigua and Barbuda. The AOGA was established with the goals of creating a better global understanding of the remote gaming industry and promoting the interests of remote gaming operators and their global customers.

B. Introductory Comments on the IGREA

For the past several years, Rep. Barney Frank has been a voice of logic and reason on the issue of online gambling in the United States. When his colleagues in the House of Representatives have moved to restrict the freedom of adult Americans to place wagers online from the comfort of their own home, Rep. Frank has been an advocate for the

rights of consenting adults to engage in recreational gambling in a responsible setting. Rep. Frank has commented that Americans love to gamble and will gamble online whether there are laws against such an activity. When Congress enacted the Unlawful Internet Gaming Enforcement Act (UIGEA) in 2006, a new tool for law enforcement to prosecute online gambling operations that access the American market, Rep. Frank rightfully called it one of the stupidest laws ever enacted.

On April 26, 2007, Rep. Frank introduced a bill known as the "Internet Gambling Regulation and Enforcement Act of 2007" (IGREA). IGREA envisions a federal framework to license and regulate certain types of online gambling. One of several positive aspects of the IGREA is that it presents Congress with a true opportunity to deliberate and enact a thoughtful, realistic and non-discriminatory system for online gambling in the United States.

However, there is an unintentional flaw in the way the IGREA treats Antiguan remote gambling operators. In simple terms, the IGREA, as presently drafted, improperly discriminates against Antiguan remote gaming operators, to the advantage of domestic gambling companies. The IGREA provides a framework for American gambling companies to offer remote gambling services by means of the Internet, telephone and other wireless devices. This same framework shuts out Antiguan operators from offering the exact same services.

The AOGA is confident that Rep. Frank does not intend for the IGREA to discriminate against foreign operators, or create a domestic-only industry. The AOGA is proposing a number of changes in this statement in the hope of assisting Rep. Frank and the Committee to fulfill this intent

The unintended trade discrimination built into this legislation, if left intact, would constitute additional violations of United States international trade commitments made in the GATS and, undermine the important dispute resolution system of the WTO.

C. The *US-Gambling* Dispute Pending Before the WTO

By way of background information, the AOGA wishes to point out to the Committee that the United States' legislative and law enforcement actions over the past few years seeking to prohibit foreign operators from offering "remote gambling" has been deemed to violate the commitments made by the United States under the GATS to allow other countries to access the domestic remote betting market.

From 2003 to the present, the Government of Antigua and Barbuda has patiently, respectfully, and persistently requested that the United States honor its commitments under the GATS so that Antiguan providers can offer remote gambling services of a nature which already exists in the United States. The Antiguan government is requesting that its operators be afforded the opportunity to access the United States gambling market without the forms of harassment and intimidation currently directed at Antiguan operators. The Antiguan government and its operators have made it clear to federal

officials that they welcome an online gambling system that ensures customer fairness, protects customers from problem gambling, prohibits underage gambling and any other social problems associated with recreational gambling.

In March 2003, after the United States refused to negotiate over this matter, Antigua initiated the dispute resolution process of the WTO to squarely challenge the United States' prohibition of cross-border gambling services offered by Antiguan operators to consumers in the United States.

Antigua, one of the tiniest members of the WTO and a small developing nation, has prevailed at every stage of the WTO dispute. On April 7, 2005, the WTO issued the Appellate Body Report in this dispute ruling that the United States had made a commitment to free trade in cross-border betting and gambling services in its schedule of commitments to the GATS. The WTO further ruled that the United States had adopted "measures," or federal laws, that interfered with its obligation to provide free trade in betting and gambling services with Antigua. The WTO further found that the United States could not invoke a "moral defense" to its violation of the GATS. Under Article XIV of the GATS, a country can violate the terms of the free trade treaty if the violation is necessary to protect "public morals" or maintain the "public order." The WTO concluded its ruling that the United States could not justify why it permitted American-based companies such as horserace betting companies or Las Vegas sportsbooks to offer remote gambling in the form of telephone and Internet account deposit wagering while the United States prohibited Antiguan companies from offering remote gambling services. The United States was given until April 2006 to comply with the WTO ruling, but did not take any action to do so.

On March 30, 2007, the WTO released a Compliance Panel Report in the continuing WTO trade dispute. In the Compliance Panel Report, the WTO concluded that that the United States remains out of compliance with the earlier adverse WTO decision. The WTO also signaled that the UIGEA would be found to violate the GATS and the United States continues to engage in unacceptable protectionist activities favoring the domestic gaming industry over the foreign competition. As a result of this latest WTO ruling, Antigua is free to impose trade sanctions against the United States, if Antigua affirmatively decides to do so, directed at "encouraging" the United States to meet its international trade obligations to Antigua.

In response to the latest WTO ruling, the United States has stated it intends to possibly withdraw its GATS commitment to free trade in gambling services, even if to do so completely undermines the WTO dispute resolution system and opens the United States to massive trade sanctions by Antigua and other WTO member nations. Antigua is hard pressed to believe that the United States will actually withdraw this commitment, as to do so is in dire conflict with longstanding United States free trade policy, not to mention that the withdrawal of the commitment will permit Antigua and other large trading partners to obtain massive trade sanctions against the United States. To the extent the Committee is informed by other parties that the withdrawal of the GATS commitment minimizes the meaning of WTO case, we would strongly disagree.

Against this backdrop, and even though federal officials have shown little or no inclination to respect the rights of the first developing nation to commence and win a dispute in "services" case before the WTO, the Antiguan government and AOGA nevertheless remain hopeful that the United States will sit down and negotiate a resolution the *US-Gambling* case in a way that is mutually beneficial to both countries.

D. The IGREA Violates United States GATS Commitments

This statement is offered to assist the Committee in crafting online gambling legislation that complies with the United States GATS commitments and the ruling in the *US-Gambling* case. This is necessary because the IGREA, as it is presently drafted, would violate United States GATS' commitments in several ways, to include:

- The federal remote gaming system envisioned in the IGREA gives a number of preferences to existing domestic gaming operators over foreign gaming operators. ***Above all, the IGREA must ensure that Antiguan operators who are licensed and regulated in Antigua have the right to offer the full array of remote gaming services to American customers.***

- The IGREA permits major sports leagues to "opt out" from allowing wagering on their games or contests. This discriminates in favor of domestic sportsbooks. ***The IGREA must permit licensed and regulated Antiguan sportsbooks to offer wagering on major sports leagues' games and contests that can be wagered upon in the United States without regard to any "opt out" rights held by the major sports leagues. Under the GATS, Antigua is entitled to remotely offer these services without interference or barriers.***

- The IGREA affirms existing United States law that permit horse race wagering to be conducted through the existing Interstate Horseracing Act (IHA) framework, a framework that discriminates against offshore companies in a variety of ways. ***The IGREA must ensure licensed and regulated Antiguan race book operators access to the American horse betting market.***

- The IGREA contemplates regulations that will be drafted and enforced by a federal administrative agency. ***The IGREA must include protections to ensure that Antiguan operators are not faced with unjustified or inappropriate regulatory obligations or responsibilities that create undue or unique barriers to Antiguan operators who desire access the American gambling market, either on a remote or physical presence basis.***

- The Unlawful Internet Gaming Enforcement Act of 2006 (UIGEA), enacted in October 2006, provides additional tools to assist American law enforcement agencies in targeting, harassing, and in certain cases, destroying, foreign remote gaming operators that are licensed and regulated in Antigua and other responsible jurisdictions. ***The IRGEA must amend the UIGEA so as to exempt Antiguan***

gambling operators from the reach of the UIGEA. This can be done so by amending the definition of unlawful gambling to exclude services provided by licensed Antiguan operators.

- The provision of IGREA that bars existing Antiguan operators with criminal histories, particularly gaming-related convictions, from obtaining a license under its terms, does not comply with the GATS. This provision would preclude certain Antiguan operators, who established a reputable and highly-qualified remote gambling business, from getting an online federal gaming license. ***To the extent individuals with past criminal histories are precluded from obtaining a federal license, the IGREA must provide an exemption for Antiguan operators from any the provision, where the operators' sole convictions were related to the cross-border provision of gambling services in accordance with the United States' GATS commitments.***

E. Conclusion

We appreciate your consideration of the vital trade issues discussed in this statement. The AOGA is certainly willing to provide further information or documentation to policymakers and legislators on how to make the IGREA compliant with the WTO ruling in the *US-Gambling* case, and to ensure that remote gambling fair and safe for all adults who enjoy recreational gambling.

Sincerely,

Richard W. George-John
Secretary and Treasurer
Antigua Online Gaming Association

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Original Paper

*107 ADOLESCENT PROBLEM GAMBLING: LEGISLATIVE AND POLICY DECISIONS

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INTRODUCTION

THE HISTORY OF GAMBLING on an international level has passed through a number of cycles from prohibition to widespread proliferation. Gambling has gone from being associated with sin, criminal behavior, degradation, and corruption to its current position as a socially acceptable form of entertainment. Gambling revenues have emerged as a major source of funds for governments, charities, and businesses throughout the world. With the widespread proliferation of gambling venues and with new emerging technologies (i.e., electronic gaming machines, Internet gambling, interactive lotteries, video game technologies being used in traditional slot machines) playing an ever increasing role, there remains concern over the social costs associated with gambling in spite of the concomitant benefits.

While gambling is often thought to be an adult activity, there is ample research to suggest that gambling begins early and that adolescents engage in most forms of non- regulated gambling (i.e., card playing, wagering on personal games of skill, Internet gambling, sports betting through a bookmaker, etc.) and regulated gambling (i.e., lottery, electronic gambling machines, casino, bingo, horse racing, etc.) in spite of legal prohibitions. [FN1]

There exists considerable variability in legislative regulation of gambling aimed at adolescents. For example, while casino entry in many jurisdictions is relegated to individuals age 21 in the United States, in other countries the entry age is 18 or older depending upon the jurisdiction. Different games can also have different age minimums and in the U.K. there are no age restrictions on fruit machine playing (low cost slot machines). In many jurisdictions special exemptions exist for bingo (often thought to be a family activity) and lottery purchases are generally regulated to ensure one must be at least 18 years old to purchase a ticket. Rose [FN2] has noted that in spite of adverse *108 political and moral pressure, those few legislators who have looked at lowering the legal minimum age to gamble have been dissuaded having concluded that revenues would not increase substantially. Yet, there is strong evidence that while the amount wagered by underage individuals may be insignificant from the industry's perspective, it is nevertheless considerable and as a group, adolescents may be particularly susceptible to gambling-related problems. [FN3]

YOUTH GAMBLING

In some early research there was clear evidence that high school students gambled in casinos in Atlantic City in spite of legal prohibitions. [FN4] Seven years ago Lesieur and Klein [FN5] noted that 86% of high school students in New Jersey indicated having gambled in the past year and 91% had participated in some form of gambling during their lifetime. These early studies eventually led to a plethora of prevalence studies, meta analyses, and reviews which concluded that gambling amongst youth was not only commonplace but that the prevalence rates for pathological gambling amongst adolescents is higher than that reported for adults. [FN6] The National Research Council [FN7] after reviewing the scientific literature concluded that adolescents were indeed a high-risk and vulnerable population likely to develop gambling problems and may be especially vulnerable. While urging caution that data sets were not always directly comparable, the National Research Council concluded that the proportion of pathological gambling of adolescents in the United States could be more than three times that of adults (5.0% vs. 1.5%).

While the actual prevalence rates for adolescent pathological gambling remains somewhat contentious, [FN8] and there is concern over the screening instruments used for the identification of adolescents with gambling problems, [FN9] there is little doubt that a vast majority of adolescents report wagering money during the past year and that an identifiable number actually experience significant gambling related negative behaviors. Prevalence rates reveal that as many 30% of youth wager money on some form of game of chance weekly, with 4% gambling daily. [FN10] Current prevalence rates suggest that between 4-8% of adolescents have a very serious gambling problem with another 10-15% at-risk for developing a gambling problem. [FN11]

Using our existing standardized measures, Derevensky and Gupta [FN12] reported that 91% of adolescents with a pathological gambling problem showed signs of having a preoccupation with gambling; 85% indicated chasing their losses; 70% lie to family members, peers, and friends about their gambling behavior; 61% gamble as a way of escaping problems; 61% use their lunch money and/or allowance for gambling; 61% become tense and restless when trying to cut down on their gambling; 57% report spending increasing amounts of money gambling; 52% gamble as a way of escaping problems; *109 27% report skipping school (more than 5 times) to gamble in the past year; 24% have taken money from a family member to gamble without their knowledge; 24% have sought help for serious financial concerns resulting from their gambling; 21% have developed familial problems resulting from their gambling behavior; and 12% report having stolen money from outside the family to gamble.

Problem and pathological gambling amongst adolescents has been shown to result in increased delinquency and crime, the disruption of familial relationships and multiple mental health, legal, academic, and behavioral problems. [FN13]

OUR CURRENT STATE OF KNOWLEDGE

There is considerable empirical support suggesting that gambling involves a complex and dynamic interaction between ecological, psychophysiological, developmental, cognitive, and behavioral components. No one single cause or social determinant can predict whether an individual will develop a gambling problem. Substantial empirical evidence and a growing body of research concerning adolescent gambling during the past decade has revealed that: (a) gambling is more popular amongst males than females, and more males than females exhibit pathological gambling behaviors; [FN14] (b) problem adolescent gamblers are

greater risk-takers in general, and on gambling tasks in particular; [FN15] (c) adolescent prevalence rates of problem gamblers are higher than those reported by adults. [FN16] While there is some controversy regarding this conclusion, there is ample empirical research supporting this finding given our current definition of pathological gambling and the screening instruments used for assessment; [FN17] (d) research data and clinical testimony suggest that adolescent pathological gamblers have lower self-esteem; [FN18] (e) adolescent problem gamblers exhibit greater depressive symptomatology; [FN19] (f) adolescents between the ages of 14-17 with serious gambling problems remain at heightened risk for suicide ideation and suicide attempts; [FN20] (g) for adolescents with severe gambling problems quality, long-lasting friendships and relationships are often lost *110 and replaced by gambling associates; [FN21] (h) adolescent problem gamblers remain at increased risk for the development of multiple addictions; [FN22] (i) adolescents with gambling problems have poor general coping skills [FN23] and report more daily hassles and major traumatic life events; [FN24] (j) adolescent problem gamblers report starting gambling at an early age (approximately 10 years of age); [FN25] (k) only a small percentage of individuals scoring in the pathological gambling range on multiple screening instruments perceive themselves as having a gambling problem, one of the reasons for their lack of seeking professional help; [FN26] (l) a high proportion of youth with gambling problems report having a learning disability, poor academic performance, higher dropout rates, as well as poor family connectedness, and low perceived social support; [FN27] (m) personality traits reveals adolescent pathological gamblers are more excitable, extroverted, anxious, tend to have difficulty conforming to societal norms, and experience difficulties with self-discipline, [FN28] exhibit higher scores on measures of state and trait anxiety, [FN29] and are more impulsive; [FN30] (n) similar to adults, [FN31] children and adolescents often have a positive attitude toward gambling; [FN32] (o) adolescents often fail to comprehend the risks and odds associated with gambling; [FN33] and (p) among adolescents there appears to be a rapid movement from social (non-problematic) gambler to problem gambler. [FN34]

EARLY GAMBLING

For those who begin gambling at a young age, the likelihood for future pathological gambling and participation in other problem behaviors increases. [FN35] In surveying age of onset of problem behaviors, gambling often precedes other risky behaviors, possibly serving as a gateway behavior to other addictive behaviors. *111 Gupta and Derevensky [FN36] reported that between grades 7-11, age 12-17, adolescents reported that past year and weekly gambling exceeded all other forms of addictive behavior including smoking, alcohol, and drug use. It is important to note that adolescent pathological gamblers often report starting gambling at the age of 9 or 10. This is not intended to suggest that young children are in fact sneaking into casinos or engaging in other regulated forms of gambling; rather many report that they receive lottery scratch cards as birthday gifts, for holidays and special occasions. [FN37] Consistent with current societal attitudes that gambling is a form of recreation, many adolescents report starting gambling for money with family members. [FN38] It is equally important to note that the majority of youth who engage in these behaviors will likely not experience any problems resulting from this activity. Nevertheless, age of onset appears to be an important predictor of future problems.

