



Online Gambling Five Years After UIGEA

Executive Summary

By David O. Stewart, Ropes & Gray, LLP

The business of online gambling spans the globe and touches every corner of the United States. Worldwide, online gambling is increasingly a legal and regulated activity that generates almost \$30 billion of revenue a year. In the United States, public policy on the subject has been schizophrenic. Online gambling is presently being conducted domestically for pari-mutuel betting on horse races and for state lotteries, yet government policy has been hostile to other forms of online gambling, and has included criminal prosecutions of online gambling operators and their payment processing partners. Despite this government opposition, millions of Americans spend \$4 billion every year to gamble online. Prosecutions against online gambling operators have driven the more responsible offshore operators out of the U.S. market, leaving Americans to conduct their online gambling through largely unregulated websites.

In contrast, about 85 nations have chosen to legalize and regulate online gambling. Numerous Western nations — including the United Kingdom, France, Italy, and some provinces in Canada — have created structures for tight regulation of the online gambling industry. This course provides consumer protections for individuals while also generating jobs, economic opportunity and government revenue. Beginning with careful confirmation of the identity of every online gambler, which is the foundation for effective regulation, these nations employ technologies that effectively ensure:

- That the games are played fairly, according to their rules, and pay off as promised;
- That underage gamblers are excluded from play;
- That people who struggle to control their gambling have access to tools to limit their deposits, bets, and overall play, or even exclude themselves from gambling websites entirely;
- That online gambling operators do not accept bets from jurisdictions that prohibit online gambling; and
- That gambling websites are not used for money laundering and other illegal purposes.

Similar protections are now required for U.S.-based websites that take bets on horse racing or sell subscriptions for state lottery tickets.

Although criminal prosecutions and legislation can cause the volume of online gambling to fluctuate in the short run, the track record shows that the demand for online gambling remains, and offshore operators will figure out ways to meet that demand.

Drawing on these experiences, Congress has a unique opportunity to blend several approaches to Internet gambling to achieve the greater good. First, it should reinforce law enforcement tools and proscriptions to protect Americans from gambling websites that now operate from offshore jurisdictions with minimal or no regulation. Second, it should authorize a state-focused program to license U.S.-based operators to offer online poker only, preserving the ability of every state government to decide whether online poker should be available within its borders. Third, it should ensure that tough regulation ensures the fairness of the games, excludes underage gamblers, and provides tools for pathological gamblers to control their gambling. Such an integrated policy would provide maximum protections to American citizens while generating new jobs, economic opportunities and public revenues.

Introduction

In little more than a decade, online gambling has exploded from a minor sideshow on the Internet into a substantial global industry. During that time, the United States has struggled to develop a comprehensive policy on Internet gambling. Indeed, federal and state governments have applied fragmented and sometimes inconsistent policies to this new technology for delivering a very old form of entertainment. For example, the government’s attitude toward online gambling has been largely hostile — including indictments of major offshore gambling operators — but it has allowed the horseracing industry and state lotteries to conduct online betting.

Because of the enduring popularity of poker in America, this paper will focus on current proposals to legalize only online poker, with particular emphasis on what we have learned since the Unlawful Internet Gambling Enforcement Act (UIGEA) became law five years ago. The broad availability of Internet gambling sites around the world has provided a real-world study of the different ways for public policy to respond to online gambling. That experience teaches three basic lessons:

- First, millions of Americans have continued to bet billions of dollars a year at offshore websites. Americans like to gamble online and have demonstrated that they will do so even if their government tells them it is illegal. Although criminal prosecutions and legislation can cause the volume of online gambling to fluctuate in the short run, the track record shows that the demand for online gambling remains, and offshore operators will figure out ways to meet that demand.
- Second, the current policy on Internet gambling ensures that foreign nations and foreign businesses reap the benefit of the jobs, economic opportunities and tax revenues that are generated

by Americans' online gambling. Legalizing online poker will create, directly and indirectly, an estimated 10,000 high-tech jobs in this country, the sort of jobs that our citizens urgently need. And it will generate an estimated \$2 billion of tax revenue every year for state and federal governments, helping preserve critical public services in a time of increasing budgetary constraints.¹

- Third, well-designed regulation can control the social risks that some fear from the legalization of online gambling. Based on years of experience with regulated online gambling in the horseracing and lottery sectors in this country, and with legalization in some Canadian provinces and in Europe, we know that a strict regulatory system can ensure that online games (i) are fair to players, (ii) exclude minors, (iii) provide tools that allow customers to limit their gambling, or self-exclude entirely from online gambling; (iv) exclude bets from jurisdictions where online gambling is illegal, and (v) prevent the use of online betting sites for money laundering or other illegal purposes. Indeed, if online gambling is not legalized and regulated, Americans will continue to gamble online at websites that are based in jurisdictions that provide the least protection for their customers and create much higher risks from online gambling.

Experience over the last five years also has taught that a nation cannot build a successful online gambling industry unless it effectively excludes unlicensed operators. To the extent that unlicensed operators are able to attract U.S. residents to their websites, those residents will not gain the protection of the regulatory structures we support, nor will the nation gain the jobs and government revenues that are at stake here. Accordingly, U.S. law should clearly prohibit those forms of Internet gambling that are not legal, clearly authorize those that are and provide strong law enforcement tools to stop illegal gambling online.

A further consideration shapes the AGA's review of this issue: the traditional doctrine in this country that gambling policy should be controlled by local preferences. Any federal authorization of Internet poker should ensure that each individual state can determine whether it wishes to have legalized online poker within its own borders. That approach — broad federal authorization of online poker that preserves each state's autonomy to decide whether or not to allow it — also would avoid the risk that individual states create overlapping, confusing and even inconsistent online gambling regimes.

This white paper will begin with a survey of the global online gambling market and then focus on online gambling in the United States. The second section addresses the challenges and achievements possible in the regulation of online gambling. The concluding section reviews current proposals to legalize online gambling.

The Online Gambling Market

Around the World

The United States is not alone in facing the complex policy concerns raised by online gambling. Approximately 85 nations have chosen to legalize Internet gambling. Indeed, in 2010, global revenue for online gambling was nearly \$30 billion, and less than 15 percent came from the U.S.² As of June 30, 2010, one survey found 2,679 Internet gambling sites owned by 665 companies. These included:

- 865 online casinos
- 616 online poker rooms
- 516 sports betting sites
- 426 online bingo sites
- 187 lottery and other sites³

Of greatest significance, in developed nations the strong trend in recent years is to legalize online gambling in order to capture the jobs and public revenues it generates, and to regulate it closely to control any social risks it might pose.

For purposes of this paper, the nations that have legalized online gambling may be divided into three broad groups.

The first group consists principally of smaller jurisdictions in the Western Hemisphere, such as Costa Rica, Curacao, Antigua and the Kahnawake Mohawk nation in Canada. These jurisdictions offer low-cost licensing to operators, along with low tax rates and little or no regulatory scrutiny. Costa Rica has no regulatory system at all for online gambling companies, while Curacao has outsourced its licensing function to a firm called Cyberluck. These low-regulation jurisdictions are home to most of the online gambling operators that still accept bets from the U.S. These jurisdictions view online gambling purely as a means of economic development and show little concern for the potential social risks associated with it, including criminal activity through the site.

