

**The Internet Gambling Industry:
The Reasons for Regulation in the United States**

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BETONSPORTS PLC

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I. INDUSTRY OVERVIEW

The Internet gambling industry has been the focus of public attention due to the debate on whether and how to legalize online gambling. What began ten years ago as a small niche eCommerce business has developed into a multi-billion dollar industry. The number of online gambling entities with multi-million dollar initial public offerings in recent years, such as BETonSPORTS plc, 888 Holdings PLC, Empire Online Ltd, Leisure & Gaming PLC, PartyGaming PLC and Sportingbet PLC, as well as financial payment processing companies such as FireOne and NETeller, demonstrate just how significant a market player the industry has become.

To date, there are over 2000 online gambling businesses that operate internationally. Internet gambling is projected to reach almost \$12 billion in business this year, up from \$8.3 billion in 2004 and revenues are projected to rise exponentially in coming years.¹ Christiansen Capital Advisors estimates that online gambling revenues will be as high as \$25 billion by 2010. Fifty percent of these revenues come from U.S.-based players.

The online gambling industry is not only growing in revenue, but also growing in consumer popularity. Research firm ComScore Media Metrix reported in April 2005 that out of a total audience of 165 million, there were more than 29.1 million unique visitors to online gambling sites.² Research firm River City Group estimates that Internet poker alone is a \$2 billion industry annually with a million players per month.³ *Forbes* recently reported that, “American consumers are spending about 20 times more on gambling than they spend downloading music...”⁴ And with the next generation of communication technology, every cell phone can become a gambling device, further driving consumer use.

¹ *New York Times*, “Celebrities Taking a Gamble.” November 16, 2005.

² “The Odds Are Good That Online Gambling Will Continue to Thrive -- But at What Price?” Knowledge@Wharton, University of Pennsylvania. July 13, 2005.

³ Internet Poker – The Real Deal. River City Group. 2004.

⁴ *Forbes*, “Matthew Miller On Digital Entertainment.” December 30, 2005.

However, despite the industry's widespread popularity, online gambling is perceived as illegal in the United States due to a dated piece of 1960's legislation, which was passed before this technology was even conceived. The Wire Act was passed mainly to prohibit bookies from transmitting bets by telephone and has little applicability to the Internet. Some courts as well have determined that the Wire Act does not apply to on-line poker. Thus confusion abounds.

Legislative efforts to stiffen laws restricting online gambling have failed in Congress seven times because of a lack of clarity over what should and should not be prohibited. The failed bills have tried to ban credit card companies from accepting transactions with online gambling companies but, for example, politicians have made exemptions for horse race betting. In December 2005, for example, Friends of New York Racing, a group of stakeholders in the New York horseracing region, issued a report calling for the restructuring of racing legislation to include allowance of wagering online.

The U.S. Department of Justice has deemed online gambling illegal, though it admits that stopping operators outside the United States might be impossible. In an effort to restrict U.S. participation in online gambling, the Department has urged credit-card companies to reject transactions made through online gambling sites and pressured media firms and Internet providers to reject online gambling advertising.

In 2004, the World Trade Organization ruled that the United States was in violation of international trade treaties because it permits online betting for horse races while prohibiting all other forms of online gambling. The decision was the result of a complaint filed by Antigua and Barbuda, which claimed a loss of \$90 million annually due to the ban. (See page 4)

II. REASONS TO REGULATE

There are many incentives to regulate.

Americans contribute as much as 50% to global Internet gambling comprising most of the \$10 billion in profits these companies will earn this year – revenue that that could be added to state and local budgets in this country, if companies were regulated, licensed and taxed.

Indeed, in March 2005 a bill that would legalize Internet poker passed in the North Dakota House of Representatives only to be later defeated by the state Senate. State Representative Jim Kasper presented the bill, arguing that state regulation of Internet poker would draw its top companies to North Dakota, bringing significant licensing revenue and other fees. Despite the defeat, Kasper has said that he plans to reintroduce the Internet poker legalization initiative in November 2006.

Regulation provides the best way to ensure that best practices in the industry are extended and standardized for the whole industry. Regulation provides systematic ways to protect vulnerable people and to prevent minors from gambling. Establishing high standards of practice and a means to enforce these standards will not only benefit users and operators, but will provide the U.S. government with a significant source of tax revenue. In addition, through regulation, there can be assurances that the integrity of sports will be enhanced and protected.