The fact that children as young as age 9 or 10 are gambling for money with family

members is also consistent with the finding that by age 12, less than 10% of youth fear getting caught gambling by their parents. [FN39] Delaying the age of onset of gambling may in fact ultimately reduce the number of youth experiencing significant gambling problems given that there is ample research suggesting that delaying the age of onset for other addictive behaviors similarly reduces the risk for developing a serious addiction. The fact that we currently have very few early prevention programs addressing excessive gambling is also problematic and it has been argued that such prevention programs need to begin in the elementary/primary school grades. [FN40]

Interestingly, a number of states (Arizona and Louisiana) in the U.S. have raised the minimum gambling age for casino playing from 18 to 21, primarily to be consistent with the legal age required for alcohol consumption. The Louisiana legislature went even further by raising the legal age to gamble on the state lottery and privately owned video poker machines to 21. [FN41] In testimony before the legislative hearings, Dr. James Westphal, an expert from Louisiana, noted that although the 18-20 year old age group only comprised 8.2% of the adult population in Louisiana, it represented almost three times (22.5%) the percentage of adults with significant gambling disorders. Confirmatory evidence comes from Audet, St-Laurent, Chevalier, Allard, Hamel, and Crépin, [FN42] in Quebec who noted that 2.6% of youth age 18-24 in Quebec are problem gamblers (3.4% of individuals reporting gambling), representing the highest age group at risk of having a gambling problem. While 18-24 year olds represent 13.3% of the adult population in Quebec, 20.1% of the problem gamblers in the province are between age 18-24. If one examines only the adult gambling population, young adults age 18-24 represented 12.7% of the population yet comprise 20.4% (almost double) of the gambling population with a gambling problem. This age group is more likely to play cards, engage in multiple casino games, purchase sports lottery tickets, use a bookmaker for placing sports bets, and play Video Lottery Terminals. Also of importance is the finding that individuals do not develop a gambling disorder after a single episode of gambling. Rather, this is a progressive disorder over time. As such, if individuals as young as 18 years old are experiencing significant problems they must have begun their gambling at a much younger age. [FN43]

TECHNOLOGY AND YOUTH GAMBLING

Aided by technological advances including the use of video-game technology, on-line gambling, *112 electronic gambling machines, interactive television and telephone wagering, and interactive CD-ROM lotteries, gaming has become even more appealing to a technologically savvy and sophisticated population. [FN44] Internet gambling in particular allows players to participate in a number of casino-type games in the privacy of their own homes, without direct parental supervision and strict controls concerning entry into this gambling environment. There are no security people checking identification and/or age of participation with most Internet gambling websites being housed in off-shore operations. [FN45]

The proliferation of online gambling sites poses a new problem for youth. Researchers have highlighted the ease with which gambling websites may be accessed by young people as well as the visually enticing aspects of Internet gambling. [FN46] Many gambling websites offer free games and free practice sites as well as financial rewards and incentives which are all available to anyone with access to a computer and the Internet. Sites now appear to be highly appealing to adolescents and young adults offering a multitude of games including blackjack,

roulette, slots, poker, and other casino games virtually identical to real life casinos while incorporating videogame technology. Other sites offer sports betting, another attractive activity for adolescents. Some early research suggests that youth who play videogames excessively gamble more than those who play infrequently. [FN47] While videogames appear random, their underlying heuristics enable youth to continuously improve their score and reach higher levels. However games of chance are truly random. While one improves performance outcomes when playing videogames, with gambling the more one plays the more one loses. Early speculation is that there may be an inappropriate transfer of learning taking place whereby adolescents believe that they can control totally random events. With new sites appearing daily, researchers suspect that the distinction between gambling and gaming may become blurred by the online gambling industry in order to maximize future profits. [FN48] Such games include sophisticated graphics, colorful and realistic sounds and images, and enhanced excitement. Even when playing on practice sites without money, adolescents report that it is engaging, exciting, and exhilarating. [FN49]

While little is currently known about the number of young people actually accessing gambling Internet sites it is clear that more and more youth are accessing and playing games on the Internet. Research by Willms and Corbett [FN50] suggested that upwards of 48% of youth age 15 are playing a variety of games on the Internet. Griffiths [FN51] in a small study of youth age 15 to 19 years (N = 119) reported that while none had actually gambled on the Internet, 4% of youth indicated that they would like to try it. Recent data by Hardoon et al. [FN52] revealed that 25% of adolescents with serious gambling problems and 20% of those at-risk for a gambling problem may be playing online gambling type games using so-called "practice sites" where no money is needed to play. Such practice sites expose youth to adult games, encouraging them to practice and perhaps move to "for money" online casinos. It may be that amongst individuals at risk for developing a gambling problem, the Internet presents a special danger. [FN53]

Adolescents appear particularly vulnerable to the appeal of Internet gambling as they find gambling enjoyable, are particularly attracted to the colorful, fast-paced videogame-like qualities, view themselves as highly intelligent, and perceive themselves as invulnerable to a gambling problem. These factors, coupled with *113 their experience playing on Internet gambling free practice sites makes them prime targets as future players. Internet casino sites (often referred to as properties) also have reward, loyalty programs which may be enticing to youth. Such programs include earning redeemable comp points through playing (Peak Entertainment which owns five sites enables players to earn comp points interchangeably on all their sites); high initial deposit bonuses (with some sites including 100% match bonus dollars); returning player bonuses of up to $20 per month; Refer-A-Friend bonuses as high as $50; 10% bonuses for wire transfers of funds, certified check and money orders; and some sites even provide "Bettor's Insurance" programs which returns 10% of net gaming losses. [FN54] Fortunately, such sites require a credit card in order to wager, and few adolescents currently possess a credit card. Are these sites training a new breed of gamblers? Only time will tell, as regulation of these sites continues to be highly problematic.

YOUTH GAMBLING: SOME MENTAL HEALTH AND BEHAVIORAL PROBLEMS

Mental health professionals are only beginning to fully recognize the magnitude and impact of problem gambling amongst teens. Awareness of the risks and harm

associated with gambling problems in youth and the public at-large is lacking. There is a growing need to examine and respond to gambling problems in adolescents from a prevention and public health orientation.

A gambling disorder is often referred to as a hidden addiction. This may be even more true for adolescents with a gambling disorder as they infrequently embezzle or steal excessively large sums of money (they don't have access to large sums of funds), they do not lose their jobs (most are still in school), they are not evicted for failure to pay rent (most live at home with their parents), and their spouse does not threaten to leave because of gambling debts (for the most part they are not married). Nevertheless, they engage in multiple forms of illegal activities to acquire money to continue their gambling. The majority of these youth initially report using their allowance money or money earned from part-time or summer employment, which ultimately leads to selling personal possessions, and stealing from parents, siblings, or other relatives in order to gamble. [FN55] While this can be viewed as petty crime some of the clients have reported stealing large sums of money over time with one adolescent client in the McGill University Research and Treatment Clinic reporting embezzling $9,000 from his parent's bank account. Others report having stolen thousands of dollars from their parents, siblings, and other relatives. One client, when asked whether or not he felt any remorse about stealing from family members responded, "Yes, it's nothing personal, I just needed the money." After these avenues are depleted some adolescents turn to bookmakers as they offer credit, others begin stealing money or items (which can eventually be sold for cash to gamble) outside of the home.

GAMBLING AND CRIMINAL BEHAVIOR

The connection between gambling and crime has been well-documented with adult gambling-related criminal offenses typically including fraud, theft, fencing stolen goods, embezzlement, tax fraud and evasion, forgery, selling drugs, and counterfeiting. [FN56] Prevalence rates for adults who report committing an illegal act to finance their gambling generally fall between 65- 89%. [FN57] Meyer [FN58] reported that 45.5% of pathological gamblers committed crimes solely for the purpose of financing their gambling, 35% had altercations necessitating police/legal intervention, and 28.3% have been convicted for a crime at least once. For incarcerated *114 adults, 97% of the pathological gamblers reported committing illegal acts to finance gambling or pay gambling-related debts.

While research has been conducted on adult crime/incarceration and its relationship to problem gambling, only a small number of studies have measured gambling behavior among incarcerated adolescents. [FN59] Incarcerated adolescents represent a particularly high-risk population for gambling problems, [FN60] a population which has been generally ignored for their gambling problems. Prevalence rates of problem gambling were found to increase dramatically for incarcerated adolescents, with 21% of these youth being identified as a problem gambler and 18-38% displaying pathological gambling symptomology. [FN61] These rates are up to nine times the prevalence of pathological gamblers in the general adolescent population, and 20+ times that of the adult general population of pathological gamblers (1-3%). Furthermore, while males and females in the general adolescent population typically differ on the amount of money wagered, self-esteem, mood levels (happiness and depression), and sensation seeking, male and female incarcerated adolescents failed to differ significantly on these measures. [FN62] Few studies have empirically examined and documented adolescent gambling-

related criminal behavior in the general adolescent population. In two separate studies, [FN63] specific questions were asked related to whether criminal acts were committed for the purpose of financing adolescents' gambling. Yeoman and Griffiths [FN64] reported that in 3.9% of the juvenile cases the offense was gambling-related. Of these, 86% involved theft or burglary, 7% involved missing persons, 5.5% involved criminal damage, and one case involved domestic dispute. Huxley and Carroll [FN65] found that 12% of adolescents reported stealing money from parents, 5% noted stealing money from outside the home, and 6% sold other people's possessions in order to finance their gambling problem. It is important to note that Derevensky and Gupta [FN66] reported that 42.4% of adolescent problem and pathological gamblers indicated borrowing or stealing money in order to cover gambling debts; 21% either committed or seriously considered committing illegal acts to finance their gambling; 24% had taken money from their family without their knowledge; and 12% had stolen from outside the family.

Adolescent gamblers are more likely to participate in or have a history of committing delinquent or illegal acts, particularly those with a serious gambling problem. [FN67]

In particular, the frequency and amount of money spent on gambling activities seem to be relevant predictors of delinquent activities. [FN68] Although these youth may not have been in contact with the juvenile justice system or been specifically asked why their illegal acts were committed, it is plausible that these acts are connected in some way to help finance their gambling.

Blaszczynski and Silove [FN69] have suggested that adolescents likely commit criminal acts more frequently because they have more peer pressure and have less available financial resources. As pathology increases, so does the need for money, with many criminal acts being committed for the sole purpose of financing their gambling addiction. [FN70] The need to participate at higher levels of gambling behavior (i.e., increased frequency) to obtain the desired *115 level of excitement often necessitates increased wagers, which results in a vicious cycle. As the probability of winning remains low, in order to increase one's level of excitement, increased wagers generally results in increased criminal behavior to acquire funds for gambling.

YOUTH GAMBLING: SOME SOCIAL POLICY ISSUES

There remains little doubt that adolescents constitute a particularly high-risk group for acquiring a gambling problem given their high rates of risk-taking, their perceived invulnerability, their lack of recognition that gambling can lead to serious problems, the ease and accessibility of gambling venues, the increasingly technological forms of gambling, and the social acceptability and glamorization of gambling throughout the world. It is important to note that gambling issues cut across a number of public health policy domains: social, economic, health, and justice, and is only beginning to emerge as an important social policy issue. Given that it takes several years to develop a significant gambling problem (the downward spiral presented in Lesieur's [FN71] work), the true social impact upon youth will likely take years to realize. Equally important is that under most governmental statutes children and adolescents are prohibited from engaging in legalized/regulated forms of gambling. Yet, we know that most youth have little difficulty accessing and engaging in most forms of gambling. [FN72] A concerted effort must therefore be made to ensure that existing statutes are adhered to, with steep fines and penalties for operators and vendors violating such laws. Where such

laws are non-existent, government legislatures are strongly urged to initiate strong legislative statutes. In recent years it has been encouraging to see industry representatives working closely with researchers, treatment providers, and prevention specialists in attempting to limit the negative consequences associated with problem gambling.

While we know that excessive gambling behaviors are associated with criminal acts, [FN73] what type of gambling behavior is more likely to promote criminal behaviors remains unknown. The fact that many young problem gamblers reach the point where they steal from family to support their habit is in contrast to a smaller number who steal from outside the home. [FN74] Stealing from inside versus outside the home may be a key distinction between adolescents who have not been involved with the juvenile justice system since family members are more likely to bail out their children and less likely to report them to law enforcement officials than adolescents stealing from strangers. How do these two populations differ? Does the type of gambling behavior differ? Clinical evidence seems to suggest that while some youth stop gambling when their access to funds is depleted others will continue stealing both within and outside the home. More research is needed to uncover how and why this transition takes place.

CONCLUSIONS

Adolescence is a time of egocentrism, testing boundaries, and societal restrictions including participation in risky and potentially problematic behaviors. Given adolescent pathological gambling prevalence rates are higher than adult pathological gambling prevalence rates, there is an assumption that adolescents will "mature out" of this behavior. However, clinical evidence suggests that excessive gambling results in many long-term negative consequences; many of which are extraordinarily difficult to overcome (e.g., dropping out of school, criminal records, severed relationships with parents, family members, and friends) and result in mental health and behavioral problems. [FN75] The short and long-term consequences to the individual, his/her family, friends, and peers can be devastating. Problematic gambling during adolescence remains a growing *116 social and public health issue with serious psychological, sociological, and economic implications. While the incidence of severe gambling problems amongst youth remains relatively small, the number of individuals with severe gambling problems combined with those at-risk for a gambling problem is substantial. The devastating long-term consequences for those youth with gambling problems, their families, and friends are enormous.

Until recently, gambling problems have not been viewed as a public health problem [FN76] or public policy issue but rather as a personal or individual problem. [FN77] New research has expanded our knowledge of gambling problems and its societal impact, with legislators being forced to carefully examine the social and financial costs associated with gambling expansion as well as assessing the accrued financial benefits. [FN78]

From a social policy perspective, legislatures and regulatory bodies have the ability to determine suitable forms of gambling, to raise the legal age for government regulated forms of gambling, and have the ability to enforce current statutes yet their frequent failure to take a proactive stance is of concern. For example, there is clear evidence that underage youth have very little difficulty in purchasing lottery tickets. In a survey of 1072 adolescents, Felsher, Derevensky and Gupta [FN79] reported that 54.2% of underage adolescents played scratch tickets, 22.4% played

lottery draws (6/49, etc.) and 14.8% played the sports lottery (Sports Select) (in Ontario, wagering on sports events is legal through the provincial lottery corporation). Overall, these adolescents reported beginning to play the lottery to win money (65%), because their parents play (48%), for enjoyment (38%), excitement (31%), and curiosity (28%), with similar reasons being cited for maintaining their playing behavior. Other studies reveal little difficulty by adolescents in gaining access to gambling venues in spite of legal prohibitions. [FN80] In discussion with several state and provincial lottery directors and representatives they frequently report that few if any vendors have been fined or had their licenses temporarily or permanently suspended. As well, several states have installed instant scratch lottery vending machines with little or no supervision as to who uses these machines.

Current research efforts have been focused upon basic issues of assessment of gambling severity; the identification of physiological, psychological and socio-emotional mechanisms underlying excessive gambling behavior among youth; understanding why some individuals continue to gamble in spite of repeated losses; and how to best educate, prevent, and treat these problems. There remains little doubt that gambling amongst youth remains an important area in need of further basic and applied research, additional funding, and responsible social policy development.

The field of youth gambling is relatively new and as a result there currently are significant gaps in our knowledge. A better understanding of the effects of accessibility and availability of gaming venues on future gambling behaviors is required. Adolescent pathological gamblers, like their adult counterpart, continue to chase their losses, have a preoccupation with gambling, have an impaired ability to stop gambling in spite of repeated attempts and their desire to do so, and frequently get involved in delinquent criminal behavior to support their gambling. This behavior continues independent of the accompanying negative consequences and ensuing problems. Stricter enforcement of current statutes and innovative way of protecting our youth are necessary. Regulatory boards and government legislatures would be well advised to take this issue seriously.

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Testimony of Mark Holland, Partner, Baker Tilly
June 7, 2007

Submitted for the Record Concerning Legislative Hearing on H.R.2046, the "Internet Gambling Regulation and Enforcement Act of 2007"

Held Before the Financial Services Committee United States House of Representatives On Friday, June 8, 2007, at 10:00 a.m.