The second group of licensing jurisdictions largely consists of small places in Europe that also use online gambling as an economic development tool, although they have imposed substantial regulations on their licensees. These generally tiny locations — such as Gibraltar, Malta, the Isle of Man and Alderney (an island in the English Channel) — license and host the largest online gambling operators. To attract those operators, they offer low taxes, an educated labor force, reliable Internet service and a European location. Yet they also provide sufficient regulatory oversight to assure customers that the games will be conducted fairly and that many of the social risks will be controlled through regulation (e.g., barring underage gamblers, requiring responsible gaming tools). In one respect,

these jurisdictions have failed to impose important regulations. Accepting the arguments of their licensees that U.S. law does not bar online gambling other than sports betting, they have allowed their licensees to accept bets from U.S. residents, except for sports betting. After the recent federal indictment of offshore poker operators, however, few of those licensed websites still accept U.S.-derived bets.

The third group of jurisdictions that have legalized Internet gambling includes larger, developed countries in Europe, plus some Canadian provinces. The United Kingdom briefly attempted to seize the lead among this group by legalizing online gambling in 2005, but its efforts largely fizzled. The UK set its tax rate relatively high and allowed offshore operators to take bets from UK residents so long as the operators were licensed in a jurisdiction that imposed regulatory standards that satisfied UK gaming regulators. Most online operators have elected to serve the UK market from low-tax, offshore locations and not to seek UK licenses directly.⁴

Some of the countries within this third group reserve online gambling to a state-owned monopoly. In Sweden, for example, only the national monopoly, Svenska Spel, may take online bets. Canadian provinces also are following the monopoly model. The British Columbia Lottery Corporation launched an online casino in the summer of 2010, followed by online poker in February of this year. British Columbia's poker network is shared by Loto-Quebec, which makes it available to residents of that province, and Ontario plans to join that network, as well.⁵

Most of the countries in this third group, however, have elected to license and regulate private gambling operators. Austria, Italy, France, the Netherlands and Estonia are following that model, while Denmark, Belgium and other countries are considering it. Both Italy and France have licensed dozens of online gambling sites while expanding the types of online gambling that are available. In March 2011, Italian licensees began to offer online poker and will add online casino games over the summer. U.S. gaming companies are beginning to enter those legalized European markets for online gambling.⁶

All of the nations in this third group — whether reserving legal online gambling to a state monopoly or licensing private operators — share a challenge: their markets continue to be invaded by websites based in the first two groups of jurisdictions. This pattern reinforces the importance of strong law enforcement measures to exclude unlicensed operators from any regulated online gambling market.⁷

The continuing strength of the operators from the first two groups of jurisdictions flows from a number of causes. The licensed businesses in the larger countries ordinarily must shoulder a substantially higher tax burden. Also, many operators based in Alderney and Gibraltar have developed

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expertise, brand-name recognition and popular products over the last decade.⁸ As a result, in the online poker market, those established operators can offer customers greater “liquidity,” an industry term that refers to the number of players available for games at any time during the 24-hour cycle. If a website has greater liquidity, it can offer a wider range of games and tournaments with a wider range of minimum-bet options and higher prize money, all features that are attractive to customers.⁹

The nations that have legalized online gambling are still developing effective strategies for excluding from their markets the online gambling operators they have not licensed. In Italy, for example, every three weeks the government issues a list of URLs for unlicensed gambling websites and instructs its Internet service providers (ISPs) to block those URLs; this approach resembles the course followed by the FBI in a recent high-profile case, where it seized the Internet domains of the online businesses it targeted. Similarly, France has ordered its ISPs to block several gambling websites based in Costa Rica, though the ISPs have opposed the effort.¹⁰ These techniques should be supplemented by additional technological and legal tools to combat unlicensed operators, which can include creating a list of such operators to ensure that financial institutions do not process their payment transactions.

In The United States

Americans like to gamble online. Over the last decade, an estimated 10 million Americans have gone to Internet websites to place bets on sporting events, to play poker, and to participate in a range of electronic casino games, including slot machines, blackjack, craps and roulette. From 2003 to 2010, Americans spent approximately \$30 billion to gamble online.¹¹

Through that period, U.S. policy has been mostly hostile to Internet gambling, though at times its hostility has been inconsistent and even not always hostile:

- Under an amendment to the Interstate Horseracing Act (IHA) adopted in 2000,¹² for a decade the horseracing industry has conducted online wagering that now generates revenues of almost \$300 million a year from bettors in 37 states. Much of this Internet betting flows through hubs authorized and regulated in Oregon.
- This explosive growth has occurred even though DOJ takes the position that the IHA amendment in 2000 did not apply to the federal criminal gambling statutes, such as the Wire Act, and thus that pari-mutuel wagering may not be conducted over the Internet. Despite announcing that position, DOJ has taken no action against online betting on horse races.
- At least a half-dozen state lotteries now sell ticket subscriptions

through their websites to residents of their states.

- In 2006, Congress adopted the Unlawful Internet Gambling Enforcement Act (“UIGEA”), which prohibits financial transactions in support of illegal online gambling, but does not define illegal online gambling.¹³
- Congress has enacted no legislation that squarely addresses the legality of online gambling.
- The U.S. Department of Justice (DOJ) has brought criminal prosecutions against major online gambling operators, most often alleging they violated anti-gambling statutes that were adopted in the 1960s, long before the Internet existed. See APPENDIX, *infra*, “U.S. Enforcement Efforts Against Online Gambling Operators.”
- Many online gambling operators have argued that the 1960s statutes, particularly the Wire Act, 18 U.S.C. § 1084, reach only sports betting, and they have pointed to a federal appellate ruling in support of that claim. Two other federal courts, however, have rejected that defense in criminal prosecutions.¹⁴
- DOJ has collected more than a half-billion dollars in criminal fines and civil seizures in cases against offshore gambling operators and payment processors.
- The FBI, through painstaking and aggressive effort, has used UIGEA to build a criminal case against major online poker operators, but that has proved the legal equivalent of house-to-house combat. As soon as some operators are shut down, others step forward to serve the demand.
- Despite entreaties from financial institutions that the government should create a list of illegal online gambling websites so they will know which ones to refuse to do business with, no such list has been disseminated.
- In defining “unlawful Internet gambling,” UIGEA specifically excludes online gambling conducted solely within the boundaries of a state or tribe, which has served as an implicit recognition that states and tribes have the power to authorize such gambling.¹⁵
- Several states have enacted bans against online gambling. Several more states are considering legalizing online gambling within their borders, as the District of Columbia recently has. Most states have done nothing about it.

These developments are described in greater detail in the Appendix to this white paper.

Enactment of UIGEA in 2006 temporarily reduced online gambling by U.S. residents, but the volume of online bets from the United States soon recovered. In 2010, online gambling revenues from U.S. bettors exceeded \$4 billion.

The inconsistency of U.S. policy reflects the novelty of the online gambling phenomenon and fluid public attitudes toward that phenomenon. For some, concerns about the social ills associated with excessive gambling are heightened with online gambling, which occurs in the home and could be accessible to young people. Those concerns drove adoption of UIGEA and have driven DOJ's campaign against offshore operators. For others, like the horse-racing and lottery industries, the Internet is a promising new vehicle for serving customers in a convenient and efficient fashion, thereby expanding economic opportunities in their industry and public revenues for the states where they do business.