II a. W.T.O. Decision

In 2003 Antigua and Barbuda filed a complaint with the World Trade Organization arguing that U.S. federal and state laws restricting online gambling were in violation of the United States' free trade agreements because the U.S. permits online gambling for horse race betting but prohibits all other online gambling. Antigua, which handles a

quarter of online bets in the industry, said that it had lost more than \$90 million in income from the U.S. ban.⁵

In November 2004, the World Trade Organization ruled that the prohibition of online gambling in the United States was in clear violation of international trade treaties and that the United States must either regulate the industry and give interactive gambling operators full access to the US market, or ban all forms of online gambling.

The Bush administration appealed in January 2005, arguing that at least 15 months were needed for the American legislative process to address the issue. A W.T.O.-appointed arbitrator ruled in August 2005, however, that the United States' need for 15 months was invalid, given the flexibility of the U.S. legislative process, and set an April 3, 2006 deadline for the United States to comply with the recommendations and rulings of the DSB (Dispute Settlement Body) in the November 2004 decision.

The W.T.O. decision drew international attention to the problems intrinsic to the United States' prohibition of online gambling. The W.T.O. ruling and subsequent appeal decision in Antigua's favor drew attention to the jurisdiction's regulatory model.

II b. Existing Regulatory Model in Antigua and Barbuda

Antigua and Barbuda was one of the first jurisdictions to license interactive gaming and wagering companies in 1994 and has subsequently been very proactive in regulating its licensees under the framework of its Interactive Gaming and Interactive Wagering Regulations (IGIWR).

In a 2003 *Antigua Sun* editorial regarding Antigua & Barbuda's challenge to the United States in the Dispute Settlement Body of the World Trade Organization, Sir Ronald Sanders, Antigua and Barbuda's Chief Foreign Affairs Representative at the time, wrote of Antigua's regulatory standards:

⁵ Bloomberg News, "WTO backs Antigua, rules U.S. online gaming ban is illegal." November 10, 2004.

The Internet gaming industry in Antigua is highly regulated, and children have no access to it. Gamblers are required to deposit funds before they can bet. To do so, they have to send a wire transfer from their bank accounts and provide their social security number, address and other means of identification. These strictly enforced rules make it impossible for children to gain access to the Internet gaming operations... The way in which the industry operates and is regulated, [money laundering] activities are impossible since the operators [can] only accept funds by bank-to-bank wire transfers which are all traceable, and that funds [can] only be paid to the accounts from which punters send money in the first place.⁶

Today, the Antigua and Barbuda Division of Gaming is home to a significant portion of the interactive gaming and wagering industry and licenses some of the largest online gambling companies. The Division is committed to upholding the highest standards of integrity and best practices among all of its licensees and ensuring that Antigua and Barbuda is regarded as a top-tier jurisdiction.

The Antigua and Barbuda Division of Gaming's existing regulatory model upholds this first-rate reputation. Through its Interactive Gaming and Interactive Wagering Regulations, the jurisdiction confronts some of the leading concerns about online gambling and focuses its regulatory measures on player protection, preventing money laundering and enhancing the industry. All licensed gaming companies are required to establish internal procedures that ensure that operators "Know Your Customer" and submit to external audits to certify that they are compliant with the Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) regime in Antigua and Barbuda in accordance with international standards.

II c. UK's Gambling Act – An Important Model

The United Kingdom provides yet another model the United States can look to in addressing its concerns about online gambling regulation. The passage of the UK's

⁶ Sir Ronald Sanders, Antigua and Barbuda's Chief Foreign Affairs Representative, "Antigua's impudence: Challenging the US in the WTO." July 9, 2003.

Gambling Act on April 7, 2005 was a significant development for the online gambling industry. The Act established provisions for licensing and regulating online gambling and created a Gambling Commission to implement these provisions and ensure that all operators within its jurisdiction are held to the same standards of fair practice. The provisions of the Gambling Act will be fully implemented in 2007.