Mr. Chairman and Members of the Financial Services Committee, I am Mark Holland. I am a member of Baker Tilly Tax and Advisory Services LLP, a UK Limited Liability Partnership, trading as Baker Tilly. Baker Tilly is a trading name of:

- Baker Tilly Tax and Advisory Services LLP
- Baker Tilly UK Audit LLP
- Baker Tilly Corporate Finance LLP
- Baker Tilly Restructuring and Recovery LLP
- Baker Tilly Services Limited

Baker Tilly ("BT") has provided back office services to SecureTrading Group Ltd, a UK Limited Company which operates a payments business that specialises in the secure processing and settlement of Internet credit card transactions.

I appreciate the opportunity to submit written testimony to you concerning my experience of the provision of back office services in relation to the secure processing of Internet credit card transactions with respect to high-risk transactions, in particular Internet gambling transactions.

I. INTRODUCTION

BT is an independent member of Baker Tilly International, a global network which has 126 independent member firms in 93 countries. The aggregate worldwide annual fee income of the Baker Tilly International member firms is in excess of $2.2 billion, making Baker Tilly International the 8th largest accounting network in the world, by fees.

SecureTrading Group Ltd and BT have together developed a combination of processes and technology in the e-commerce sector which is specifically designed with the intention of providing security, protecting against fraud and money laundering and restricting other abuses in areas of e-commerce that are perceived to pose special risks, such as travel reservations and Internet gambling transactions collectively known as the 'SGBT System'.

II. THE OPERATION OF THE SGBT SYSTEM

BT is not a payment service provider and does not have oversight of any of Secure Trading Group Ltd's activities other than those within the SGBT system for which it has responsibility.

BT is contracted to provide back office and funds management services to SecureTrading Group Ltd.

I have read the testimony of Gerald Kitchen of SecureTrading Group Ltd submitted to the Financial Services Committee in connection with the Legislative Hearing on H.R.2046 and confirm that it accurately describes how the SGBT system operates.

By way of providing a little more detail of those aspects of the SGBT system for which BT is responsible, the back office and funds management functions operate as follows:

- On a daily basis BT extracts all authorised transactions from Secure Trading Group Ltd's secure systems into BT's own secure systems.
- For each Merchant, BT generates a daily notification of the transactions processed by the SGBT system.
- All funds are received into bank accounts controlled exclusively by BT.
- All trading and reserve accounts are reconciled on a daily basis by BT; this includes reconciling funds received from the card acquirer with the transactions processed by SecureTrading Group Ltd.
- BT calculates all relevant deductions, including deposit taxation as per the relevant jurisdiction and similar transaction based costs. These funds are then identified separately from Merchant funds and paid over to the relevant authorities or other recipient 3rd parties.
- All payments are made via electronic banking systems, with payments being made to pre-assigned Merchant bank accounts only.
- BT retains an audit trail of all transactions it processes, detailing all information received by BT and the eventual trail through to payment to the relevant parties.
- BT is compliant with all applicable anti-money laundering requirements.
- All of the BT systems data (including all transaction records) are stored safely on state-of-the-art high security servers.

Other than the back office and funds management functions, all other elements of the SGBT system are operated by Secure Trading Group Ltd, which has the trading relationships both with the Merchants and the acquiring banks.

III. SUPPORT FOR H.R.2046

Whilst BT makes no representations in relation to the legality or illegality of gambling generally or Internet gambling in particular, to the extent that legislation is passed which has the effect of permitting Internet gambling in the United States to any extent, BT supports the introduction of regulation in the Internet gaming industry

with a view to ensuring high standards of consumer protection and the security of financial transactions permitted by any such legislation.

BT considers that the technology exists and is already being utilised successfully, specifically through the operation of the SGBT system, to provide (through the introduction of appropriate regulation) a high degree of consumer protection should the House of Representatives and the Senate choose to pass legislation permitting Internet gambling in the United States.

Mr Chairman, I am grateful to you and the Committee for your time and appreciate the opportunity to submit my remarks for the record.

TESTIMONY OF

CRAIG POUNCEY, PARTNER,
HERBERT SMITH LLP (BRUSSELS)

ON

CAN INTERNET GAMBLING BE EFFECTIVELY REGULATED TO PROTECT CONSUMERS AND THE PAYMENTS SYSTEM?

BEFORE

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

FRIDAY JUNE 8, 2007
10:00 a.m.
2128 RAYBURN HOUSE OFFICE BUILDING

Mr. Chairman and Distinguished Members of the Committee

Introduction

I am Craig Pouncey, a partner in the Brussels office of UK law firm Herbert Smith, and head of my Firm's international trade law practice. In that capacity, I have had the opportunity to work on the case between Antigua and the United States, in which the WTO found that a number of U.S. laws violate the General Agreement on Trade in Services ("GATS") because they prohibit the supply of Internet gaming services from jurisdictions outside the U.S.

I do not currently represent Antigua but act for a number of EU companies with an interest in the gaming sector.

In this testimony, I will explain the role of the WTO in the Internet gambling debate and the different options that the U.S. has in the WTO, following its loss in the Antigua case.

General background and the Antigua dispute

The GATS, which is the relevant WTO Treaty here, works on an "opt in" basis. This means that key obligations only apply to the extent that a country has "opted in" for a specific sector (or, in GATS language, made "specific commitments"). In the case brought by Antigua, the Appellate Body of the WTO found that the U.S. had made "specific commitments" with regard to the cross-border supply of gambling and betting services. As a result, the U.S. had to provide "market access" to the suppliers of such services from other WTO member countries. The Appellate Body went on to find that the U.S. violates that obligation because several federal laws prohibit the use of the Internet to supply gaming services from foreign jurisdictions to consumers in the U.S.

By way of defence, the U.S. had invoked an exemption clause that allows a country to depart from its normal WTO obligations (*i.e.* in this case to prohibit access to Internet gaming services from countries such as Antigua) because of the need to protect public morals. The U.S. argued that Internet gambling posed uncontrollable risks of youth gambling,

fraud and money laundering. This defence failed, however, because the U.S. allows Internet betting on horse races.

The U.S. was given until April 3, 2006 to comply with the findings of the Appellate Body Report. On July 6, 2006 Antigua convened a WTO "compliance Panel" to assess the steps taken by the U.S. to comply with the Appellate Body's findings. The U.S. used these proceedings, *inter alia*, to reargue its case that Internet gambling cannot be regulated and that Internet horse race betting was not lawful in the U.S. The U.S. lost the argument again and, on March 30, 2007, the latest WTO report in this saga was issued. In the context of this debate, the most interesting points of this most recent WTO Report are the following:

- The WTO Panel found that "there are at least 18 State laws that expressly authorize wagering by wire within the United States, including on a wholly intrastate basis".
- The WTO Panel states that, while the U.S. originally argued that Internet gambling could not be regulated, it has changed its position because the Unlawful Internet Gambling Enforcement Act 2006 explicitly acknowledges that such regulation is possible.
- The WTO Panel refers to the recent prosecution of foreign Internet gaming operators but adds that it finds it "striking" that the DOJ has never prosecuted any of the U.S. based operators of Internet horse race betting.
- The WTO Panel notes that the U.S. had an opportunity to clarify that Internet gambling on horse race betting is prohibited but that the Unlawful Internet Gaming Enforcement Act does precisely the opposite by deliberately maintaining the ambiguity.

The U.S. recently decided not to appeal this latest WTO report, which, therefore, became final.

Option 1 for the U.S.: withdrawal of commitments

On May 4, 2007, the USTR announced that the U.S. would start a procedure to withdraw the U.S. commitment on gambling and betting services. Pursuant to this procedure, all WTO Members, not just Antigua, are entitled to claim compensation from

the U.S. Such compensation normally adopts the form of additional trade liberalisation in other areas. This procedure has never been used in a context such as the one at issue here and the U.S. move is generally perceived as an attempt unilaterally to change the WTO contract after losing the legal fight.

The USTR press release announcing the withdrawal of the GATS commitment mentioned that, in its view, other WTO Members have "very little, if any" basis to claim compensation because the U.S. made the commitment on gambling by mistake.

It is unlikely that other WTO Members will share the U.S. view on this matter. First of all, they may well find it difficult to believe that the U.S., which was the main driver of the GATS negotiations during the original negotiations, was unable to understand its own commitments.

Further, it should be noted that the U.S. has requested, obtained, and used the right to impose countermeasures in a WTO dispute settlement case where such a "misunderstanding" had effectively occurred. In the well known *Bananas* dispute between the U.S. and the EU, the U.S. argued that the activities of U.S. companies such as Chiquita were "banana distribution services" covered by the GATS and the EU's GATS commitment on "distribution services".

The EU disagreed. In fact, the EU had taken a series of measures to protect its banana regime from being challenged in the WTO but it had never considered that its commitment on "distribution services" could have been used against its regime for the importation of bananas. If the EU had realised this, it would no doubt have excluded "banana distribution services" from its commitment on "distribution services". However, the EU had not done that and thus lost the dispute with the U.S. The U.S. then obtained the right to impose painful economic sanctions on the EU for a total value of USD 191.4 million per year. This caused very serious hardship to the EU companies targeted by those sanctions and, in at least one case that I am aware of, it caused bankruptcy. The total amount of these sanctions related to a lack of compliance with GATS obligations which the EU never intended to make.

The same U.S. that requested, obtained, and applied these economic sanctions *vis-à-vis* the EU is now claiming that it can withdraw commitments without compensation because *it* did not intend to make these commitments. In my view this is wrong as a matter

of law. I am convinced, therefore, that a number of WTO member countries will take the same view and seek compensation from the U.S. I also believe that the U.S. will be asked, as a result, to open up other markets. This will be the price that the U.S. has to pay to avoid option 2, *i.e.* regulation of Internet gambling.

Option 2 for the U.S.: regulation of Internet gambling

Appropriate regulation of Internet gambling would put the U.S. on a road to resolving the WTO problem. The U.S. would avoid having to offer possibly substantial compensation in the form of opening new markets to foreign competition, and, as a result, affecting possibly numerous other economic players in the US who have absolutely nothing to do with gambling, or the WTO gambling dispute. Further, rather than losing credibility, the U.S. would strengthen the WTO and its legal system, which the U.S. wants other countries, and in particular China, to respect.

Thank you, Mr. Chairman and Distinguished Member of this Committee for considering this testimony and I would be happy to answer any questions that you may have.

4 June 2007

INTERNET GAMBLING REGULATION AND ENFORCEMENT ACT 2007, H.R. 2046

Committee on Financial Services' hearing: 8 June 2007

1. The purpose of this note is to provide evidence to the Committee to assist it in determining whether internet gambling can be regulated to protect consumers and the payments system.

Introduction

2. In order for the Committee to assess how much weight to attach to this submission it would be sensible to set out some background about the Remote Gambling Association (RGA) and its expertise in this field.

3. The Remote Gambling Association (RGA) became operational on 1 August 2005 as a result of a merger between the Association of Remote Gambling Operators (ARGO) and the Interactive Gaming, Gambling and Betting Association (IGGBA). Although we are based in London we have engaged with several different regulators and governments and this reflects the international nature of the industry and our members' interest in diverse markets.

4. It is a trade association whose role is to promote the interests of its membership, which includes the world's largest and most well known remote gambling companies. A full list of members is at Annex A.

5. As a condition of membership, all of our members must be licensed for gambling purposes in Europe and they must agree to abide by our codes of social responsibility. This is for reasons of probity and customer protection.

6. Further information about the RGA is available on our website at www.rga.eu.com

7. On a personal note I have been Chief Executive of the RGA since its establishment and before that was General Secretary of ARGO (see para 3 above). Prior to that I spent 6 years as an official in the British

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Government advising Ministers on policy matters relating to horseracing, betting, and remote gambling. During that period we addressed many of the issues that are being reviewed by the Committee on Financial Services. In addition I have experience of working in the British betting industry and am also currently a Director of the Responsibility in Gambling Trust (RIGT), the charity that was established at the request of the British Government to channel donations from the gambling industry towards problem-gambling related research, education and treatment.

8. For ease of consideration we have deliberately focused here on a number of key issues, but if the Committee would find it useful to have evidence on other related areas we would of course be glad to supply it.

Crime & money laundering

9. The main areas of risk are criminal infiltration, fraud and money laundering. However, despite statements that have been made by opponents of online gambling there is no evidence that this sector is more prone to criminal activity than any other.

10. The United States is renowned for having robust regulatory standards to combat crime in the bricks and mortar gambling industry, especially in States such as Nevada. It also has effective regulations in the finance sector for dealing with online and cross border financial transactions.

11. The obvious case in point is the use of credit cards, which are still the preferred form of payment for most online gamblers. Within the United States vast amounts of credit card transactions take place on a daily basis. The system is well established and well policed in order to counteract fraudulent and criminal transactions. From a crime prevention perspective we would argue that it is irrelevant whether the transactions involve payment for gambling services or any number of other products. The point is that the same protections apply and are as equally effective. The removal of cash gambling from the equation is understood to significantly reduce its attractiveness to potential money launderers.

12. Taken together with international experience, for instance in Britain, this demonstrates clearly that there are effective tools and procedures to ensure that:

    - Probity checks can be made to prevent criminal elements becoming licensed operators;

- That those checks and ongoing regulation will prevent licensed operators from perpetrating fraud; and

- Money laundering can be stamped out in the same way that it has been in other industries where the United States has chosen to regulate the activity. In this respect it is worth noting that all online casinos that are based in the European Union are subject to the Money Laundering Directive as well as the legislation in each Member State (for example, in the UK online casinos will be bound by the Money Laundering Regulations 2007 which will go before Parliament for approval later this year).

13. Particular requirements could include procedures to:

- Establish and record the identities of all customers
- Record all transactions over a certain level
- Have a named director or employee to take responsibility for compliance with money laundering rules
- Have staff trained to a standard where they can ensure compliance with measures of this kind.

14. Added assurance can be gained from the knowledge that in a regulated US online gambling market all of the transactions would go not just through the gambling operators but also through the regulated financial services sector with all of the augmented checks and balances that would be entailed.

15. In short, there is nothing unique about gambling in general or online gambling in particular. As with all other industries and sectors it is capable of control in order to prevent it being used as a source of crime.

16. The only circumstance in which crime can flourish is if the activity is unregulated.

Consumer protection - problem and underage gambling

17. Online gambling, as with all forms of gambling, brings with it the risk of problem and underage gambling. The industry willingly acknowledges that risk and its responsibility to deal with it in co-operation with regulators and specialists, such as academics and treatment providers.

18. Thankfully, again despite claims to the contrary, online gambling provides many opportunities to put in place protections that are not there in all traditional gambling environments. While technology may

be perceived by some as a threat the truth is that when it comes to combating crime and problem gambling it offers a whole range of additional solutions and protections.

19. There is not space here to list them all, but our own minimum standards are set out in our codes of practice on social responsibility and age verification. Both can be accessed at our website. These issues have also been at the forefront of the thinking of the British regulator, the Gambling Commission, as it has developed its new licence conditions and codes or practice. From September these will apply to all British-licensed online casinos and sports-books. Copies can be found at www.gamblingcommission.gov.uk.

20. To illustrate this point the following are examples of the measures that are commonly applied by our members currently:

- Deposit and spend limits for customers
- Facilities to allow customers to self exclude themselves from the gambling site
- Information on the sites about responsible gambling
- Links to sources of advice and counselling
- Financial support for treatment services
- Enabling websites to permit filtering software, such as that provided by the Internet Content Rating Association (ICRA), to enable parents to restrict their children's access to sites that they deem to be undesirable.
- Use of third party suppliers, such as credit reference agencies or holders of related databases, to confirm the identity and age of customers

Consumer protection – fairness

21. In the same way that a roulette wheel in Las Vegas must be tested to ensure that the player is offered a fair game, online gaming products must also be tested. This is longstanding industry practice. There are various methods, but the most common is called output testing. The result in nearly every virtual game, be it poker, roulette or a simulated slot machine is determined by a random number generator (RNG). Output testing will be employed to ensure the randomness of a new product before it is introduced and will then be employed to ensure that it continues to operate in the way that it is intended.

22. This is underpinned by compliance regimes which are designed to prevent external interference with the systems.

23. Again, regulation can ensure that consumers are adequately protected and that appropriate safeguards are put in place.