The popularity of Internet gambling persists despite government attempts to discourage it. Enactment of UIGEA in 2006 temporarily reduced online gambling by U.S. residents, but the volume of online bets from the United States soon recovered. In 2010, online gambling revenues from U.S. bettors exceeded \$4 billion.

A very recent development has prompted a similar downturn in online betting by U.S. residents. On April 15, 2011, the federal government announced that a New York grand jury had indicted the founders of the three largest Internet poker operators that were accepting bets from U.S. residents — PokerStars, Full Tilt Poker and Absolute Poker/Ultimate Bet. The charges focus on the processing of payments to and from their customers, alleging that those transactions involve bank fraud, money laundering and the maintenance of illegal gambling businesses.¹⁶ DOJ filed a parallel civil complaint demanding forfeiture of the Internet domains used by those operators.¹⁷

Online gamblers responded swiftly to these charges, which are often referred to as the “Black Friday” indictment. Online gambling by U.S. residents promptly dropped; many customers were uncertain about when they would be able to recover funds they had deposited with operators who were leaving the market, and the customers were understandably leery of gambling online again. Before the indictment, PokerStars and Full Tilt held 60 percent of the global Internet poker market; after the indictment, Internet traffic to their websites fell by 26 and 40 percent, respectively, from the previous week. Within a day of the indictment, both firms stopped taking new bets from U.S. residents; the third poker business named in the case, which operates Absolute Poker and Ultimate Bet, continued to allow Americans to play but froze those customers' ability to deposit or withdraw funds.¹⁸

Nevertheless, an estimated 300 offshore gambling operators — mostly those based in lightly regulated or unregulated jurisdictions in the Western Hemisphere — continue to operate in the U.S. market through more than 1,000 online gambling websites. They stand to prosper greatly in the

current situation. In the immediate aftermath of the Black Friday indictment, those remaining operators saw a surge in their business: traffic at Merge Gaming Network was up 23 percent, Bodog rose 26 percent, and Cake Poker Network rose 19 percent.¹⁹

The long-term consequences of the Black Friday indictment are not entirely certain. The indictment makes no difference to online betting on horseracing or with state lotteries. Those activities continue to be legal in this country and can be expected to grow. In 2000, Oregon reported that \$6.2 million was wagered through its regulated sites for betting on horseracing; for 2010, it reported wagers of \$1.445 billion, an increase of more than 200-fold. States selling lottery ticket subscriptions online — which include Idaho, Illinois, Maryland, Minnesota, New York and North Dakota — also can be expected to continue to do so.

In the short term, the indictment likely will retard other online gambling activity by U.S. residents, but that dampening effect will erode over time. Following enactment of UIGEA in 2006, several major offshore operators stopped taking bets from U.S. residents, and the volume of online betting from the U.S. shrank. Yet the market recovered all of that lost activity and then some. That pattern suggests that the illegal online gambling market for U.S. bettors will recover again. Moreover, DOJ's enforcement activity has the perverse effect of pushing the market into the hands of online gambling operators that are generally less regulated and less trustworthy. The result is that those U.S. residents still gambling online are at greater risk than before.

Legalization of online gambling in the U.S. could come in very small and inconsistent pieces. In defining “unlawful Internet gambling,” UIGEA specifically excludes online gambling within any state or tribal jurisdiction, creating an implicit recognition that states and tribes have the power to authorize Internet gambling within their boundaries. In early 2011, the New Jersey Legislature approved intrastate online gambling under this authority, but the governor vetoed the measure. Similar proposals have been under active consideration in several other states, including Iowa, Nevada, Florida and California, while the District of Columbia is moving forward with a plan to offer online gambling this year.²⁰ Most states — and certainly the District of Columbia — are too small to provide sufficient liquidity to create a successful online poker market. Moreover, if individual states move forward separately in authorizing online gambling, they are likely to establish inconsistent regulatory practices and authorize different games; some may legalize all forms of Internet gambling. The result could be both confusion and diffusion of the market that will only strengthen the position of unlicensed offshore operators.

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Online Poker Can Be Regulated Effectively

Experience with the regulatory regimes in Western Europe, Canada and the United States demonstrates that regulatory techniques have evolved to address effectively the principal public policy concerns that surround online gambling:

- To ensure the integrity of the games by preventing cheating by operators, by other gamblers and through the use of “bots” (software designed to play on online gambling sites);
- To restrict access to gambling services to those players who reside within the territorial market the operator is authorized to serve;
- To exclude underage gamblers;
- To give customers the tools to control their own gambling, which can involve limits on the money they deposit with the gambling website, limits on the size of bets they can make, or total self-exclusion from the website; and
- To prevent the use of online gambling sites for money laundering and other illegal purposes.

Ensuring the Integrity of the Games

The most basic requirement of a regulated gambling industry is that customers have confidence that their money is safe and that the games are conducted fairly and in accordance with established rules. Notably, the most notorious scandal in Internet gambling involved insiders connected with an online poker operator, Ultimate Bet, who undermined the website’s procedures to look at the “hole cards” of other players at virtual poker tables.²¹

Protecting the integrity of the games begins with ensuring that only trustworthy individuals and firms qualify for licenses. Regulators also must establish standards for the fairness of the games, and should require both testing of online gambling systems and audits of their financial transactions. Online poker presents particular issues because players compete against each other, so regulatory systems must defend against player collusion. Also, online poker operators must block the use of “bots,” or artificial intelligence, to play the games. Finally, procedures need to minimize the potential that customers will use online poker sites to launder money.

Suitability Licensing — Several of the jurisdictions that license online gambling operators have borrowed the “suitability” standard that applies to the commercial casino license holders in the United States. Under that standard, casino operators and those who produce gaming systems must satisfy regulators that their personal and business backgrounds

demonstrate that they may be trusted to operate within legal requirements. They must submit extensive information about their business and professional histories, all of which is subject to further investigation by the regulators.

Suitability-based licensing is effective in excluding individuals with criminal or undesirable backgrounds and in ensuring that gambling operators have proper experience and financial support. That licensing standard can be employed for the same purpose in the licensing of online gambling operators, as is now done in the United Kingdom, France, Alderney and the Isle of Man.²² Similarly, those seeking licenses from the Oregon Racing Commission to accept online bets on horse races must show that they are of “good repute and moral character.” Such open-ended standards ensure that regulators have the discretion to deny license applications, or revoke previously granted licenses, when they simply doubt the integrity of the license applicant.²³

Customer Identification Procedures — For several essential reasons, online gambling sites must identify their customers accurately. A strong customer identification process ensures that the operator:

- can exclude underage customers from gambling;
- can exclude customers living in jurisdictions that have not legalized online gambling;
- can exclude individuals who have engaged in cheating or otherwise violated the rules of the games; and
- can properly evaluate financial transactions to gauge the risk of money laundering or other offenses.