The Gambling Act revised the British regulatory system to govern all gambling in Great Britain, excluding the National lottery and spread betting. The Gambling Bill, drafted initially in November 2003, was in response to a white paper “A Safe Bet For Success,” published by the Department for Culture, Media and Sport. The government paper itself was a response to the Budd Report of the Gambling Review Body, published in July 2001.

These reports found that the existing regulatory framework for the gambling industry was no longer relevant to the current technology and, therefore, was no longer equipped to provide a safe and transparent arena for participants. Further, the existing regulatory framework had been drafted in a time when the social perceptions of gambling were more negative than that of the current social climate. “Almost three quarters of the adult population participate in gambling of one kind or another,” the Department for Culture, Media and Sport wrote. “It has become part of the main stream of leisure activity. There is a powerful case for lifting regulatory burdens on an industry which has build a world reputation for integrity.”⁷

In addition to establishing provisions for licensing and regulating online gambling, the UK’s Gambling Act created a Gambling Commission granted with the authority of ensuring that all remote gambling businesses within its jurisdiction are held to the same standard of fair practice.

The newly established Gambling Commission is charged with implementing the provisions of the Act. The Commission is tasked with establishing practices for ensuring

⁷ “A Safe Bet For Success,” Department for Culture, Media and Sport. March 26, 2002. Pg. 3.

that consumers are protected, money laundering and other criminal activity are prevented, and minors are restricted from gambling on the sites. The Commission will work alongside gambling industry organizations and will actively consult with consumer organizations, faith groups and members of the public.

II d. Independent Oversight

Third party organizations exist which can help federal and state governments and the industry develop best practices. For example, the Remote Gambling Association, based in the UK, represents the world's largest and most well known remote gambling companies and serves as a voice of the industry on issues related to regulation and legislation. The RGA is the result of an August 2005 merger between the Association of Remote Gambling Operators (ARGO) and the Interactive Gambling and Betting Association (IGGBA).

Beginning in November 2005, the RGA launched a six-month pilot program with the Independent Betting Arbitration Service to extend independent non-statutory arbitration services to RGA members to settle betting disputes. IBAS has arbitrated land-based gaming disputes for the British gambling industry since its launch in 1998. This pilot program will provide the first arbitration service to online gambling operators licensed in the UK and, in conjunction with the RGA, provides an example of how the industry can be effectively regulated and managed.

In addition the RGA and IBAS not only establish and uphold high standards of integrity and probity from their members, but also serve as a resource to governments developing regulatory regimes by providing a means of standardizing business practices across the industry.

III. IN THE FACE OF OPPOSITION

While the online gambling sector has grown rapidly in recent years, the industry has increasingly come up against harsh criticism from a handful of U.S. politicians. In the ongoing debate about online gambling, opponents have cited the 1961 Federal Interstate Wire Act to maintain that online gambling is an illegal activity and should be prohibited. This law is inappropriately applied to online gambling, as it is intended to prohibit the use of wire communication facilities for gambling or aiding in the placement of wagers or bets. As online gambling is not a wire communication facility, it should not be prohibited by the Act. Furthermore, the law is archaic as it was written prior to the creation of the Internet and does not acknowledge the many ways in which electronic transfers have come to be standard practice in many areas of legal eCommerce.

Over the past 10 years, Senator John Kyl (R-AZ) has tried and failed 7 times to create legislation that would prohibit U.S. citizens from participating in online gambling. Rep. James Leach (R-IA) has also tried numerous times to push his “Unlawful Internet Gambling Funding Prohibition Act” through Congress. The bill would criminalize the electronic transfer of funds in connection with online gambling, such as those done via credit card.

Rep. Leach reintroduced his “Unlawful Internet Gambling Funding Prohibition Act” to the House on November 17, 2005, four days after writing each member of Congress asking them for their support. Leach added that in hope of clearing the bicameral hurdle, he and Senator Kyl are working together to draft a bill that would constrain online gambling.

Fundamental to both Kyl and Leach’s arguments are the following claims:

- *Online gambling sites cannot effectively provide safeguards for minors and problem gamblers;*
- *Online gambling increases risks of bankruptcy and fraud;*
- *Online gambling provides a hotbed for money laundering and terrorism*

All of these concerns can be addressed fully and completely through a comprehensive regulatory regime.