Conclusion

24. We believe very strongly that any objective assessment of these issues will inevitably lead to the conclusion that online gambling is capable of being regulated to the required standard. There is also no doubt that a jurisdiction which has a viable regulatory and tax regime will be attractive to both consumers and businesses. This would certainly be the case for the United States where the establishment of a properly regulated online gambling industry would give American consumers a clear choice between gambling operators who are licensed and regulated by the Government, and those operators who for whatever reason choose to remain offshore. It is reasonable to expect that in such a situation the vast majority of US citizens would opt for US-regulated businesses and gambling products.

25. We appreciate that if and when the Committee satisfies itself that internet gambling *can* be regulated effectively it will then need to consider whether the United States *should* regulate it. We would welcome the chance to comment again at that stage in the process, but for now we would like to restate our offer to provide any help that we can as the decision making process develops. We have a great deal of first hand knowledge of the industry, the associated regulatory issues, and of operating in regulated environments. It is at your disposal should you want it.

Clive Hawkswood
Chief Executive
Remote Gambling Association

Annex A

Remote Gambling Association Membership

Barcrest
BellFruit
Bet 365
Betfair
Blue Square
Cantor Index
Cashcade
Chartwell Games
Club On The Park
CryptoLogic
Eurogaming
Gala/Coral Group
Inspired Broadcast Networks Limited
Ladbrokes
Leisure & Gaming
Littlewoods
Microgaming
Million21
Orbis Technology Ltd
Paddy Power
PartyGaming
Playtech
PKR
Ritz
Skybet
Sportingbet
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Statement of Keith Whyte, Executive Director
National Council on Problem Gambling

Submitted for the Record Concerning
H.R.2046, "Internet Gambling Regulation and Enforcement Act of 2007"

Financial Services Committee
United States House of Representatives
Friday, June 8, 2007, at 10:00 a.m.

Dear Chairman Frank and members of the Committee:

Thank you for the opportunity to testify on this bill. National Council on Problem Gambling (NCPG) is the U.S. advocate for programs and services to assist problem gamblers and their families. Our mission is to increase public awareness of pathological gambling, ensure the widespread availability of treatment for problem gamblers and their families, and to encourage research and programs for prevention and education. As an advocate for problem gamblers, NCPG does not take a position for or against legalized gambling, but concentrates on the goal of helping those with gambling problems. We were founded (on this day!) in 1972 and our 35-year history of independence and neutrality makes the National Council the most credible voice on problem gambling issues. We are a 501(c)(3) not-for-profit charitable corporation. NCPG membership is restricted to U.S. companies, and NCPG does not accept any restrictions on the use of contributions except as provided under Federal and state non-profit guidelines.

NCPG programs include the National Problem Gambling Helpline Network (800.522.4700) a single national point of access for problem gambling information; National Problem Gambling Awareness Week (www.npgaw.org); the Annual Conference on Prevention, Research and Treatment of Problem Gambling; and an information clearinghouse. In addition, the majority of problem gambling services are provided on the state level by the 34 state affiliate chapters of NCPG.

The National Council on Problem Gambling neither supports nor opposes HR 2046. My purpose is to provide additional information and a broader perspective on gambling and specifically on problem gambling and responsible gaming that may assist the committee in its consideration of these matters.

It is important to note that regulation is only a small part of a comprehensive solution for underage and problem gambling. A comprehensive solution would include funded programs for prevention, education, treatment, enforcement and research, or PETER, to effectively address the mental health disorder of problem gambling. It is unfortunate that H.R. 2046 does not contain any funding for and responsible gaming programs.

It is likely that individuals with gambling problems will find the internet attractive for pursuing their addiction. Risk factors include underage access, high speed of play, anonymity, social isolation, use of credit/non-cash, 24-hour availability. A snapshot of the anecdotal evidence shows there is little doubt that individuals have developed problems by gambling on the internet. The National Problem Gambling Helpline (800.522.4700) was dialed more than 30,000 times between January 1 and March 15, 2006. In a review of the 1,300 calls for immediate help, 106 clients (8%) reported that their primary problem was internet gambling. The predominant age of these individuals was aged 18-25 and when asked their occupation 16 reported they were students; other occupations included accountant, attorney, ER doctor, engineer, nurse, policeman and church worker. A recent study by the Annenberg Foundation found that almost 600,000 youth (aged 14-22) reported gambling on the internet on a weekly basis, and this age group also has the highest rates of gambling problems.

Problem gambling is a serious and even life-threatening mental health disorder characterized by an increasing preoccupation with gambling, a need to bet more money more frequently, restlessness or irritability when attempting to stop, "chasing" losses, and loss of control manifested by continuation of the gambling behavior in spite of mounting, severe, negative consequences.

However, the graphical and interactive structure of the internet provides a revolutionary opportunity to create informed consumers with access to a variety of information designed to encourage safe choices and discourage unsafe behavior. With other addictive behaviors such as alcohol or tobacco use, such educational programs are usually done at home and school, not at the point-of-sale. An adjunct to an internet gambling site can be constructed that would provide interesting (and possibly mandatory) information, quizzes, video presentations, etc...on responsible gaming before players join or begin play. The scope of the information on the gambler is enormous and the number of interventions is limitless.

The technology also exists, unlike for other forms of gambling, to allow players and operators to set limits on limits on time, wagers, deposits, etc...as well as to exclude themselves. These standards can be improved by utilizing the data collected by these websites to develop profiles of general online wagering behavior. From this information (properly redacted and pooled to eliminate individual and site identification) medians and benchmarks could be created to allow the development of predictive programs for abnormal usage as well as publicized norms. Research in other addictive behaviors has shown that many of those who are at-risk do not have accurate information on normative use, and that the less accurate information one has, the more at-risk they are to develop a problem.

Clearly gambling on the internet raises some difficult issues, but it provides theoretical opportunities for operators to deliver responsible gaming programs that meet or exceed current standards in the "bricks & mortar" gaming industry.

Mr. Chairman, I thank you and the Committee for its time and appreciate the opportunity to submit my remarks for the record and I would be happy to respond to any written questions.

Isle of Man
Government

House Financial Services Committee Hearing

"Can Internet Gambling be Effectively Regulated to Protect Consumers and the Payments Systems"

June 8, 2007
Statement for the Hearing Record
Submitted by Mary Williams, Chief Secretary, Isle of Man Government

Chairman Frank, Members of the Committee, the Isle of Man Government welcomes the opportunity to submit written testimony to your Committee.

Summary

The on-line gambling industry is now a legitimate business recognised by banks, stock markets and investors and one that is increasingly based in well-regulated jurisdictions.

The Isle of Man has been at the forefront of introducing legislation regulating the on-line gaming business. The Isle of Man is in a position to attract the best businesses in the world because it has adapted to the new on-line gambling environment.

It is of paramount importance to the Isle of Man that the industry is well regulated to protect persons under the age of 18 and the vulnerable, to ensure gambling is fair, and to prevent the use of the gambling sites by the criminal fraternity and terrorists.

The Isle of Man believes the best way to achieve this is to ensure such businesses are well regulated and not pushed further off-shore by prohibitionist actions which will be to the detriment of Governments, customers, and the vulnerable as well as to the benefit of terrorists and organised crime.

All Isle of Man gaming companies have surmounted strict compliance procedures including police, Treasury and data protection checks on individuals as well as their companies. In addition, the Island's Gambling Control Commission will have approved both the games and the underpinning software. Tough money laundering rules - including "know your customer" practices - will be enforced, to parallel the Isle of Man's strict and internationally recognised financial services regulation.

The Isle of Man wishes to work with the other jurisdictions including the United States so that its licence holders are not in contravention of the laws of the United States and other jurisdictions and therefore, to provide fair workable solutions to obtain access to worldwide markets.

On-Line Gambling Regulation Act 2001

Gambling is defined under Isle of Man legislation as all types of gambling including casino games, sports bets, lotteries etc. "Betting" is distinguished as being limited to sports betting, and "gaming" includes casino type games and lotteries.

In June 2000 it was decided to permit the extension of on-line betting to include other on-line games such as those available in land-based casinos. As a result of this decision, endorsed by the Isle of Man's Council of Ministers, the On-line Gambling Regulation Act became law in May 2001.

The decision to extend the limit of on-line gambling transactions was based on the need to extend the Island's economic base into a new area of business that was growing at a rapid rate. The advantage the Isle of Man could exploit, at the time, was that the larger gaming companies wanted to be involved in the on-line business, but only in a well regulated jurisdiction and thereby compete with small specialised companies that had set up in jurisdictions with limited regulation.

The reputational risk to the Isle of Man was a paramount concern, and it was decided that only if the reputational risk could be kept to an absolute minimum would the Isle of Man involve itself in this new area of business. One of the main requirements at the time to reduce reputational risk was the provision of a licence condition that prevented any on-line gaming company taking bets from jurisdictions where such on-line gambling was deemed illegal.

Also at this time, a number of the on-line businesses that were locating to the Isle of Man had U.S. regulators for their land-based operations and, therefore, the Isle of Man took a cautious view on the legality of taking such bets. Although it was left to the individual operators to ensure they were acting within the law of jurisdictions from which they were taking bets, it was known that the Isle of Man Government's stance, at the time, was that bets should not be taken from the United States.

The On-line Gambling Regulation Act is designed to do the following:-

- Make all on-line gambling conducted from the Isle of Man without a licence illegal whilst permitting licensed interactive gaming on the internet on a tightly regulated basis which is considered key to the success both for companies providing services and for the Island itself.

- Provide a secure regulatory regime, involving the following Agencies in the Isle of Man: the Gambling Control Commission ("the Commission"), the Financial Supervision Commission ("the FSC"), Data Protection, Customs and Excise and the Isle of Man Constabulary.

- Limit licence holders to offering only games that are approved by regulation. Not all games are available to all licence holders. This ensures each licence holder is competent to provide each game licensed to it.

- Ensure companies are registered in the Island, their designated official or operations manager are resident here, and that licence holders maintain sufficient financial reserves or a bond in the Isle of Man to pay customers in the event of financial problems. Regulations protect players' privacy, prohibit sales to minors, prevent money laundering and the use of on-line sites in relation to any movement of monies for terrorism purposes. There are also other player protections within the Act, such as gaming contracts being enforceable in law, codes on advertising and accuracy of web-site claims and regulations governing the conduct, fairness, and probity of gambling on the site. The regulator also has rights of entry and powers to inspect software and all gaming transactions.

  The Act is considered to provide an important opportunity for the Island to benefit from a growing e-commerce market, but the Island's reputation for probity has to be protected. That is why regulation is given such emphasis within the Act.

  The number of licences was initially restricted to three to avoid overburdening the new regulatory system whilst it became established. This restriction was raised to thirteen and is currently being removed.

Consequences of the On-Line Gambling Regulation Act 2001

As a result of the new legislation, the Isle of Man was successful in attracting household names from the international gaming industry, including companies such as MGM, Rank and Kerzner. However, despite the well-known brands, the Isle of Man licence holders were unable to attract enough business to their sites. Additionally, the cost of complying with the regulations under which the licensees operated made it uneconomic to carry on gaming businesses.

The result was that the high-profile names either closed down their operations or re-located to jurisdictions where regulation was less burdensome or from where they could take bets from the United States.

Since the departure of the major licence holders, the Isle of Man has been re-examining its regulation and in particular the manner in which it requires software to be tested. In this connection the software is considered to meet the regulatory requirements if it has been certified as such by a major accountancy firm or a specifically approved testing house. In addition, testing is carried out on a result-based basis to ensure the systems meet regulatory requirements.

A new system has now been put in place that will accomplish the Government's aims whilst providing a commercially viable approach to software testing which is:

a) where certain companies are certified to undertake testing by the Department of Home Affairs ("the Department") (such as the large accountancy firms and the premiere software testing companies (known as certified testing companies)), they are able to test the software of licence holders and certify that the software is fully compliant with the regulations;

b) once the certificate has been received and licence conditions have been complied with, such as putting in place a bond, the licence comes into force;

c) the Commission is then responsible through the accountancy firm, statistician and other technical experts employed for regulating and monitoring the site by requesting periodic reports which are examined by the experts for regulatory compliance. This is known as result-based testing which identifies any problems by measuring output figures against house advantage, pay out rates, etc;

d) the licence holder is responsible for notifying the certified testing company and the Commission of any changes to their software so the software can be tested if required;

e) the licence holder is responsible for providing any updated certificates to the Department;

f) The Anti-Money Laundering Code also requires licence holders to report any suspicious transactions to the Financial Crime Unit.

The other important change that has occurred in the Isle of Man since 2001 is that the onus on deciding the territories from which wagers are to be accepted is now the responsibility of the operator and not the Isle of Man Government or the Gambling Control Commissioners. This means of dealing with the jurisdictional issue is in line with that taken by the United Kingdom Government.

The Isle of Man is up against stiff competition to attract such business, but it has considerable advantages over its competition because of the Island's state of the art telecommunications infrastructure and the geographical size of the Island which permits expansion of business which is not possible in other competing jurisdictions.

Another advantage the Isle of Man holds over its competition is the increasing wish of gambling companies to legitimise their businesses by launching them on, for example, the London Stock Exchange. In order for them to achieve this aim they need to be located in a premier, well-regulated jurisdiction like the Isle of Man.

Gambling Regulation

In order to ensure that the Isle of Man provides the most competent regulatory environment in the world for the on-line gambling industry, the Department has, through detailed world-wide consultation, produced a number of important documents which are considered by both regulators and the industry as ground breaking.

Application Procedure

The first aspect put in place relates to the application procedure for a licence, and in this connection a comprehensive application procedure was formulated based on the procedures used by the Gaming Board of Great Britain.

This procedure impressed the industry world wide because of its extensive nature and because the follow-up checks exceed those conducted by the strictest regulatory regimes in other jurisdictions. Checks include those on the applicant, parent and associated companies, the individuals involved in these entities (including checks on police records),

data protection compliance, customs, identification, involvement in professional organisations, personal banks and building societies accounts, etc.

Therefore in the first instance it is extremely difficult to obtain an Isle of Man licence. Indeed some entities have not proceeded based purely on the comprehensive nature of the application procedure.

Regulatory Regime

The second regulatory aspect relates to four sets of regulations to deal with systems verification, advertising, registration of accounts and prescribing descriptions of permitted games. These regulations are continually appraised and updated to ensure there is no weakening of the regulatory process as technological advances continue in this developing industry.

The prescribed regulations provide a list of games that are permitted under the Act to ensure that only games that can be strictly regulated are available on Isle of Man regulated sites.

The advertising regulations provide for the rules for advertising off and on a licensed website and include strict rules in relation to what has to be provided on the site and what is prohibited. The regulations also provide the Commissioners with powers of enforcement and penalties of up to £5,000 for each violation.

The Registration of Account Regulations provide for the rules and procedures that must be followed by the operator in registering new customer accounts. The Regulations also specify detailed rules on the way accounts must be managed, privacy of information on account holders and prescribe the penalty for contravention which is £5,000 for each violation.

The System Verification Regulations provide for the rules with which an operator must comply in conducting on-line gambling, provide certification of software and impose penalties for noncompliance of £5,000.

In relation to noncompliance with any Regulations made under the On-line Gambling Regulation Act, the Commission has the ultimate power to suspend or revoke the licence.

Anti-Money Laundering

The third regulatory aspect relates to the Anti-Money Laundering Code the Isle of Man has put in place which applies specifically to on-line gaming businesses. This Code eliminates the potential that such sites could be used for money laundering. The Code imposes requirements on on-line gambling businesses to establish anti-money laundering procedures, training and record keeping with failure to comply resulting in prosecution in relation to the breach. This Code is kept under constant review in compliance with the FATF principles.

Strict anti-money laundering procedures are required to be complied with which relate to identification of prospective customers, evidence of identity, changes to patterns of transactions, record keeping, records of transactions, retention of records, reporting suspicious transactions and training.

There is a legal requirement for licence holders to report any suspicious transactions to the Financial Crime Unit ("FCU"). These transactions are identified by software which is designed to highlight transactions on any account that for example, show that money has been deposited and few gaming transactions have taken place before it is withdrawn. The FCU will then investigate the report, check their data base, and if deemed necessary involve foreign jurisdictions in a staged approach to the investigation. In 2005 there were three cases where suspicious transactions, relating to gambling, were reported to the FCU. This information was passed to US law enforcement agencies.