Because of the importance of customer identification, the better-regulated online gambling sites, like those governed by the Oregon Racing Commission, demand that a customer provide his name, address, telephone and credit card information or bank account data. That information can be checked immediately through sophisticated databases maintained by Experian, Equifax, First Union and similar firms, and through public databases such as motor vehicle registrations. If there is any question as to the customer’s identity, the operator will follow up by demanding additional information, which can include a social security number or personal data that only the customer should know. For example, the British Columbia Lottery Corporation may require the customer to fax copies of essential documents, such as a driver’s license, or speak live to a customer service representative.²⁴

Testing and Auditing — The software that operates online games can and should be subjected to testing to ensure that the games play out according to their own rules and that they pay off as promised. For online poker, this involves testing the random number generation function that is

used to drive the dealing of cards for each hand. Many jurisdictions that issue online gambling licenses currently prescribe detailed requirements for these critical functions and require certification by outside testing laboratories that the licensee has satisfied those requirements.²⁵ This technical compliance testing is not materially different from the testing that applies to electronic gaming machines (slot machines, video poker and video lottery machines) that are popular in bricks-and-mortar casinos.

Similarly, regulators of land-based casinos routinely audit licensees to confirm that they have paid off jackpots as required, have applied the rules of their games fairly, and have accounted correctly for funds due to customers and to governments as tax or fee payments.²⁶ The same oversight is applied to online licensees.²⁷ Indeed, because all online gambling is recorded electronically, it is easier to audit Internet gambling operators.

Controlling Player Collusion — In online poker games, players compete directly against one another. The operator does not participate in the games, and no employee of the operator observes the online poker game as it progresses. This has created concern that two or more players might collude at a virtual poker table to take unfair advantage of other players. They might, for example, communicate by telephone to coordinate their strategies, or even play together in the same real-world room, exchanging information. Online poker providers and regulators deploy strategies that effectively counteract this risk.

The collusive player problem is often policed by the other players at the virtual poker table. When other players note patterns of play that are out of the ordinary, they report them to the online gambling operator; because operators retain a record of every hand of poker played on their systems, they can then analyze the play at that table for suspicious patterns. As one online gambling regulator has stated, “Cheating at poker sticks out a mile.”

Operators also deploy auditing software to review every hand of poker that has been played on the website and to analyze the patterns of play. If two players show up at the same virtual table with any frequency and show winning or losing patterns beyond those predicted by the law of averages, the auditing software will highlight those players for further study. If the gambling operator concludes that the players may be colluding, the operator can refuse to allow them to play at the same virtual table together, or can exclude them from play outright. When collusive play is discovered after it has happened, operators can issue refunds of losses to the other players at the table.²⁸

Poker Bots — “Poker bots” are software programs that play the games automatically. They are currently marketed on eBay and other Internet sites and have drawn some public notice. Many of the bots, in fact, have been revealed not to play very good poker. In a recent episode, one type of bot played more than 8 million hands but won only \$57,000, a fairly mediocre

performance. Whatever the strengths and limitations of poker bots, online gambling operators bar them and other forms of artificial intelligence, and exclude players whom they suspect of using them. Several strategies control attempts to use poker bots to gain an unfair advantage.²⁹

Again, the other players in the game form an early-warning system about the possibility that a poker bot is in use. Other players notice and report machine-like play. Poker bots tend to play in identifiable patterns and not to show the variability that human poker players demonstrate — bluffing, for example, or taking breaks for food or personal hygiene. Also, the audit software used by operators will detect poker bots. Operators routinely download bots into their computer systems in order to analyze how the bots play, which allows the systems to recognize those bots in the future. For example, many bots will click on the same location on the screen for play after play, something that humans cannot do and which is readily detected by audit software.³⁰

Anti-Money Laundering Programs — Although DOJ has charged that the payments processing systems set up by offshore operators represent a form of money laundering, fears about potential money laundering through online gambling sites have generally not been realized. As a threshold matter, of course, the risk of money laundering with currency is eliminated for online gambling sites that do not accept currency. Moreover, every financial transaction with an online website is recorded and therefore subject to audit and questioning by both the operator and regulators. Nevertheless, the potential for money laundering through online transactions has drawn regulatory attention.

As with bricks-and-mortar casinos, the most common form of money laundering involves the deposit of a large amount of money, followed by very limited gambling activity, and then an attempt to cash the funds out in another form. This pattern of classic money laundering — deposit, limited play, withdrawal — can be identified through auditing software deployed both by operators and regulators. Indeed, regulators in developed nations ordinarily require online operators to report “suspicious transactions,” a requirement that applies to bricks-and-mortar casinos and financial institutions in this country, as well.

Regulators and operators also limit the risk of money laundering by restricting the ways that online sites can transfer money. Many online gambling operators will transfer a customer’s money only to a pre-designated account in a financial institution.³¹ For example, the British Columbia Lottery Corporation allows a player to have only one account on its website and will transfer funds into or out of that account only from one source, whether it be a credit card or an account at another financial institution.³²

Another form of potential money laundering in online poker involves

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“chip dumping,” a pattern where one player will attempt to lose to a confederate at the same poker table, thereby transferring assets to that player. Chip dumping can be undertaken to launder funds, or to transfer value from a stolen credit card to a confederate, who then can cash out the value in another, more negotiable format. Other players often will identify and report potential chip dumping situations. Auditing software also will identify chip dumping by detecting players who lose or win more often than they should under the law of averages, and when they do so at the same tables with apparent confederates.

Despite the extensive efforts of online gambling operators to exclude cheaters and money launderers from their websites, the industry does not currently have a mechanism for sharing information about rogue customers. In the commercial casino industry in the United States, regulators ordinarily provide for the sharing of information about undesirable customers through a “black book” or some similar method. Any online gambling legalization in the U.S. should ensure that information about cheating on one licensed gambling site is shared with other online gambling operators.

Respecting Territorial Limits on the Market

Any legalization of online gambling in the United States should provide that each individual state may choose not to have legalized online gambling within its borders. Online betting on horse racing has followed that model, with some states embracing it and others declining to legalize it. Canada has taken a similar approach; two Canadian provinces now allow online gambling and a third will do so shortly, but the others have elected not to join that effort.

To enforce each state’s determination, online gambling operators will have to ensure that only bettors from authorized jurisdictions can play on their sites. Systems for enforcing territorial restrictions have been refined in connection with online betting on horse races, and with Canadian online gambling. In addition, in several European nations, including Italy and France, online gambling licensees can accept bets only from residents of that country. Although no territorial enforcement system will be perfect, a high degree of compliance can be achieved through the customer identification procedures outlined above. All of the public and private data bases consulted through that verification process will confirm or question the customer’s address, allowing the operator to exclude the extraterritorial customer.