III a. CLAIM: Online gambling sites cannot effectively provide safeguards for minors and problem gamblers

The best way to protect minors from online gambling is to create measures that effectively prevent minors from gambling. This can be done through strong collaboration between government and industry and consistent, standardized use of technology to block minors from playing. Many online gambling operators currently have procedures to confirm identification of payment methods. In addition, many companies also provide information to parents about how to apply appropriate filters on their computer to prevent their children from playing. As technology evolves, there will be even more ways to limit the access of minors to online gambling sites.

To prevent and combat problem gambling, many industry leaders are using technology to track players' betting behavior and set limits on their account balances. Companies are also providing educational material and resources to their customers on the dangers associated with gambling and provide them with links to organizations that can provide help. Regulation would standardize these practices.

The Interactive Gaming Council advised in a June 2005 article in *Casino Gaming International* that advancements in technology offer both the opportunity and resources to improve gaming regulations – both traditionally and interactively.

New technologies actually provide regulators with tools not previously available in most traditional forms of gambling, including the ability to provide an audit trail for each transaction; enforce maximum wagering limits, either for individual bets or total bets over a designated period of time; and to block participation by specified players or classes of players, such as college athletes.⁸

⁸ *Casino Gaming International*, "10 Year Review: Online Gaming, An Evolving Industry." July 2005.

III b. CLAIM: Online gambling increases risks of bankruptcy and fraud

The application of technological advancements will also address the problems of fraud. It is imperative that online businesses establish controls that not only protect the interests of their consumers, but also themselves. To ignore the dangers of eCommerce is to ignore not only the future, but also the present. Concerns regarding fraud and identity theft due to online transactions are real and legitimate. However, such concerns cannot be allayed by prohibiting online gambling. Regulation provides controls that will protect the interests of consumers who participate in online gambling and to the operators that provide these services.

Assertions that online gambling, or gambling in general, is correlated to increased risk of bankruptcy is unfounded. The Department of the Treasury found in 1999 that there was no correlation between gambling and state bankruptcy rates and little correlation between the frequency of gambling with personal bankruptcy rates.⁹

III c. CLAIM: Online gambling provides a hotbed for money laundering and terrorism

Similarly, the assertion that online gambling provides a hotbed for money laundering by terrorists is unfounded. A 2002 report conducted by the United State General Accounting Office titled “Internet Gambling: An Overview of the Issues” found that views on the vulnerability of the online gambling industry to money laundering are mixed.

Banking and gaming 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, are used for payment. Likewise, credit card and gaming

⁹ Department of the Treasury, “A Study of the Interaction of Gambling and Bankruptcy,” July 1999

industry officials did not believe Internet gambling posed any particular risks in terms of money laundering.¹⁰

While law enforcement officials did express concerns that online gambling could be vulnerable to money laundering, they cited the lack of regulatory oversight as a significant contributor to this vulnerability.

The very nature of the Internet is that any transaction conducted is auditable from start to finish. As a result, if regulated, the Internet would provide a safer, more scrupulous and more controlled environment than land-based operators.

¹⁰ United State General Accounting Office Report to Congressional Requesters, "Internet Gambling: An Overview of the Issues". December 2002.

IV. CONCLUSION AND RECOMMENDATIONS

The online gambling industry is at a pivotal point. While the U.S. continues to prohibit the operation of online gambling businesses, the industry continues to boom outside its borders. As its popularity continues to increase and technological advancements make it increasingly easy for consumers to access, there is a need to make the industry transparent and provide safeguards for minors and resources for problem gamblers.

Regulation will standardize the best practices already employed by leading industry members and ensure that customers and players are afforded the safest arenas of practice and measures are set in place to protect the vulnerable.

We recommend the creation of a U.S. Advisory Council to Explore Regulation of the Online Gambling Industry.

In order to establish a framework for regulation, leading advocates from both sides of the debate would coalesce to form an Advisory Council to establish effective ways to deal with the social, economic and public concerns about the online gambling industry in the United States. Council members would be drawn from all corners of the online gambling industry as well as legal, ethical, academic technology experts and participants from social organizations and law enforcement agencies. Through a series of meetings, members of the Advisory Council would explore the rationale, impediments, incentives, precedents, disadvantages and benefits of regulating the rapidly growing online gambling business.

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