The anti-money laundering processes, other regulatory requirements, and the strict application procedure ensure that those who would attempt to use such gambling sites in the Isle of Man for the purposes of laundering terrorist or other illegal funds are prevented from doing so.

Latest Additional Regulations

In addition, the Isle of Man has developed new Regulations to permit disaster recovery and the advertisement for off-Island on-line gambling sites as a means of attracting other business and building a level of expertise. Assistance is also being given to existing on-line companies that wish to re-locate to the Isle of Man through the introduction of transitional arrangement Regulations.

The Advertising Regulations provide that the promotion of gambling web sites elsewhere in the world have to comply with regulations on advertising to ensure they are not indecent or offensive, they are based on fact and they are not false, deceptive or misleading in any material particular.

The development of Regulations in the field of disaster recovery relate to the need for companies to have back-up facilities for on-line sites in well-regulated jurisdictions with excellent telecommunications systems. These sites are, as with all on-line gambling, subject to stringent regulation and licence requirements.

Gambling Forum

The Department of Home Affairs has continued regulatory development by setting the terms of reference for the On-line Gambling Forum. When established, this body will bring industry and Government together to work in partnership to provide an optimally regulated and commercially attractive on-line environment and avoid reputational risk. This body is seen world-wide as a model for providing a well-regulated environment for on-line gambling.

The Gambling Control Commission

The Isle of Man Gambling Control Commission ("the Commission") is an independent corporate body, initially established as the Gaming Board of Control in 1962. Its members are appointed by the Council of Ministers. It is probably one of the oldest established gambling regulatory bodies in the world and is empowered to regulate the entire gambling industry in the Isle of Man, excluding the United Kingdom National Lottery. There are five Commissioners one of whom acts as Chairman who must be legally qualified, and all of whom are Isle of Man residents.

The Role of the Commission

The role of the Commission in relation to on-line gambling sites is to supervise on-line gambling operations and includes the following:

a) To ensure that on-line gambling is fairly and properly conducted and ensure compliance with the provisions of the 2001 Act, the Regulations and licence conditions;

b) To investigate the character and financial status of persons behind on-line gambling operations and to ensure that all fees payable to Treasury are duly paid and accounted for;

c) To approve the company's Isle of Man resident "Designated Official" who must be a Director of the licence holder, and a person of integrity and competence. In addition the Commission considers the character and reputation of the Designated Official and their competence and experience in both IT and gambling;

d) To ensure accounts are secure against invalid access and systems failure;

e) To ensure the site is regulated, the licensee has a physical address, it has a regulator namely the Isle of Man Government, persons under the age of eighteen years are not permitted to play and that persons who do play have the assurance that their winnings are legally recoverable;

f) To ensure advertisements are not indecent or offensive, are based on fact and are not false, deceptive or misleading. Additionally, advertisements must not have any sexual content or contain any material in breach of copyright. If the Commission is of the opinion there has been any breach of these standards it will direct the licensee to cancel the advertisement or to change it. Breach of these standards also constitutes an offence as does failure to comply with directions issued by the Commission;

g) To ensure that the licence holder continues to supply current information;

h) To undertake routine inspections and audits. In particular the Commission can order a licensee to remove a director or manager from office and can also direct that a particular person should not be appointed a director or manager;

i) To enter premises to access records, documentary or otherwise, and computer programmes. It is an offence to obstruct entry and access to such records or to provide false or misleading information;

j) To supervise the audit of sites. The Commission demands the co-operation of the licence holder and a full and unrestricted information flow which in all cases must be without prompting by the Commissioners. If a random audit reveals anything less than complete co-operation and a full and accurate information flow, licences are at risk of suspension or cancellation and the Commission may recommend prosecution to the relevant authorities;

k) To suspend or cancel the licence if the Commission is satisfied that the licence holder was not eligible to have been granted a licence.

age. In addition in order to withdraw funds a pin number is issued by post by on-line gaming licence holders to the name and address provided at registration.

The Isle of Man Government works with licence holders to ensure that further restrictions will be put in place to prevent under age gambling.

Gambling Addiction and Problem Gamblers

The protection of the vulnerable is one of the Commission's core values and one which is taken very seriously. All holders of gambling licences in the Isle of Man are, as a matter of course, required to satisfy the Commission that they undertake and provide for a high-level of social responsibility in their specific gambling activities so as to ensure that should a particular player be recognised as displaying signs of addiction, there is immediate access to assistance.

Licence holders or applicants for licences are required to demonstrate their social responsibility procedures and to provide a link, or for terrestrial operations provide literature, or information and a contact number for a problem gambling agency. These procedures are audited on an ongoing basis.

The Commission is working with other International Regulators to continue to add to their current broad understanding of the international context of this problem and with local agencies in order to maintain best practices. This work will continue as, regrettably, there are jurisdictions which permit internet gambling without addiction deterrents.

There is a customised gambling site 'self-exclusion aid' for those who want to take immediate action themselves, which prevents their computer from accessing any on-line gaming site until they feel they are in control again.

It has been suggested by the Responsibility in Gambling Trust ("RIGT"), a major co-founder of the international referral portal for problem gamblers that on-line operators should be persuaded to donate to the Trust. The Isle of Man Government is supportive of this suggestion and intends to put in place licence conditions that will require Isle of Man licence holders to contribute to the provision of this service.

In addition the Gambling Control Commissioners at the Gambling Regulators European Forum Conference in 2005 requested information from participating member states relating to problem gambling :

a) To ascertain what solutions other jurisdictions offer to problem gamblers and whether these solutions differ for 'local' and foreign operators and;

b) To ask if there is an official or recommended help organisation which might be included on the web sites of internet gambling operations in their jurisdiction.

Benefits of the Isle of Man Regulatory System

a) Prior to enactment of the Unlawful Internet Gambling Enforcement Act, a major proportion of bets placed by US citizens were with on-line casinos and sports book operations in poorly regulated jurisdictions. The Isle of Man provides an alternative to these off-shore locations by providing a strictly regulated jurisdiction which ensures operators have processes in place to prevent access from underage persons, deters problem gambling, deals with money laundering, provides legal redress for customers, provides player protection for monies owed and provides strict tests on software and pay out levels, etc.

b) The Isle of Man wants to work with the United States to put in place any additional regulatory measures considered necessary.

c) Terrorist organisations exploit any weakness in financial systems to launder funds. By insisting that on-line gambling business is carried out only in well-regulated jurisdictions, such organisations will be deterred from using on-line gambling operators to launder funds.

d) The on-line gambling market is a worldwide business. It is likely that the number of on-line gambling businesses will reduce as the regulation of the industry becomes more comprehensive. Those businesses that succeed in this business environment may well choose to be listed on a stock exchange, and this will encourage the location of such business in well-regulated jurisdictions such as the Isle of Man.

e) The Isle of Man believes, as with land-based gambling, on-line gambling is a well established recreational activity and therefore a regulatory environment must be provided in which it is safe to gamble on-line, ensuring the vulnerable are protected.

Conclusion

It is submitted that Internet gambling in the Isle of Man is effectively regulated with the result that consumers and the payments system are indeed protected.

Testimony of André Wilsenach, Chief Executive Officer, Alderney Gambling Control Commission, Channel Islands

June 6th, 2007

Submitted for the Record Concerning
Legislative Hearing on H.R.2046, the "Internet Gambling Regulation and Enforcement Act of 2007"

Held Before the Financial Services Committee
United States House of Representatives
On Friday, June 8th, 2007, at 10:00 a.m.

1. Introduction

Mr. Chairman and Members of the Financial Services Committee, I am André Wilsenach. I am the Chief Executive Officer of the Alderney Gambling Control Commission and have been with the Commission from January 2002 to present. I am responsible for overseeing and managing the regulation of eGambling on behalf of the Commission. The Commission is responsible for the regulation and control of the eGambling industry, based on Alderney in the Channel Islands.

I am grateful for the opportunity to submit written testimony to you concerning my experiences in regulating eGambling transactions and ensuring that consumers are ensured of the highest level of consumer protection.

I shall attempt to answer the question *"Can Internet Gambling be effectively regulated to protect Consumers and the Payments System?"* It is my contention that the evidence, based on my experience in regulating gambling over the last 10 years, of which the last five years was spent on regulating eGambling, shows that eGambling can indeed be regulated.

This paper sets out to explain how the Alderney Gambling Control Commission, where I have been employed for the last five years, has regulated the eGambling industry. In doing so, I will provide the Committee with:

- A brief background on Alderney's constitutional position; the regulatory framework in place for licensing and regulating eGambling; and the values underpinning the regulation of eGambling;
- An introduction to the Commission;
- A brief synopsis of the licensing regime available in Alderney;
- A short description of the approach followed by the Commission over the last seven years in ensuring that:
    - The industry is kept free from crime;

- Gambling is conducted in a fair and transparent way;
- The young and vulnerable are protected.

2. Background to regulating eGambling in Alderney

- **Constitutional position of Alderney**

Alderney is a self-governing, democratic territory and one of the principal islands of the Bailiwick of Guernsey, which is a Crown Dependency. Alderney is outside the EU and is part of the Bailiwick's internationally recognised financial services centre.

The Crown, acting through the Government of the United Kingdom, has responsibility for Alderney (along with the other Channel Islands) in the fields of foreign affairs and defence. The island's relationships with the EU and other countries are primarily through appropriate UK Government departments. Domestically, Alderney's "constitutional" measure is the Government of Alderney Law, 2004. The island is governed by the States of Alderney (the Legislature), which consists of a President and ten states members, all elected by universal suffrage.

Routine matters of government are performed by three committees: Policy & Finance, General Services and Building & Development Control. Between them, they deal with all aspects of the island's finances and day-to-day administration. Certain matters of government and services are dealt with by the States of Guernsey under arrangements in place since 1948. The Policy & Finance Committee, consisting of all ten States Members, has responsibility for eGambling.

As a consequence of the 1948 arrangements for some key services to be provided in Alderney by the States of Guernsey, Guernsey provisions on taxation apply in Alderney and the States of Alderney has no authority to raise

revenue itself through such taxes. Because of the relationship with Guernsey, two members of the States of Alderney are chosen to be full members of Guernsey's States of Deliberation and participate in that legislature/government accordingly.

- **Background to the legalisation of eGambling**

In 1994, the States of Alderney resolved as a matter of policy to introduce legislation permitting *inter alia* land-based casino gaming in the island. Although this resolution has not resulted in all the legislation intended, the underlying reason for it was to provide an incentive for further development within the tourist sector. By 1996, a property development company, intending to re-develop one of the island's premier hotel sites, suggested to the States that the fledgling online gambling industry provided a potential revenue stream that would enable it to proceed with the proposed development. Only electronic betting, being an extension of well-established telephone betting, was mentioned. The opportunity and scope for such an industry to operate successfully out of Alderney was quickly recognised and the States enacted the Gambling (Betting) (Alderney) Ordinance, 1997, made under powers contained in the Gambling (Alderney) Law, 1975, as amended, part of which enabled the Policy & Finance Committee to license and regulate what were termed "electronic betting centres". The first licences were granted by the Committee in 1998 and operations commenced later that year.

The 1997 Ordinance was substantially amended in 1999 and 2000 in order to introduce additional regulatory safeguards, drawn principally from the various legislative regimes by then enacted in the Australian States and territories. These more industry-specific principles better reflected the online activity being conducted by the Alderney licensees at the time, namely, Sportingbet and SkyBet. Many of the core features introduced into the Alderney regime at that stage have been carried forward into the current legislative framework.

- **Regulatory framework and arrangement**

Primary legislation, the Gambling (Alderney) Law, 1999, as amended, (hereafter referred to as 'the Law') provides that all forms of gambling are unlawful, unless authorised under an Ordinance of the States of Alderney (a form of subordinate legislation, albeit an act of the entire legislative assembly) made under powers contained therein. (The Law repealed and replaced the 1975 Law.) The Law also established an independent body, known as the Alderney Gambling Control Commission (hereafter referred to as 'the Commission') to license and regulate those forms of gambling that are made lawful by way of an Ordinance. The Commission's duties also include "to keep under review the extent and character of gambling" in Alderney.

All forms of eGambling, are, subject to compliance with specified conditions, made lawful by virtue of the Alderney eGambling Ordinance, 2006, (hereafter referred to as 'the Ordinance'), made by the States of Alderney in June, 2006. It came into force on 11th July, 2006 and replaces and combines two earlier Ordinances, (the Gambling (Interactive Gaming) (Alderney) Ordinance, 2001 and the Gambling (Electronic Betting) (Alderney) Ordinance, 2002, both as amended), which had provided separately for gaming and betting respectively. The 2002 Ordinance had, in turn, repealed and replaced the original Ordinance of 1997, as amended, which had dealt in part with electronic betting centres.

Apart from establishing the basic framework for lawful eGambling, the Ordinance contains a series of obligations and powers for the Commission to make Regulations. On 11th July, 2006, the Alderney eGambling Regulations, 2006, (hereafter referred to as 'the Regulations'), were made by the Commission. These Regulations, since amended twice in minor ways, contain very detailed provisions which supplement the Ordinance's basic framework. Therefore, when taken together, the Ordinance and the Regulations constitute

a complete framework for the licensing and regulation of all forms of eGambling operations conducted under an Alderney eGambling licence.

The Ordinance provides for the Commission to issue such written guidance as it considers appropriate for the purpose of providing information about compliance with the Ordinance and the Regulations made thereunder. To assist eGambling licensees with preparation of applications for approval of internal control systems, as required under the Ordinance and the Regulations, and regarded by the Commission as the most important post-licensing matter before a licensee can "go live", the Commission has issued Guidelines for the Preparation of an Internal Control System (hereafter referred to as 'the Guidelines').

The legislation referred to here is available on the Commission's website at http://www.gamblingcontrol.org/index.php?page=25 and the guidelines are available at http://www.gamblingcontrol.org/index.php?page=27

- **Values underpinning the regulation of eGambling**

The values underpinning the regulation of eGambling are:

- all electronic gambling on Alderney is conducted honestly and fairly;
- the funding, management and operation of electronic gambling on Alderney remains free from criminal influence;
- electronic gambling is regulated and monitored so as to protect the interests of the public.

These values are summarised in the mission statement set out in recent annual reports of the Commission which is available at http://www.gamblingcontrol.org/index.php?page=32

3. Introduction to the Commission

Within the first year or so of granting electronic betting centre licences through its own Policy & Finance Committee, the States realised the importance of establishing a body external to government to perform duties associated with regulation and conferring on it all the powers essential to its licensing and regulatory functions.

The Commission appointed by the States of Alderney to license and regulate operators in the eGambling industry is an independent and non-political body. Three of the Commissioners who have been appointed come from outside Alderney and have experience of gambling, regulation and licensing. The fourth Commissioner is a local resident who, in addition to her particular experience in fraud detection and licensing, brings an Alderney perspective to the deliberations of the Commissioners.

The legislation gives the Commission the necessary powers to conduct wide ranging investigations, to obtain such information necessary to conduct its investigations, to gain access to licensed premises and to ensure compliance by monitoring and investigating the software, systems and business processes of its licensees.

The Commission has a staff of twelve people with appropriate experience in management, finance, legal, IT and regulation of the gambling industry. The staff has access to outside experts in the field of eGambling and works closely with international testing houses and with financial and legal consultants.

4. Licensing arrangements

The licensing regime in Alderney has been developed to address the following:

- The need to prevent crime;

- The need to have legal jurisdiction over the licensed operator;
- The international nature of eGambling systems;
- The cross-border nature of the gambling transactions;
- The need to ensure that the management and other persons concerned with a licensed eGambling business are appropriate in terms of both skill and integrity.