The identification checks can be reinforced by a geolocation system that locates the IP address (“Internet protocol” address) of the computer that the customer is using. Except when that location is close to a geographic border or is otherwise cloaked, existing databases of IP

addresses will reveal the jurisdiction in which the customer is located. The British Columbia Lottery Corporation and the New York State Lottery use this technology to ensure that only residents of those jurisdictions gain access to online gambling, as do the U.S. companies that take online bets on horse races through hubs in Oregon. Indeed, these techniques are routinely used to ensure the territorial identity of customers in other industries, such as when Major League Baseball imposes geographic limits on the online distribution of a video version of its games. Although there are techniques for defeating geolocation systems, a territorial screening system can identify when those techniques may be in use. In those situations, an online gambling operator can decline to provide service until the customer provides additional evidence of his location. The British Columbia Lottery Corporation follows this procedure. Regulators also can test how effectively an operator is enforcing territorial limits by using “mystery shoppers” to attempt to register online from forbidden jurisdictions.³³

Regulators have had less success, however, in keeping out of their markets those offshore operators that have not acquired licenses to serve those markets. For example, after Svenska Spel had strong initial success with its online gambling service in Sweden, it has steadily lost market share to unlicensed offshore operators.³⁴ Although the Canadian online gambling operation is still in its first year of operation, competition from unlicensed offshore operators has forced it to revise downward its anticipated revenues.³⁵

Excluding Underage Gamblers

Many who oppose legalization of online gambling recite first and most prominently the danger that young people will gain access to online gambling sites. This objection overlooks the reality that unlicensed online gambling sites are freely accessible today, and that those operators based in the lightly-regulated jurisdictions in the Caribbean may make little or no effort to exclude underage gamblers. Nevertheless, customer identification procedures can do a thorough job of excluding underage gamblers. Regulators in Canada, Oregon and Europe report that they receive almost no complaints that their operators have permitted underage gamblers on their websites. Comparable age-verification procedures are currently followed with success by online vendors of liquor and tobacco, and by the websites of Hollywood movie studios.³⁶

The process of screening out underage gamblers follows many of the steps that are applied to determine the geographic location of customers. Through the customer identification procedures described above, including telephone follow-up when required, online gambling operators can usually determine when an applicant is below the legal age for gambling. Because

“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.”

online operators require that customers have credit cards or bank accounts, underage customers ordinarily can gain access to gambling websites only by impersonating a parent or other adult; follow-up screening of such applications by customer service personnel will often reveal the impersonation. In the unlikely event that the online gambling operator is deceived by the impersonation, the deception will be revealed as soon as the parent or other adult receives a monthly bank or credit card statement reflecting the minor’s activity on the website.

A report prepared in 2009 by a professor from the Kennedy School of Government at Harvard University concluded that current methods of excluding underage gamblers from online websites are effective: “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.”³⁷

Implementing Responsible Gambling Programs

Research has demonstrated that only about 1 percent of the people in any community become pathological gamblers. Indeed, researchers also have found no evidence that online gamblers are more likely to be pathological gamblers.³⁸ A major British study found no increase in the rate of pathological gambling between 1999 and 2007, even though online gambling became widely available during that period. Similar results emerged in a study of Swedish gamblers.³⁹

Although the prevalence of pathological gambling is low, and even though there is no evidence that online gambling will change that pattern, many jurisdictions require that online gambling operators include tools to help customers control their gambling. These steps involve the display of information on players’ screens about the availability of counseling and other assistance for those unable to control their gambling. In addition, customers are given access to current information about how much they have wagered and lost, and how long they have played. Other tools can be provided that allow the customers to impose limits on their own play:

- Allowing the customer to direct the website to exclude him from play for a specific period of time, or indefinitely.
- Allowing the customer to direct the website to cease sending promotional notices to him.
- Allowing the customer to establish limits on his activity on the website, including:
 - how much he can deposit into his gambling account per transaction, or over a period of time (for example, per week),⁴⁰

- the maximum bet the player can make,
- the total amount he wishes to be able to lose in a specific period of time, or
- the total amount he may maintain in his account (for example, in the British Columbia system, an account may not hold more than \$9,999 for more than 72 hours).⁴¹

In many systems, customers must wait out a specified period (often seven days) before they can change the settings they have set on these “player protection” features; that “cooling-off period” is intended to ensure that the customer fully considers any changes in the limits he has imposed on his own play.⁴²

Academic research suggests that relatively few online gamblers use the limits that are made available through social responsibility programs, but a substantial majority of those gamblers like having those player protection tools available on gambling websites.⁴³ By requiring that licensed websites include those social responsibility protections, legalization of online gambling would actually improve efforts to assist pathological gamblers. Today, without any U.S. regulation, there are no uniform requirements for player protection tools at gambling websites. Indeed, many foreign jurisdictions, especially in the Caribbean, require no such tools, so gambling operators located in those jurisdictions often do not provide them. In addition, a portion of online gambling tax revenues and license fees can be directed to research about pathological gambling, as well as to treatment and public education on the subject. For these reasons, the report prepared by the Harvard Kennedy School professor concluded that “regulators should be able to design sufficient protections to prevent any significant growth in problem gambling that results from legalization.”⁴⁴

Legalization Proposals in the United States

Both federal and state lawmakers have proposed legalization and regulation of online gambling, arguing that such a move will (i) provide consumer protections for Americans who will continue to bet online despite government policies banning the activity, (ii) establish appropriate law enforcement tools to prevent illegal online gambling, (iii) generate jobs and economic opportunities in this country, and (iv) provide tax revenues for government.

As noted above, UIGEA included an implicit recognition that any state or tribal government may authorize Internet gambling that is confined to its own jurisdiction. Several states have been considering such a course, but none has done so yet. The District of Columbia is moving forward with an online gambling plan now, though Congress could obstruct it.⁴⁵

Although each state should have the discretion to decide whether or not to permit online gambling within its borders, as is done under the Interstate Horseracing Act, individual states should not be able to create their own online gambling regimes. The result would be a legal patchwork that would make little economic sense, with online poker permitted in one state, a state lottery offering casino games in a second state, and a third state authorizing only Internet blackjack. The result would be confusion for consumers and an inefficient overlap in regulatory effort.

Legalization by individual states might spur congressional action on pending legalization proposals. At the national level, two major legalization initiatives have emerged. Rep. Barney Frank, while he was chair of the House Financial Services Committee, introduced and held hearings on a bill that would have created a licensed Internet gambling industry, subject to federal regulation. The Internet Gambling Regulation, Consumer Protection, and Enforcement Act was reported favorably by the House Financial Services Committee in July 2010, but progressed no further. Reps. John Campbell and Frank have reintroduced the legislation in the 112th Congress.⁴⁶

At the very end of 2010, when the outgoing Congress met in a “lame duck” session, Senate Majority Leader Harry Reid of Nevada actively considered presenting a bill to legalize only Internet poker, though he never moved forward on that plan.⁴⁷

Through these legislative activities, several central issues have been defined concerning the possible legalization of online gambling in the United States, including:

- What games should be legalized: the more modest course, followed by Sen. Reid, would legalize only online poker.
- Preserving traditional state control over gambling matters: both federal legislative efforts would allow each individual state to exclude online gambling from its borders.
- What regulatory body should oversee online gambling operators: the Campbell-Frank legislation would create a federal regulator, while Sen. Reid was considering an approach that would use existing state gaming commissions to regulate online operators.
- Whether regulatory measures can protect key social values by ensuring that underage gamblers are excluded, that bets are not accepted from jurisdictions that have barred online gambling and that pathological gamblers have tools to help them control their gambling. Both legislative initiatives would require such social responsibility protections.
- The need to create effective law enforcement tools to combat illegal online gambling, including establishing a list of illegal operators so financial institutions may refuse to complete payment transactions.

The federal legislative proposals also would preserve the status quo with respect to sports betting (explicitly barring it) and online betting on horse races (explicitly preserving the current betting arrangements under the Interstate Horseracing Act) and with state lotteries.