Accordingly, the Ordinance empowers the Commission to issue the following types of licences and certificates:

- A **full eGambling licence** to an Alderney company which wishes, probably as part of a larger group of companies, to operate an eGambling business from Alderney;
- A **restricted use eGambling licence** to a non-Alderney operator enabling it to make occasional and temporary use of servers located in Alderney or Guernsey for the purpose of effecting gambling transactions under the stringent conditions attached to its exercise, designed primarily as part of the operator's disaster recovery package;
- An **associate certificate** by which the Commission approves a person during the currency of the certificate as being a fit and proper person to be associated with the operations of any eGambling licensee;
- A **hosting certificate** to a person enabling it to accommodate at its approved premises gambling equipment utilised by an eGambling licensee for its operations;
- A **key individual certificate** to a person who occupies or acts in a position designated as a key position or is an associate, or occupies or acts in a managerial position.

The licensing process seeks to satisfy the Commissioners that the applicant is a fit and proper person to hold a licence or certificate and, where applicable, that any associate of the applicant is a fit and proper person to be associated with the operations proposed by the applicant. Each type of licence has a particular purpose

and the range of them is designed to ensure that the Commission has a direct regulatory relationship with all the core elements of an eGambling operation.

A list of licensees and certificate holders is available from the Commission's website at http://www.gamblingcontrol.org/index.php?page=4

5. Keeping out crime

One of the primary objectives of regulating gambling in Alderney has been, and will continue to be, to prevent crime and the influence of crime within its eGambling industry. This objective has been met over the ten years that eGambling has been permitted.

One reason why the Commission has been successful in keeping crime out of the industry is that, rather than attempting to reap the fiscal benefits of larger numbers of operators, Alderney has set out to attract operators who seek a comprehensive and tightly controlled regulatory regime. These are for the most part established, major gambling operators with brands they wish to protect. They are also the types of company most likely to conduct their businesses in a way that is consistent with the standing of Alderney and Guernsey as highly reputable financial services centres.

The primary defence against criminal involvement is to establish sufficiently high barriers to entry. Alderney's legislative framework, as operated by the Commission, has developed a reputation as one of the strictest in terms of licensing. This is mainly due to the Commission's thorough process of investigation into the backgrounds of operators, shareholders, beneficiaries, sources of funding, business associates, third party providers, key individuals and hosting providers.

Investigations are conducted by the staff of the Commission, with outside assistance where necessary. Comprehensive reports compiled following these investigations

enable the Commissioners to determine whether or not an applicant is 'fit and proper' to hold a licence. Investigations can include interviews with the key individuals and the Commissioners may also require their own meeting with representatives of the applicant before deciding whether or not to grant a licence.

The Commission has from its inception recognised the difficulty of regulating an international industry without the cooperation of other law enforcement bodies. The Commission has therefore sought to establish working relationships with other regulators and with domestic law enforcement agencies such as the Police, the Law Officers of the Crown and the Guernsey Financial Services Commission which has its own gateways to financial and criminal intelligence.

It adds particular comfort to the Commission to know that an applicant has good standing in another jurisdiction and it has been most helpful to enter into informal reciprocal arrangements for sharing information with other regulators.

Applications for licences are restricted to Alderney registered companies. This is to ensure that the licensee has a legal presence in Alderney, but it also enables the Guernsey Financial Services Commission to look into the suitability of shareholders, beneficiaries, associates and key individuals associated with a potential licensee as part of the incorporation process. This provides a valuable additional level of scrutiny and helps to inform the Commission's own investigations.

The granting of a licence, although very important, is only a finding of the general suitability of the operator. It does not imply permission to commence operations. Before licence holders can commence operations, they are required to obtain approval for both a detailed internal control system and for all gambling equipment. An advantage of this phased approach is that it provides a further opportunity for the Commission to ensure that the licensee has the experience, ability and resources

to conduct eGambling successfully and in such a way as to keep crime out of its operations.

Documentation of an approved internal control system contains a comprehensive account of the licensee's entire operation and may run to several hundred pages. Of particular significance in any internal control system is a requirement to confirm how a licensee will handle key issues such as anti money laundering provisions and the protection of minors. The approval process enables the licensee's detailed operating plans to be reviewed and, if necessary, changed through dialogue with the Commission. Similarly, a detailed review of gambling equipment ensures the fair conduct of games.

After a licensee has commenced operations under its eGambling licence, the Commission monitors its operation and periodically checks compliance with the approved internal control system. This ongoing regulation is designed to ensure that any potential criminal activity or influence continues to be kept out of all parts of the Alderney licensed operation.

6. Ensuring that gambling is conducted in a fair and transparent manner

The States of Alderney believes that customers of operators licensed in Alderney should be able to gamble secure in the knowledge that the games and other gambling transactions offered are fair, that their money is safe and that the licensees (and, if applicable, their associates involved in the delivery of the services) are reliable.

The Ordinance therefore contains powers which enable the Commission to protect the interests of the customer with regard to game fairness, clear and transparent terms of the contract with the operator, protection of customer funds, a clear statement of the rules of the games and, most importantly, provisions enabling the

customer to address complaints and disputes to an independent body. These are matters that licensees must cover in their approved internal control systems and which play a prominent part in the Commission's monitoring and inspection processes.

In addition, Alderney has addressed the inevitable inequality of bargaining power within gambling transactions by seeking to ensure that the customers of its eGambling licensees will not be subjected to disadvantageous trading practices and that the monies held on their behalf are secure and available for return upon legitimate demand. The legislative framework in Alderney is intended to strike a suitable balance: ensuring player protection whilst encouraging genuine entrepreneurial flair and competition between licensees. In doing so, the States of Alderney has sought to guard against the artificial imposition of unnecessarily burdensome regulation whilst creating a sufficiently robust set of absolute requirements and other "fairness choices" to ensure a more than adequate level of customer comfort.

In short, the regulatory framework established in Alderney ensures that:

- The terms under which customers gamble are clear;
- There is comfort in the financial probity and reliability of operators;
- The funds of customers are protected;
- Clear procedures for the transfer of monies and payouts to customers are in place;
- Rules of gambling are clear and easily accessible;
- Credit may be extended to customers only when appropriate;
- Procedures for dealing with customer complaints and disputes are provided;
- Approval of the licensee's gambling equipment and games is an essential requirement;
- Approval of the licensee's internal control system provides a basis for the regulatory regime;
- Hosting premises are approved;

- Appropriate registers are maintained;
- Customer privacy and data protection principles are observed;
- There is maximum flexibility in the regulatory framework so that it can evolve swiftly to encompass technological and other changes.

7. Protection of children and the vulnerable

The Commission requires gambling operators to conduct their businesses in a socially responsible manner. It is recognised that although gambling forms part of the leisure and entertainment industry in most parts of the world today, it presents certain special risks, particularly with regard to children and vulnerable persons, including the risk of addiction.

One of the fundamental conditions for a gambling transaction under an eGambling licence to be lawful (section 1(b) of the Ordinance) is that it "is not effected by, with or through a young person", i.e. someone under 18 (section 20(1) of the Law). Furthermore, the Commission is obliged by section 20(2)(e) of the Ordinance to make regulations, which it has, enabling a customer to impose limitations on his gambling activity with a licensee.

Within these basic premises, the Commission believes that the measures required for protecting children and the vulnerable are different. Measures aimed at preventing children from gambling typically focus on registration and/or participation as a customer (i.e. barriers to entry that are put in place by the licensee), whilst measures aimed at protecting the vulnerable tend to involve a combination of warnings to customers about the dangers of gambling, reports available to customers which set out the details of their gambling, systems that enable customers to restrict their gambling in various ways and readily available information as to where to obtain help if needed.

The Commission's experience has been that gambling addiction amongst adults seems to be more of a risk than children wishing to access gambling sites. During the seven years that the Commission has been regulating the industry, it has not had any complaints from parents about a young person who has managed to gain access to an eGambling licensee's site. It is public knowledge that when Gamcare in the UK, posing as minors, tried to gain access to the sites of eGambling licensees based in Alderney a few years ago, they found it very difficult. The main reason for Alderney licensees' success in keeping minors out is the use of third party verification software by most licensees. Although it is not an absolute requirement to do so, the Commission encourages its licensees to make use of such third party verification systems because they have been shown to be very effective, particularly in relation to prospective customers from the UK, where these third party verification providers have access to reliable demographic data.

Despite this encouraging success, the Commission still regards the possibility of children gaining access to gambling sites as a major risk and continues to monitor systems that will provide additional protection.

As regards the protection of potentially compulsive customers, the Commission's experience indicates that the customer's ability to make informed choices, to have information readily available regarding spending patterns and to have access to an independent body if aggrieved, are all significant measures towards reducing the risk of compulsive gambling.

Common to the twin concerns to protect minors and compulsive gamblers is the prohibition of inappropriate advertising. Accordingly, licensees are required to comply with the Commission's guidelines on advertising, which are intended to make sure that advertising by licensees or their agents is not aimed at minors and does not create false expectations.

8. Closing remarks

Having been involved in the regulation of eGambling for the past five years in the manner described above, I have no doubt that:

- The eGambling industry can indeed be regulated in an effective way;
- Due to its electronic nature of internet gambling, where there is always a clear audit trail for every transaction, I am of the opinion that it is easier to regulate eGambling than it is to regulate terrestrial gambling;
- The regulation of the industry is the only way of effectively protecting the consumer. Neither the prohibition of the industry nor the introduction thereof on a self-regulatory basis is in the interest of the consumer. History has shown that people gamble irrespective of whatever from of prohibition is introduced. Similarly, operators that are not subject to any form of independent regulation may not always act in the best interest of the player.

I am available to provide further information to your Committee, as well as to other Members of Congress, regarding my experience with the regulation of eGambling.

Mr. Chairman, I thank you and the Committee for its time and appreciate the opportunity to submit my remarks for the record.

Prepared by:

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Frank Catania, Jr.

Frank Catania
of Counsel

June 3, 2007

Honorable Barney Frank, Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C.

Dear Mr. Chairman:

As a former New Jersey gaming regulator, a private consultant to numerous gaming companies, and a person who has testified before various Congressional Committees in connection with proposed Internet gambling legislation, I write to this Committee to express my support for H.R. 2046, the Internet Gambling Regulation and Enforcement Act of 2007.

As recognized in the Bill's findings, Internet gambling is a multi-billion dollar business, which continues to grow worldwide. Despite the official hostility of the United States Government and its enforcement agencies, Americans continue to engage in Internet gambling, wagering billions of dollars on casino games, including poker. Online gambling businesses operate from outside the United States, under regulatory frameworks that vary in effectiveness from jurisdiction to jurisdiction.

This state of affairs invites inevitable comparison to this nation's experience under Prohibition, which should have taught us that where public demand for a product is great and public acceptance widespread, supply of the product is ample and the financial rewards for delivery of the product are substantial, enforcement of a legal ban will be ineffective if not counterproductive. This lesson notwithstanding, United States public policy with regard to Internet gambling suffers from many of the identical flaws, including the following:

- Despite the purported illegality of Internet gambling, millions of Americans continue to gamble online, but without uniform regulatory structures that protect against fraud, underage gambling, problem gambling and money laundering or other financial crimes;

- The disconnect between the purported illegality of Internet gambling and its widespread availability and acceptance breed public disrespect for other laws;

- Money paid by Americans to offshore Internet gambling operators creates no jobs in the United States and generates no tax revenues;

- The illegality of Internet gambling in the United States effectively disables legitimate American gaming companies from engaging in a profitable activity which has found widespread acceptance in the rest of the world.

By establishing a system for the licensing and regulation of Internet gambling in the United States, H.R. 2046 would reverse the public policy deficiencies of the existing Internet gambling prohibition. As a result of my familiarity with online gambling companies, I am confident that the technology exists to regulate a United States Internet gambling industry at least as effectively as we now regulate our land-based casinos. Inasmuch as almost every State already has some form of legalized gambling, the immorality of gambling can no longer be considered a serious objection. To the extent any State or Tribe disagrees, the opt-out provisions of Section 5385 provide sufficient protection.

If I can be of any further assistance to this Committee in its consideration of this Bill, please feel free to have Staff contact me.

Very Truly Yours

Frank Catania

COLORADO SPRINGS, CO 80995 • (719) 531-5181 • WWW FAMILY ORG

June 7, 2007

The Honorable Barney Frank
2252 Rayburn House Office Building
Washington, DC 20515-2104

The Honorable Spencer Bachus
2246 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Frank and Mr. Bachus,

Greetings from Focus on the Family and the millions of concerned families we represent. As an organization dedicated to defending and nurturing families, we write today concerning two extremely important subjects: (1) Our support of the Unlawful Internet Gambling Enforcement Act of 2006 (Public Law 109-347) and (2) Our opposition to the Internet Gambling Regulation and Enforcement Act of 2007 (H.R. 2046, sponsored by Rep. Barney Frank).

Focus on the Family supports the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA), approved by Congress and signed by President Bush in October of 2006. For nearly a decade, Congress has attempted to protect children and households from the assault of the predatory online gambling industry, finally achieving success in 2006. This law empowers states to determine policy on Internet gambling, while protecting our national borders from illegal, foreign online gambling operators.

Approximately 230 million Americans access the Internet, not the least of these being children. Focus on the Family hears from thousands of frustrated parents of children who have been destroyed by their "secret" addiction to Internet gambling. Gambling counselors calculate that 20 percent of people who gamble—one in five—have a problem with or a pathological addiction to gambling. If gambling were a children's toy that hurt or killed one in five children, it would be taken off the shelf immediately. Ironically, some members of Congress believe Internet gambling should stay on the shelf, completely accessible to the public (including children) regardless of the dangers.

Focus on the Family opposes H.R. 2046, sponsored by Rep. Barney Frank, because this legislation completely destroys the UIGEA legislation to protect households and children from being assaulted by predatory, unlawful, foreign Internet gambling

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operators. This goes without mentioning the immense threat to our national security, due to online transactions that potentially fund organized crime and terrorist groups.

H.R. 2046 excuses Internet gambling operators from prosecution or enforcement action under any federal or state law, if operators simply obtain a license and follow this bill's requirements. This invasive legislation again opens the door for thousands of Internet casinos to access every Internet-connected home in the United States, without state or voter approval. H.R. 2046 exploits children and families so that a small handful of individuals can gamble online, and foreign gambling operators can continue taking $6 billion-plus out of the U.S. economy to launder money, fund terrorist organizations or expand a predatory industry.

As an organization that speaks on behalf of millions of families and parents, Focus on the Family strongly opposes the H.R. 2046. Thank you for your time, service and consideration.

Sincerely,

Chad Hills
Analyst for Gambling Research & Policy
Focus on the Family Action

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June 5th 2007

Honourable Barney Frank
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C.

Dear Mr Chairman

Re: H.R. 2046, Internet Gambling Regulation and Enforcement Act of 2007

I am taking the opportunity to write to you, as Head of Online Services for the UK charity GamCare, to provide testimony to the success with which an increasing number of remote gambling operators are implementing robust policy specifically to minimise and manage the potential for harm through gambling online.

Perhaps however, it would be useful if I first gave more background regarding GamCare and our services. GamCare has, for the last ten years, existed first and foremost to provide treatment services – telephone helpline, face-to-face counselling and more recently Internet treatment services – to those people adversely affected by a gambling problem. We are not anti-gambling, but instead believe in adopting a 'pro-responsible' gambling stance. By this we seek to promote and support the responsible engagement in, and operation of, gambling as a form of entertainment. Our services are recognised as the primary point of access in the UK and indeed we lead on best practice in treatment provision in this specialist field. Furthermore, GamCare continues to play an active role in providing expert consultancy and advice to the UK Government, notably the Department for Culture Media and Sport and the Gambling Commission. GamCare contributed as one of a number of expert witnesses during the scrutiny of the Draft Gambling Act that has subsequently been passed as the Gambling Act 2005.

GamCare firmly believes that an open and clear dialogue with Regulators, Trade Associations and gambling operators is the most productive opportunity to work to continually minimise the potential for harm whilst at the same time enabling a legitimate industry to develop in a competitive marketplace.

In working to promote responsible attitudes towards the operation and supply of gambling services and software GamCare has established a certification programme based upon compliance with our player protection Code of Practice. Introduced four years ago GamCare Certification continues to be pursued by a growing number of operators wishing to demonstrate that they take customer welfare seriously. The remainder of this document will explore key elements of the code which represent a level of social responsibility at least equal to, and frequently higher than, any formal regulation currently in enforcement globally. It is GamCare's firm consideration that the requirements of our code are reasonable, practicable and achievable for all Internet gambling operators, though some elements should be recognised as being relevant and applicable only to particular products.

The Code of Practice for remote gambling platforms is currently undergoing revision, but I have attached version 3.0 for your attention (Appendix A). We kindly ask that you recognise that our experience and the application of the code is largely concentrated on those operators who have a predominant UK or European customer base. Many have adopted the requirements voluntarily in anticipation of future formal regulation. The requirements of the code have subsequently informed and influenced formal regulation and licence conditions across a number of jurisdictions.

In brief summary:

1. *Age Verification*

> Site operators must take steps to ensure the age and identification of every new customer

Responsible gambling operators now most frequently rely upon third party verification solutions. Verification should take place at either point of registration or at first deposit.

> Sites should clearly display an 'over 18's only' sign on their home page

Intended to act as a deterrent to minors and often provides a link to operator Terms and Conditions highlighting that underage play is an offence

> The registration process should include a clear message regarding underage play and the steps the company takes to verify age

Again, intended as a further deterrent and additionally to highlight that formal verification of age and identity will take place.

> When the age verification systems in place are not totally effective the site should not be allowed to accept payments from cards that are available to those under the age of 18

Verification systems have advanced significantly since these conditions were written. Many forms of payment, particularly debit cards available to minors, have historically proved to be a challenge when seeking to verify age and identity. Whilst verification systems are reliant on and occasionally limited by

the records and data available for them to scrutinise, they are much improved. Responsible operators will have a secondary verification system, perhaps manual, (relying on the submission of faxed / scanned documents such as a passport or driver's licence) for those instances when electronic verification proves inadequate.

2. *Advertising and Promotional material*

(Please note, our consideration of advertising for the purposes of certification focuses on the advertising limited to the operator site and to direct email / print advertising to registered customers.)

Advertising and Promotional material should:
> Not target minors
> Give a balanced message regarding the likelihood of winning and losing
> Not encourage customers to reinvest winnings or to chase losses with further gambling
> At no time suggest that gambling is a means of solving financial difficulty

3. *Customer-led deposit limits*

> Customers should be able to set their own deposit limits for a given period of time (daily, weekly or monthly)

It is important to ensure that customers are enabled to take responsibility for their own participation and spend. Whilst a site operator may have default minimum and maximum deposit limits within a given period of time the customer should be able to play within their own affordability.

> When a customer reaches their pre-set limit the site operator must take responsibility for ensuring that no further deposits may be made during that period of time

> If a customer wishes to increase their pre-set deposit limit the site operator should impose a delay of no less than 24 hours before the increased limit becomes available. A request to decrease a pre-set limit should be implemented by the site operator with immediate effect.

A delay should be imposed to minimise the opportunity for a customer to increase their deposit limit in order to chase losses. The delay will often allow sufficient opportunity for a break in gambling participation and serve as a 'reality check' for those at risk of gambling more than they can afford to lose.

> The option to set a deposit limit should be introduced to the customer either at the point of registration or at first deposit

Whilst it perhaps should not be mandatory for a customer to set a deposit limit the site operators should proactively undertake to highlight the availability of the option to do so.

4. *Customer-led session limits*

(Applicable only to fast and continuous games for example casino games, slots and ball games such as bingo and keno.)

> To assist the customer to control their gambling and protect against the possibility of continuous rapid gambling without a break, they should have the option to set a session duration limit

Many problems gamblers reflect on losing track of time when gambling. The ability to set a limit on the duration of play for particularly absorbing games that do not offer a natural break in play, allows an enforced break.

> When the set duration has expired and on completion of the last game, a message should appear to inform the player of the period of time they have been playing for

The customer should be presented with a clear message identify the full duration of play and given the opportunity to continue. Positive action must be taken by the customer to confirm that they wish to continue.

5. *Self Exclusion*

> The player should be able to exclude from gambling on a site at any time

> An exclusion period of six months should be implemented

Six months has generally been regarded as best practice for both land-based and remote gambling. It is considered that the period of time enables a customer who recognises that their gambling has become problematic to seek advice and support and to consider their future participation.

> A customer requesting to be excluded should have any outstanding account balances repaid with immediate effect and should be removed from marketing lists

Where practicable steps should additionally be taken to cancel and refund ante-post bets and pre-purchased entries to tournaments or future games (notably in the case of poker)

> A site operator may additionally wish to make available a 'cooling off' period of 7 days

6. *Social Responsibility / Player Protection information*

> The site operator homepage should contain a logo and link to the site operator's social responsibility partner

> The site operator homepage should contain a clear link to a Responsible Gambling page delivering the following information as a minimum:

a) The message that gambling can be harmful if not controlled and kept in moderation.

b) Advice on responsible gambling and a link to the social responsibility partner and other sources of help for problem gambling, including helpline number(s).

c) Links to, or inclusion of an accepted and simple 'self-assessment' process to determine risk potential.

d) A list and explanation of the player protection measures that are available on the site

e) Link(s) to a recognised filtering programme to enable players to prevent minors from accessing gambling sites.

f) Details or a link to a page with details, of the site operator's social responsibility policy.

7. *Reality checks*

> A clearly visible clock

> The currency unit of the amount wagered should be clearly displayed relevant to the customer

Though it is recognised and accepted that poker is played in USD and that currency will be displayed as such.

> Fast and continuous games should not play at an unrealistic speed

8. *Customer Account*

> The customer should only be allowed to register one account with an individual site operator

Multiple accounts should be regulated and prohibited to remove the opportunity for confusion over the setting of customer-led limits, self exclusion etc.

> The customer should be able to access a full account history detailing in particular deposits and withdrawals and an up-to-date balance

9. *Free Play*

(Please note, it has proven unrealistic to require site operators to implement proper age verification for those wishing only to access free play games. The cost of verification against the low rate of subsequent transfer to 'real money' play frequently becomes prohibitive.)

> At the point of access clear signage should indicate that free play is available to over 18's only.

> As a minimum customers wishing to play for free should enter an email address and tick a box to confirm they are over 18 or enter a date of birth

Marketing to 'unverified' customers should not take place. This process is intended to act as a basic deterrent to minors.

> Free play games should display the same Responsible Gambling information as real money games

> Free play games should have the same payout ratios as their real money equivalents

10. *Training and support*

> The site operator should ensure that as a minimum customer services staff and relevant management have undertaken appropriate problem gambling awareness training.

> Training should be refreshed annually.

> The site operator should demonstrate further commitment to the minimisation of harm through gambling by contributing to local, national or international research, treatment and education funds.

11. *Auditing and Consultancy*

> The site operator should seek the advice of their social responsibility partner when launching new products or making significant alterations to relevant policy, practice or systems.

> Renewal of certification is dependant upon an annual site review

All of the above have been successfully implemented by those gambling operators wishing to demonstrate voluntarily their commitment to safe, fair and responsible gambling. Whilst it may have been arguable in past years that technical limitations presented real barriers to implementation, we are satisfied that this now is rarely a justified case. Indeed, many of the site operators that GamCare has worked with have demonstrated practice above and beyond these requirements, using them simply as a starting point.

GamCare applies the knowledge and experienced gained in providing counselling support to its work with the gambling industry, ensuring that we remain conscious of the negative impact, both potential and actual, that Internet gambling may have on an individual. We are satisfied that if the move towards more responsible operation continues to gather pace, as is increasingly observed across Europe and the rest of the world, that the continued legitimate development of the industry need not be off-set against significant increases in problematic gambling. Robust, formal regulatory frameworks undoubtedly represent the best opportunity for achieving this

Crucial to any responsible gambling framework is the need for proactive customer education. Government, industry and organisations such as GamCare (and its international partners) must play a role in ensuring that not only does industry act responsibly, but that customers wishing to participate in

gambling services do so with the right motivation and understanding of the risks involved. Restricting choice is ill-advised and unlikely to result in long term benefits. Informed choice in a mutually responsible environment is both desirable and achievable.

Chairman, in concluding I would like to thank you for allowing GamCare the opportunity to present its experience and consideration on this important matter. I, and indeed GamCare, wish to make ourselves available should you have any further need for assistance.

Further information about GamCare and our services may be accessed at www.gamcare.org.uk or please do not hesitate to contact me directly.

Yours faithfully

Andrew Poole
Head of Online Services
GamCare

Player protection and social responsibility: Code of practice for remote gambling platforms

Version 3.0

05.02.2003

1. Age Verification

1.1 Sites must take steps to ensure the age and identification of every new customer. This is especially important to all cases where the method of payment does not itself constitute an age check (e.g. debit cards). Sites should employ the use of a reliable electronic checking system to verify the age and ID of new customers.

1.2 All sites should clearly display an 'over 18's only' sign on their home page. This signage should link through to a page with a clear message about underage play.

1.3 Through the registration process there should be a clear message regarding underage play and the steps the company takes to check on age. This will act as a good deterrent to put minors off trying to access a company's site. Such a message should also be in the 'over 18's only' link.

1.4 When the age verification systems in place are not totally effective the site should not be allowed to accept payments from cards that are available to those under the age of 18. This should also include third party payment systems that accept those cards as well – such as netteller or paybox.

2. Advertising and Promotional Material

2.1 Advertising and promotions must be compliant with the relevant regulatory and advisory codes of practice.

2.2 Advertising should not target those under the age of 18. This includes not just content but placement of advertising as well.

2.3 Advertising should give a balanced message with regards to winning and losing.

2.4 Customers should not be encouraged to chase their losses or re-invest their winnings.

2.5 At no time should it be suggested that gambling is a means of solving financial difficulties.

3. Customer led deposit limits

3.1 Whilst sites should still be able to set their own limits on player deposit and even vary those limits on an individual basis, sites should also provide the ability for the customer to determine their own deposit limits.

3.2 Sites should provide options for setting limits on customer deposit per day and/or per week.

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3.3 The minimum deposit limit that a customer can set for themselves should be lower or equal to the minimum deposit required on the company's site, with the maximum deposit limit going up to the site's set limit.

3.4 When a player reaches their previously set limit the operator will be responsible for ensuring that no other bets are accepted from them.

3.5 If a customer wants to increase their deposit limit, they should be required to go through a call centre and this will be effective 24 hours after the call. However they should be able to decrease their limit with immediate effect.

4. Customer led session limits. (applicable to interactive, fast and continuous gambling)

4.1 To assist the customer control their gambling and protect against the possibility of continuous rapid gambling without a break, they should have the option to set a session duration limit. This limit will determine how long the player will be able to play on a game until there is a break. This should apply to any game that involves rapid continuous gaming, for example casino games, slots and ball games such as Keno, bingo etc. GamCare can advise on games that would require session limits.

4.2 The minimum time limit available should be no more than 10 minutes.

4.3 The player should be able to set the session time limit as a default for all games.

4.4 If a session duration limit is not set by the player then a default of one hour should be the maximum default time for all players.

4.5 When the set duration has expired and on completion of the last game, a message should appear to inform the player of the period of time they have been playing for. The player will then have to acknowledge the message before they can continue gambling. This process should take no less than 5 seconds, so to allow the player enough time to make a conscious decision on whether to continue or cease playing

5. Self-exclusion

5.1 The player should be able to exclude themselves from making any bet on a site

5.2 The period of self-exclusion must be for at least 6 months

5.3 Once a player has requested to be excluded, the account should be closed with any money on the account paid back to the customer.

5.4 Information regarding the self-exclusion policy and process must be clearly explained within the responsible gambling/player protection page.

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5.5 The site may also provide a 7 day cooling off exclusion as well as the full 6 month exclusion opportunity. However once a customer has excluded themselves 3 times via the 7 day exclusion option they should be automatically excluded for at least 6 months.

5.6 Once a player has excluded themselves from the site, they should be taken of any mailing list that they have subscribed to on the company's site.

6. Social Responsibility/Player Protection Information

6.1 The site's home page should contain the logo and link to the company's social responsibility partner.

6.2 The site's home page should also contain a link to both the player protection page and responsible gambling page. These can either be two separate pages or one page with the information combined. The content of which is to be defined below.

6.3 The social responsibility page should contain at a minimum:

a) A message that gambling could be harmful if not controlled and kept in moderation.

b) Advice on responsible gambling and a link to the social responsibility partner and other sources of help on problem gambling, including helpline number(s).

c) An accepted and simple "self-assessment" process to determine risk potential. This could either be or the social responsibility page or as a link through to a site, such as their social responsibility partner, that contains such information.

d) A list of player protection measures that are available on the site, and a link to that page (if separate to the social responsibility page).

e) Link(s) to a recognised filtering programme to enable players to prevent minors from accessing gambling sites.

f) Details or a link to a page with details, of the company's social responsibility policy.

6.4 The player protection page information should contain:

a) The protection measures available to the player if they wish to use them.

b) These measures should be the options on customer led spend limits, customer led session limits and the self-exclusion instructions with a link to the email address required or buttons for automatic exclusion.

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6.5 The deposit page should contain a reminder to the customer about the need to gamble responsibly, with a link to the responsible gambling/player protection page. This information must be clearly visible without the need to scroll down the page.

6.6 The responsible gambling/player protection page(s) should be readily available from any screen where game play may occur.

6.7 The player protection page should be included within the registration process for a new customer so they have to set their own limits.

6.8 Messages of a company's support of social responsibility should not be misleading. ***(i.e. a company should not claim to be a member of or have support for a social impact or support organisation if this is not true . Such messages mislead the customer into believing that the company is more socially responsible than they actually are)***

7. Reality checks within game play

7.1 It is vital that where a game allows continuous, interactive and rapid gambling without a natural break, there should be mechanisms implemented that help the customer to monitor their spend and amount of time they have played so they can make conscious decisions on whether to stop or continue. ***(The majority of clients that have attended counselling at GamCare have emphasised the loss of awareness of time and money spent whilst gambling as a key factor to the development of their problem)***

7.2 A clearly visible clock which displays the time within the player's time zone should be visible on the screen at all times.

7.3 The currency unit of the amount wagered should be clearly displayed on the games screen as well as the denomination of each credit.

7.4 Counters should be used to inform the player on the time they have been playing. This should be displayed at the end of either the default time period or the time period set by the customer. **See section 4 for more detail.**

7.5 No game should be quicker than 3 seconds between plays.

7.6 The operator should seek guidance from the regulator on which games would require the implementation of suitable reality checks.

8. Customer Account

8.1 The customer should only be allowed to register and use two debit/credit cards or other form of payment on their account. If for whatever reason they need to change either card they should have to go through the customer services line.

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8.2 The customers should also only be able to register one account on a site, rather than multiple accounts with the same name and address but with different user names. ***(The ability to set up multiple accounts using multiple credit cards not only increases the possibility for fraud, but also increases the risks of problem gambling and uncontrollable debt)***

8.3 The customer should be able to access their recent account history, including all deposits, withdrawals and bets.

9. Free Play

The ability to play free casino games with complimentary credits without having to register or prove age is now commonplace within the online industry. It is a practice that has become a popular marketing tool and figures show that a high amount of customers just play on the 'for free' games and stay away from the 'for money' games. It is also a practice that goes completely against policy within the terrestrial industry. Children are not allowed into casinos, bingo halls, bookmakers or adult arcades and allowed to play for fun with complimentary credits – It is illegal to do so in the UK. However this practice is allowed online and has a significant impact on the exposure of young people to gambling. What affect this exposure may have on young people and problem gambling is unknown, but it is an issue that should be carefully monitored. Whilst it would be unrealistic to suggest that 'play for free' games should only be available when a customer has registered and proved that they are of legal age, this would be the ideal solution. However the following recommendations should be standard practice and may help negate the potential risks.

9.1 The free play game screens should display the same links to the responsible gambling/ player protection page that the 'play for cash' display. The computer clock or another should also be visible at all times.

9.2 At a minimum a player should have to enter their email address and date of birth (which must be over 18) to 'play for free' ***(however the ideal would be for the player to have to go through the same registration process as those wanting to play for cash)***

9.3 There should be a clear message that the play for free is for over 18's only.

9.4 The payout percentages must be the same as the 'play for cash' games.

10. Training/Support

10.1 The company should ensure that their customer service team are trained on the issues of social responsibility and problem gambling. This is especially important for the occasions when a problem gambler will contact the customer service line, or when the company suspects one of their customers may have a gambling problem. This training should be refreshed on a yearly basis.