For a viable online poker business to thrive, some core economic questions will have to be addressed. First, legislation would have to specify the eligibility for licensing of online poker operators that are currently based overseas. These fall into several categories. A number of those operators have not been accepting bets from U.S. residents since UIGEA was enacted in 2006. Others, like PokerStars, Full Tilt, and Absolute Poker and Ultimate Bet, continued to accept bets up until the recent Black Friday indictment. And many offshore sites now continue to accept bets from U.S. residents. In defining what offshore operators are eligible for licensing in the U.S., federal legislation properly would recognize the different equitable positions of those different types of offshore operators.

In addition, any overseas operators who already are serving large numbers of online poker players would have a substantial liquidity advantage if they could combine new American customers with their existing pool of players. That increased liquidity would allow them to offer a much more attractive range of games and tournaments in the early months following legalization. To avoid that unfair advantage, both France and Italy have barred their licensees from pooling customers from within their countries with foreign customers. The United States would be well advised to follow that model.

The most vexing problem, as explained above, is how to exclude unlicensed operators. After legalization, licensed and unlicensed operators each would enjoy certain competitive advantages. The licensed operators would be able to offer customers greater assurance that their games are honest and that the operators will honor their financial commitments. In addition, many of the licensed operators already have their own brand names from operating bricks-and-mortar casinos or operating online in other markets. Operators with land-based properties in this country would be able to cross-market those properties and offer participation in their existing customer loyalty programs.

Moreover, DOJ enforcement against payment processors for foreign operators has increased the cost of taking online bets from the United States by any unlicensed operator. The payment processing schemes described in the Black Friday indictment were elaborate and expensive to follow. In order for offshore companies to continue to take bets from the United States, they will have to develop new schemes for processing payments. Those schemes would be at least as elaborate and expensive to consummate. Operators serving the U.S. market without a license also would have to expect occasional seizures of their funds from U.S. bank

(I)t will be important to create clear criminal statutes that exclude unlicensed operators and to fashion law enforcement tools to make that exclusion a reality.

accounts. One industry participant estimates that, in current conditions, foreign operators taking U.S. bets must pay 10 percent or more of their revenue to process payments; in contrast, that cost would be less than 1 percent if conventional credit card merchants like Visa or MasterCard were able to handle the transactions.

Yet the unlicensed operators would enjoy advantages from not having to compete on a level playing field. They would be free to pool American players with those from overseas markets, and thus offer greater liquidity. They often have their own brand names, built up over years of flouting American law. Because the unlicensed firms would usually be subject to less regulation in their home jurisdictions, their costs of operation are likely to be lower, though that advantage would be somewhat offset by the higher costs they would incur to arrange sub rosa payment processing. Finally, if the U.S. were to legalize only online poker, then unlicensed offshore operators would continue to be the only option for those U.S. residents who prefer other online gambling activity, such as casino games or sports betting.

Perhaps most important, the effective tax rate on licensed gaming operators would loom large in any competition between licensed and unlicensed operators. Gambling websites based in the Caribbean now pay almost no taxes and minimal license fees. For example, Costa Rica imposes a maximum tax of \$54,000 per year on its online gambling operators; Antigua requires only an annual license fee of \$75,000; the Kahnawake Mohawks in Canada charge only \$10,000 per year. For U.S.-licensed operators to compete effectively with unlicensed operators from those jurisdictions, it will be essential to set a moderate tax rate. Both France and the United Kingdom found that their tax rates were initially set too high, which made it far too easy for unlicensed operators to continue to command substantial market shares in their countries.

In view of these countervailing advantages in the marketplace, the unlicensed poker operators will continue to be able to command a significant market share. In addition, they will be the only providers of online gambling other than poker. That would leave many American consumers still exposed to the risks of doing business with lightly regulated firms and would reduce the tax and license fee revenue generated by legalization. Consequently, it will be important to create clear criminal statutes that exclude unlicensed operators and to fashion law enforcement tools to make that exclusion a reality.

A high priority will be to build tough technological fences that keep unlicensed offshore operators out of the U.S. market. This could involve an adaptation of a current program to control money laundering through the Office of Foreign Asset Control (“OFAC”). Just as OFAC maintains a constantly-updated list of individuals and entities whose financial

transactions should be questioned, law enforcement agencies can maintain a similar list of unlicensed offshore gambling operators. Italy now follows a similar policy. With legalization of online poker in this country, U.S. regulators also will be able to coordinate with their counterparts in foreign countries to further refine and target their enforcement efforts. Other approaches may include adapting technologies now used to exclude spam from e-mail accounts, or affixing an electronic signature to transmissions relating to licensed Internet gambling sites and thereby making it easy to screen unlicensed transmissions. All of these techniques should be authorized as part of the essential law enforcement element of U.S. policy.

Conclusion

In the almost five years since UIGEA was enacted, we have learned critical basic lessons about online gambling in the United States. Those lessons should guide the nation's policy response to online gambling today.

First, despite energetic and creative enforcement efforts by DOJ, online gambling by U.S. residents continues in every community, largely unabated. Until now, the principal effect of DOJ enforcement has been to drive the more responsible online gambling operators out of the market, leaving U.S. residents at the mercy of relatively unregulated operators.

Second, the tools have been developed to regulate online gambling effectively, protecting key values: excluding underage gamblers, protecting the integrity of the games, ensuring that bets are not accepted from jurisdictions where online gambling is prohibited, barring money laundering and providing tools for the customers themselves to control their own gambling. A top priority should be achieving equal regulatory effectiveness in the exclusion of unlicensed operators from a market.

Third, it is possible to create a tightly-regulated online poker industry that protects consumers, grows jobs and generates meaningful new tax revenues.

From these lessons, Congress can build a comprehensive policy on Internet gambling that includes (i) legalization of Internet poker at the option of each individual state, (ii) a uniform regulatory structure to ensure essential consumer protections, and (iii) reinforced law enforcement tools to exclude lightly-regulated offshore operators who would take advantage of an un-level playing field to siphon dollars from the U.S. market. The result would be a limited online gambling industry, subject to strict regulation, which generates jobs, economic opportunity and public revenues.

APPENDIX: U.S. Enforcement Efforts Against Online Gambling Operators

The dominant U.S. policy toward online gambling has been to prohibit the activity and pursue legal enforcement actions against operators and those providing financial services to operators. The legal foundation for this policy and its results have been mixed.

U.S. Laws On Internet Gambling

Because Congress has never enacted a specific prohibition on Internet gambling, federal prosecutors have had to rely on two statutes that were adopted in the 1960s to deal with telephone betting operations, plus the recently-enacted UIGEA.