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10.2 The company should demonstrate its support to addressing the social impact of gambling by making the appropriate contribution to the Gambling Industry Charitable Trust.

11. Auditing/Consultancy

11.1 The site should be given an independent annual review by an organisation such as GamCare to ensure compliance with the social responsibility policy. The review will consist of:

- A cross check of operations versus the Code
- A review of the last 12 months majoring on incidents recorded by the operator
- Checks acting as a customer (mystery shopper principle)
- Examination of the consequences of any site changes particularly technical alterations/upgrades.

On completion of the Review, a Corrective Action Plan should be agreed ensuring full compliance within 6 months of any highlighted areas requiring attention. If GamCare are used for this Review and for the CAT Plan then the operator will be entitled to GamCare Certification.
A fuller independent audit should be carried out every three years or as often as the operating licence is renewed. This will involve all the elements of an annual Review plus an audit of policies, staff understanding of social responsibility, related training, supplier service level agreements etc.

11.2 Before launching a significant new product or developing an existing one the company should consult with the regulators or social responsibility partner to ensure compliance with the Social Responsibility Guidelines.

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General Board of Church and Society
of the United Methodist Church
100 Maryland Ave. NE, Washington, DC 20002

June 6, 2007

Dear Members of the House Financial Services Committee:

On July 11, 2006, the House passed the Unlawful Internet Gambling Enforcement Act 317 to 93, reaffirming its commitment to protect American citizens by enforcing current law which prohibits gambling on the Internet. We cannot fathom that after less than a year, Members of Congress would reverse their position on Internet gambling after hearing compelling testimony and research which shows that people are much more susceptible to addiction from this form of gambling. This happens because often computers are set up in bedrooms or family rooms inside family homes or in college dorm rooms enabling one to gamble on the computer for hours on end with virtually no interruption. Just this week a news report pointed to organizers of Gamblers Anonymous and other addiction-prevention groups in Pennsylvania and New Jersey who say they are seeing many more teens in their meetings because of the rapid rise of online gambling in recent years. Quoted in the news report was the executive director of the Council on Compulsive Gambling of Pennsylvania who said, "These kids just have to punch in a credit card number, or are given access to their parents' credit cards. You have college kids using their college debit cards, which they're supposed to be using to buy books, to gamble online. It gets out of control real fast." (Philadelphia Inquirer, 6/7/07)

The United Methodist Church opposes H. R. 2046, *The Internet Regulation and Enforcement Act of 2007* on the following basis:

1. This bill would clearly enable expansion of a form gambling which is especially harmful and addictive. Though we would wish otherwise, there are already plenty of other forms of gambling from which people can choose. There is really no need to expand to another form of gambling.
2. We are particularly concerned with the rising number of young people, some of whom are underage who engage in Internet gambling and have become addicted to Internet gambling.
3. Internet Gambling businesses operate largely outside the United States and thus, are largely outside U.S. regulatory authority.

The United Methodist Church's position on gambling states that:

Gambling is a menace to society, deadly to the best interests of moral, social, economic, and spiritual life, and destructive of good government. As an act of faith and concern, Christians should abstain from gambling and should strive to minister to those victimized by the practice.

Where gambling has become addictive, the Church will encourage such individuals to receive therapeutic assistance so that the individual's energies may be redirected into positive and constructive ends.

The Church should promote standards and personal lifestyles that would make unnecessary and undesirable the resort to commercial gambling as a recreation, as an escape, or as a means of producing public revenue or funds for support of charities or government. (United Methodist Book of Discipline/Social Principle ¶163G)

Contact: Rev. Cynthia J. Abrams, (202) 488-5636, cabrams@umc-gbcs.org

THE NATIONAL COALITION
NCAGE
AGAINST GAMBLING EXPANSION

100 Maryland Avenue NE, Room 311, Washington, DC, 20002 ~ (800) 664-2680 ~ ncalg@ncalg.org

June 6, 2007

Members of the House Financial Services Committee,

The National Coalition Against Gambling Expansion stands in opposition to Representative Barney Frank's bill (H.R. 2046) which would legalize and regulate Internet gambling. Although Congressman Frank considers the Unlawful Internet Gambling Enforcement Act of 2006 "one of the stupidest laws ever passed," we agree with the 317 members of Congress who voted for the UIGEA just last year, a more than 3 to 1 landslide victory for the legislation prohibiting most forms of Internet gambling. Representative Frank's bill would greatly undermine that landmark vote from last year.

Representative Frank expresses fears regarding an Internet where there are restrictions on "...pictures they should not look at, or perhaps booze they should not buy, or bets they should not make, then freedom for the Internet goes away." There are already laws in force that prohibit child pornography and pay for view suicides. We would hope that Internet gambling legalization and regulation would meet similar revulsion.

If H.R. 2046 is adopted, Internet gambling will incrementally grow out of control, with organized and international crime wielding significant power. Money laundering, loan sharking, fraud and coercion are all among the reasons the National Gambling Impact Study Commission recommended NO Internet gambling in its final report in 1999. The Justice Department has testified publicly and discussed privately with the NCAGE board of directors about the great money laundering potential of Internet gambling.

Internet Gambling has all of the elements of the most addictive forms of gambling, plus the added inducement of anonymity. It makes a computer a virtual addiction delivery device in nearly every home and office in America. We just don't need un-monitored, ubiquitous, highly addictive gambling in our homes and offices throughout the US. The social costs would be staggering.

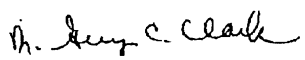
Internet gambling has tremendous potential to increase both community and international crime, including organized crime. (Gangsters have always loved legalized gambling. It trains their customers. NO jurisdiction has ever shown that legalizing gambling has helped decrease illegal gambling.) Gambling of every sort has greatly corrupted the political process with huge amounts of money flowing to politicians that support their legislation. The Abramoff scandal is an excellent example of that, and Internet gambling has the potential to meet or exceed those abuses.

Internet gambling takes money out of our communities and our country and pays nothing for the social costs that gambling always causes. States already have a difficult time regulating gambling at

casinos and racetracks. Stories of fraud, theft, embezzlement, money laundering are rife. These problems would all increase exponentially with Internet gambling.

The National Coalition Against Gambling Expansion calls on the members of the House Financial Services Committee to vote against this dangerous bill.

Respectfully,



Dr. Guy C. Clark, chairman
National Coalition Against Gambling Expansion
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VICE PRESIDENT
LAWRENCE WASDEN
Attorney General of Idaho

IMMEDIATE PAST PRESIDENT
WILLIAM H. SORRELL
Attorney General of Vermont

March 21, 2006

Via Facsimile

The Honorable J. Dennis Hastert, Speaker
United States House of Representatives
H-232, The Capitol
Washington, DC 20515

The Honorable Nancy Pelosi, Minority Leader
United States House of Representatives
H-204, The Capitol
Washington, D.C. 20515

The Honorable Bill Frist, Majority Leader
United States Senate
S-230, The Capitol
Washington, DC 20510

The Honorable Harry Reid, Minority Leader
United States Senate
S-321, The Capitol
Washington, DC 20510

We, the undersigned Attorneys General, wish to express our strong support for the efforts of the 109th Congress to pass legislation seeking to combat illegal Internet gambling in the United States. While we do not support federal preemption of our state laws related to the control of gambling, Internet gambling transcends state and jurisdictional boundaries and requires that all segments of the law enforcement community (state, federal and local) work together to combat its spread.

NAAG has historically supported federal efforts to clarify federal prohibitions on Internet gambling. As we stated in a similar letter in 1999, gambling laws and regulations have more state-to-state variety than almost any other area of law. For example, gambling policies range from the absolute prohibition of any gambling, as found in the States of Utah and Hawaii, to full casino gaming as allowed in Nevada and Atlantic City, New Jersey. The myriad of regulatory schemes related to gambling is constructed within the framework of each jurisdiction's moral, law enforcement, consumer protection and revenue concerns. Most jurisdictions believe that they have established the most appropriate combination of law and policy to address their own population's needs and desires.

Internet gambling is a threat to this carefully crafted system. Moreover, the potential problems associated with the availability of gambling activities on the Internet are exacerbated because the inability of technology to reliably guard against many of the same hazards that led to the policy considerations used by jurisdictions to construct their

gambling regulations. These policy considerations include moral attitudes towards gaming, issues of game integrity, effective consumer dispute resolution procedures, access to gambling by minors, cash controls to hinder money laundering and other criminal activity, as well as efforts to recognize and treat problem gamblers.

We encourage the United States Congress to help combat the skirting of state gambling regulations by enacting legislation which would address Internet gambling, while at the same time ensuring that the authority to set overall gambling regulations and policy remains where it has traditionally been most effective: at the state level.

Sincerely,

John Suthers
Attorney General of Colorado

Troy King
Attorney General of Alabama

David Márquez
Attorney General of Alaska

Terry Goddard
Attorney General of Arizona

Mike Beebe
Attorney General of Arkansas

Bill Lockyer
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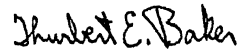

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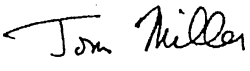

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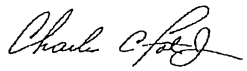

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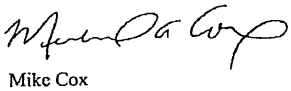

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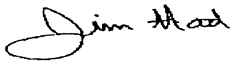

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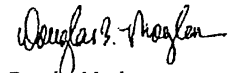

Douglas Moylan
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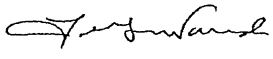

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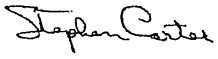

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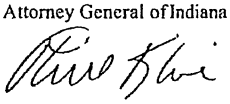

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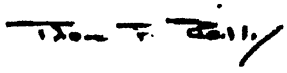

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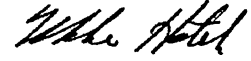

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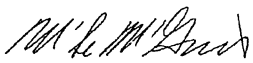

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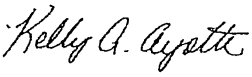

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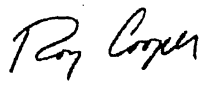

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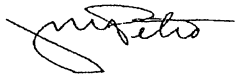

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Hardy Myers
Attorney General of Oregon

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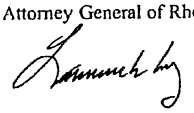

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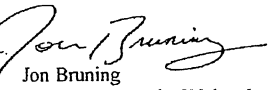

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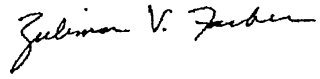

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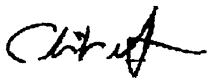

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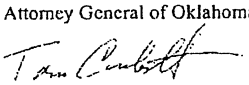

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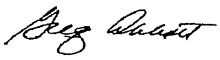
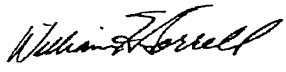
Henry McMaster
Attorney General of South Carolina

Paul G. Summers
Attorney General of Tennessee



Greg Abbott
Attorney General of Texas



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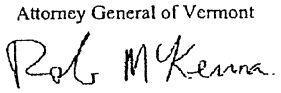

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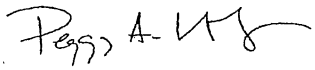

Peg Lautenschlager
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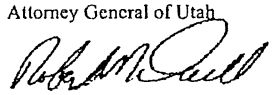
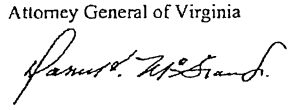


Robert McDonnell
Attorney General of Virginia



Darrell McGraw, Jr.
Attorney General of West Virginia

Pat Crank
Attorney General of Wyoming

May 31, 2007

Dear Members of the House Financial Services Committee:

On behalf of our respective professional and collegiate sports organizations, we ask for your continued support in protecting American athletics from the corrupting influence of sports gambling.

We wrote to you on April 25, to express our concerns about H.R. 2046, Chairman Frank's Internet gambling bill. Since then, advocates of H.R. 2046 have contended that we have no basis for concern, because H.R. 2046 creates "opt-outs" that permit individual leagues to prohibit gambling on their sports. However, with or without an opt-out, the bill sends a destructive message on how Congress views gambling on professional and college sports. Moreover, we believe that the bill's opt-outs will prove illusory. If H.R. 2046 were to pass, sports betting would likely proliferate and the integrity of American athletics would be compromised.

Congress has historically and consistently opposed sports gambling. In 1992, a bipartisan, overwhelming majority voted to enact PASPA—the Professional and Amateur Sports Protection Act. The House of Representatives' report found that that "there exists a special relationship between American sports fans of all ages and their favorite teams, and that athletic competition embodies and affirms fundamental American values worth protecting from the potential taint of corruption and scandal," and thus "these activities should be declared off limits from further exploitation as State 'revenue enhancers.'"

The Senate report further explained, "Sports gambling threatens to change the nature of sporting events from wholesome entertainment for all ages to devices for gambling. It undermines public confidence in the character of professional and amateur sports. Furthermore, State-sanctioned sports gambling will promote gambling among our Nation's young people." It also concluded that "[t]he moral erosion it produces cannot be limited geographically. Once a State legalizes sports gambling, it will be extremely difficult for other States to resist the lure."

PASPA passed 88 to 5 in the Senate and by voice vote in the House.

Since then, gambling operations—largely based outside of the U.S.—have turned to the Internet, where they were able to evade existing, longstanding gambling laws, including laws against sports gambling. Last year, Congress responded by passing UIGEA—the Unlawful Internet Gambling Enforcement Act—which enhances enforcement of America's gambling laws, including PASPA and other laws against sports gambling.

On July 11, 2006, the House passed UIGEA 317 to 93, reaffirming its commitment to protect American athletics from sports gambling. This strong vote tally reflects majorities of both parties and the affirmative votes of both Leaders.

H.R. 2046 would reverse Congress' longstanding consensus on the harms of sports gambling. Unsupported by any factual record, H.R. 2046 declares that sports betting is acceptable, and the bill expressly authorizes Internet sports gambling. Regardless of the existence of opt-outs, Congress' fundamental message would for the first time be one of approval for sports betting. Moreover, the sports opt-outs are likely to provoke legal challenges in U.S. courts and before the World Trade Organization.

We oppose H.R. 2046 for the following reasons:

- First, the bill states that sports betting is acceptable to Congress.

- Second, the opt-outs are subject to challenge in U.S. courts on the grounds that Congress has unconstitutionally delegated its lawmaking power (to ban Internet gambling) to private parties (commissioners of various sports leagues and conferences).

- Third, the "opt outs" for states and sports leagues are illusory because, if exercised, they might very well be struck down by the WTO as discriminating against foreign providers of gambling services. In that case, the U.S. would be hard pressed to invoke the "public morality" defense to argue, for instance, that offshore internet gambling facilities used by Louisiana citizens corrupt pubic morals, while Louisiana land based casinos do not, or that sports gambling on football would corrupt pubic morals, but gambling on boxing or horse racing would not. Consistent with prior WTO rulings, the opt-outs will also prove difficult to defend if Congress gives its consent to Internet sports betting by passing H.R. 2046. Although the United States has announced its intent to withdraw from GATS "commitments" on gambling access, that process will be prolonged and with uncertain outcomes. Thus, the threat of WTO litigation remains active.

- Fourth, H.R. 2046 will lead to demands that PASPA be repealed. The bill would grant greater rights to foreign sports gambling operations, which could conduct Internet sports betting, than to State governments, which would remain barred by PASPA from authorizing sports betting. Arguments to "level the playing field" by repealing PASPA undoubtedly will follow and, once Congress is seen as having endorsed sports betting, will be difficult to resist.

We have long opposed sports betting because of the harm it inflicts on fans of all ages, professional and college athletes, and the integrity of American sports. Congress has long agreed and enforced a policy against sports betting. H.R. 2046 moves in exactly the opposite direction. In doing so, it advances no public interest and simply rewards foreign entities who have shamelessly ignored U.S. law for the past ten years. Accordingly, we urge you to reject it.

Sincerely,

Rick Buchanan, Executive VP and General Counsel
National Basketball Association

Elsa Kircher Cole, General Counsel
National Collegiate Athletic Association

William Daly, Deputy Commissioner
National Hockey League

Tom Ostertag, Senior VP and General Counsel
Major League Baseball

Jeffrey Pash, Executive VP and General Counsel
National Football League

cc: Members of the House of Representatives