For much of the last 10 years, the Wire Act has been the principal tool used in online gambling prosecutions, beginning with the prosecution in 1999 of Jay Cohen, who ran an Internet gambling business in Antigua.⁴⁸ A controversy over the scope of the Wire Act quickly emerged. The statute applies to people who transmit information over wires that relates to “bets or wagers on any sporting event or contest.” Ruling in a civil lawsuit in 2002, the U.S. Court of Appeals for the Fifth Circuit held that the Wire Act reaches only betting on sporting events, concluding that the term “sporting” in the key phrase modifies both “event” and “contest.” That ruling emboldened many Internet gambling operators, who concluded that U.S. law prohibited only online sports betting. That ruling, however, has never been applied in a criminal case. Indeed, federal courts in Utah and Missouri have rejected that reasoning in two criminal prosecutions, specifically holding that the Wire Act reaches all forms of online betting — in effect, that “sporting” in the key statutory passage does not modify “contest.”⁴⁹

In a recent prosecution, DOJ has charged online gambling operators with violating the federal Unlawful Gambling Business Act, which applies to “illegal gambling businesses.” That statute defines an illegal gambling business as one that (i) violates state law, (ii) is operated by five or more persons and (iii) receives at least \$2,000 per day in revenue. Both this statute and the Wire Act were adopted in the early 1960s as part of a drive against telephone bookmaking services, long before the Internet was operating.⁵⁰

At the end of 2006, Congress attached UIGEA as an amendment to the Safe Ports Act. The statute does not apply directly to online gambling, attempting instead to choke off financial transactions related to “unlawful Internet gambling.” The law provides only a circular definition of “unlawful Internet gambling,” describing it as online gambling that is “unlawful under any applicable Federal or State law in the State or Tribal

lands.” UIGEA bars online gambling businesses from engaging in financial transactions relating to unlawful Internet gambling, even though those businesses are ordinarily located offshore, beyond the reach of American prosecutors. The law also may be used against a person or financial institution for aiding and abetting such transactions.⁵¹

Although most gambling over the Internet crosses state and national borders, eight states have nevertheless enacted legislation barring online gambling.⁵² In five additional states, the state attorney general has issued an advisory opinion that Internet gambling is contrary to the state’s law.⁵³

A major exception to the general government hostility toward Internet gambling concerns betting on horse races. Under the Interstate Horseracing Act of 1978 (IHA), as it was amended in 2000, the horseracing industry has developed an online system of “advanced deposit wagering” (ADW) through “hubs” that are regulated by the states that authorize them; the largest hubs are based in Oregon and regulated by the Oregon Racing Commission. If the state in which a bettor resides has authorized ADW, the individual may deposit funds with one of the hubs for pari-mutuel wagering on races at tracks across the country. The individual then may direct that the funds be wagered as he wishes. The amount wagered through Oregon’s hubs has increased from \$6.4 million in 2000 to \$1.445 billion in 2010.

This explosive growth has occurred even though DOJ takes the position that the IHA amendment in 2000 did not apply to the federal criminal gambling statutes, such as the Wire Act, and thus that pari-mutuel wagering may not be conducted over the Internet.⁵⁴ Despite announcing that position, DOJ has taken no action against online betting on horse races, which has flourished.

Criminal Prosecutions

Since 2006, DOJ has consistently pressed to build criminal prosecutions against some of the largest online gambling operators. Although criminal prosecutions had occurred earlier, the DOJ campaign crashed into public consciousness in July 2006 with the arrest of David Carruthers of BetOnSports.com, a Costa Rica-based sports betting business, while he was changing planes at the Dallas-Fort Worth Airport. Nine months later, the founder of that business, Gary Kaplan, was seized in the Dominican Republic and taken to the United States to stand trial. Both men pled guilty in federal court in St. Louis to conspiracy to violate the Wire Act. Kaplan was sentenced to 51 months in prison and paid a fine of \$43 million; Carruthers received a sentence of 33 months.⁵⁵

DOJ next challenged PartyGaming PLC, which was the largest online poker company until the enactment of UIGEA persuaded it to exit the U.S. market. In 2008, one of the company’s founders, Anurag Dikshit, entered

a guilty plea to a charge of violating the Wire Act. He was sentenced to probation and forfeited \$300 million. The company entered into a non-prosecution agreement in return for forfeiting \$105 million.⁵⁶ An online betting firm based in the United Kingdom, Sportingbet PLC, forfeited \$33 million in a September 2010 deal with prosecutors.⁵⁷

DOJ also challenged a number of payment processors, which perform the financial transactions between online gambling firms and their customers. Two founders of NETeller, a major payment processor based in Canada, pled guilty to money laundering charges in New York in 2007. The parent company of NETeller entered a separate agreement to forfeit \$19.2 million.⁵⁸ Another payment processor, Douglas Rennick, was indicted in 2009. He later pled guilty to violating the Wire Act, forfeiting \$17 million in return for a sentence of six months probation.⁵⁹ An Australian payment processor, Daniel Tzvetkoff, was arrested while visiting Las Vegas in April 2010 and charged with bank fraud, money laundering and the first criminal charges brought under UIGEA. He is cooperating with prosecutors, leading to speculation that he provided key information supporting recent criminal charges against leading online poker companies.⁶⁰ Other payment processors have faced federal criminal charges in Utah, Pennsylvania and Maryland.⁶¹

The most sensational DOJ action was the recent indictment of 11 individuals associated with the three largest Internet poker operators that still accepted bets from U.S. residents — PokerStars, Full Tilt Poker, and Absolute Poker/Ultimate Bet. Because eight of the named defendants in that indictment reside overseas, the government has arrested only three individuals so far. Once more, the charges focus on payment processing activities, which have emerged as an Achilles heel for the offshore operators that continue to take U.S. bets. The gambling operators generally can keep all of their gambling operations beyond the physical reach of United States law enforcement, but have to form U.S. connections in order to arrange financial transactions with their U.S. customers.⁶² DOJ filed a parallel civil complaint against the corporate entities controlled by the three online poker operators, demanding the forfeiture of their Internet domains.⁶³

The market's response to these charges — often referred to as the Black Friday indictment — was swift. Until those charges were announced, PokerStars and Full Tilt enjoyed a dominant position in the global Internet poker market, with a combined market share of more than 60 percent. They achieved that dominance to a considerable degree because they continued to serve American players. Within a day of the

indictment, both firms stopped taking new bets from U.S. residents; the third poker business involved, which operates Absolute Poker and Ultimate Bet, continued to allow Americans to play but not to deposit or withdraw any funds. Overall online gambling activity by U.S. residents immediately dropped; the Internet traffic on Full Tilt Poker, for example, fell by 40 percent from the previous week. Those operators still willing to take bets from U.S. residents, however, showed some increases in traffic.⁶⁴

The criminal and civil charges filed on Black Friday accuse the defendants of engaging in bank fraud and money laundering, as well as violating UIGEA and operating unlawful gambling businesses. The charges describe several ways that the defendants were able to evade UIGEA and keep the money flowing between them and their U.S. customers.

First, the government contends, the defendants created phony online businesses with innocuous-sounding names, such as www.petfoodstore.biz and www.bedding-superstore.tv. The offshore operators routed credit card transactions with their customers through those front companies, which also involved mis-coding the transactions so the credit card companies did not realize that the funds were connected to online gambling.

Second, the government alleges that the defendants fostered the expansion of pre-paid, anonymous credit cards (or “stored value cards”) which could be purchased in local retail locations, including CVS, Target and Wal-Mart. Although those stored value cards can theoretically be used in other types of commercial transactions, the government asserts that they were almost exclusively applied to online gambling.

A third financial arrangement described by the prosecutors was more elaborate. The operators arranged for third parties to open bank accounts through which they could funnel customers’ funds in the form of “e-checks,” which are electronic payments conducted through the Automated Clearinghouse (“ACH”) system. Again, the defendants allegedly first ran the customers’ payments through phony businesses, such as a website devoted to environmentally friendly living, [Green2YourGreen](http://Green2YourGreen.com), or www.oneshopcenter.com or www.mygolflocation.com.

A final arrangement for payment processing, as described by the government, involved gaining effective control over SunFirst Bank of St. George, Utah, a struggling financial institution. The defendants allegedly invested \$3.4 million in the bank and paid its president \$20,000. In return for processing payments for Pokerstars and Full Tilt, the bank received above-market fee compensation on each transaction.

Civil Enforcement Strategies

At least three different civil enforcement strategies have been employed against online gambling in the United States: (i) challenging Internet firms for accepting advertising for illegal online gambling, (ii) seizing online gambling funds from bank accounts where they reside temporarily, and (iii) shutting down the Internet domains that are used for illegal online gambling.

Internet Advertising — In late 2007, the three largest Internet firms entered into settlements with the U.S. Attorney in St. Louis, who charged them with accepting advertising that promoted illegal Internet gambling. Microsoft paid \$21 million, Yahoo paid \$7.5 million, and Google paid \$3 million.⁶⁵ The case drove advertising by offshore Internet gambling operators from major Internet sites.

Bank Seizures — In more than a half-dozen actions, DOJ has seized more than \$100 million of bank funds that were deposited by payment processors working for offshore gambling websites. These actions exploited the vulnerability of the payment processing system and laid the groundwork for the Black Friday indictment:

- ESI Entertainment Systems (\$9.1 million, 2008).⁶⁶
- Wachovia, Bank of America, Sun Trust, Regions Bank (\$24 million, 2008).⁶⁷
- Zippayments.com (\$9.8 million, 2009).⁶⁸
- Wells Fargo, Citibank, Goldwater Bank, Alliance Bank of Arizona (\$34 million, 2009).⁶⁹
- Mercantile Bank (\$860,000 2010).⁷⁰
- Electracash, Direct Channel, HMD, Forshay Enterprises, Atrium Group (\$5 million, 2010).⁷¹
- Allied Wallet, Allied Systems (\$13 million, 2010).⁷²
- Etegrity Processing, Arrow Checks, Secure Money, Anaya Trading Solutions, Blue Lake Capital Management and Logistics (\$8 million, 2011)⁷³

Shutting Down Internet Domains — Two states have tried different strategies for closing down websites that conduct illegal online gambling, though neither strategy has worked very well. In 2009, the Minnesota Department of Public Safety gave notice to 11 Internet service providers (ISPs) that they should block 200 sites that were accepting online bets in alleged violation of the Wire Act. After a trade association of online sites challenged the state’s action in federal court, the state abandoned its effort. None of the ISPs had taken any steps to implement the state’s demand.

In September 2008, Kentucky filed an in rem action in state court seeking the forfeiture of 141 Internet domains used for illegal online gambling. The lawsuit still continues almost three years later. A trial court granted the state’s petition, but the Kentucky Court of Appeals granted an emergency petition to overrule that order, holding that a domain name was not a “gambling device” that can be seized under Kentucky law. The Kentucky Supreme Court then found that the prevailing party in that appeal lacked standing to conduct the case, so a new petitioner has been substituted, and the case has been returned to the trial court to decide whether the new petitioner has standing.⁷⁴

Endnotes

¹ Our estimate is adapted from a paper issued by H2 Gambling Capital, “United States: Regulated Internet Gambling Economic Impact Assessment,” April 15, 2010.

² H2 Gambling Capital, “Quarterly Interactive Gambling” (April 2011).

⁵ Spectrum Gaming, White Paper for National Indian Gaming Association, p. 5 (2010).

⁴ Marcos Charif, “UK Online Gaming – Where Did Things Go Wrong?”, *European Gaming Lawyer* (Winter 2010); “It’s all about the tax,” Global Betting and Gaming Consultants, www.gbgc.com, February 9, 2011.

⁵ www.playnow.com; “BCLC share online poker with Loto Quebec,” *Gambling News*, November 20, 2010.

⁶ Eric Pfanner, “Governments in Europe Warming to Online Gambling,” *New York Times*, July 28, 2010. A listing of current licensed gambling sites in European jurisdictions can be found at www.GamingZion.com. See also “Italy the Clear Online Gaming Frontrunner,” *Online Casino Reports*, February 10, 2011; “Italy Preparing to Implement Additional Online Wagering,” *Online Casino Spotlight*, February 17, 2011; “Dutch Government Seeks to Allow Online Gambling,” Reuters, March 19, 2011; “Online Gambling: Estonia Issued the Second License,” *Estonian Free Press*, April 14, 2011; “Nevada regulators back Caesars’ Internet Gambling Gambit,” Reuters, March 25, 2011.

⁷ France recently reported that revenues from online sports betting had dropped by 26.5 percent in the first quarter of 2011, and some estimate that unlicensed operators command more than three-fourths of the online sports betting market in that country. After initial success, Svenska Spel in Sweden has steadily lost market share to offshore operators from the first two groups of licensing jurisdictions. (Jonas Odman, “Trouble Ahead for Poker in France?”, *EGR Magazine*, December 7, 2010; James Kilsby, “Svenska Spel Retreats as Pokerstars Shine in Sweden,” *Gambling Compliance*, February 16, 2010.) Although only in its early months of operation, the Canadian online gambling operation is struggling with the same offshore competition and has had to revise downward its anticipated revenues. (Bob Mackin, “Lotto corp. feels heat as gambling support wanes,” 24 Hours Vancouver, February 15, 2011.)

⁸ Jonas Odman, “Trouble ahead for poker in France?”, *EGR Magazine*, December 7, 2011; Graham Wood, “Le Débat,” IGB Affiliate, February/March 2011, p. 23; “La cote des paris sportifs sur Internet plonge,” *Le Figaro*, April 10, 2011.

⁹ “Italy and France – Will Start-ups bother to get a license?”, Global Betting and Gaming Consultants, www.gbgc.com, February 9, 2011;

¹⁰ “French ISPs fight requirement to block illegal betting sites,” *Telecom Paper*, March 18, 2011; “ISP Block Failure Forces Italy to License Poker Cash Games and Casino Games,” *EGR Magazine*, September 6, 2009. Some technology professionals suggest that offshore operators can stay one step ahead of the governments and the ISPs by constantly changing their URLs. For example, the FBI has seized the domain www.pokerstars.com, but U.S. residents still can gain access to www.pokerstars.eu and www.pokerstars.uk. Moreover, for many poker operators, customers do not always gamble through the website. Rather, customers download an application to their computers that links them directly with the poker operator’s server. The confiscation or disabling of the website’s Internet domain has no effect on transactions conducted in that manner; experts estimate that some online poker operators are connected with 90 percent of their customers in this fashion. Similarly, Norway, which bans online gambling entirely, adopted a policy that followed the approach taken in this country’s Unlawful Internet Gaming Enforcement Act of 2006 (UIGEA) of barring all financial transactions relating to offshore gambling operators. After nine months, the Norwegian government abandoned the effort, finding that traffic to illegal online gambling sites was increasing despite the financial transaction ban. Jane Fae Ozimek, “Norway gov mulls blocking online gambling,” *The Register*, February 24, 2011.

¹¹ Source: H2 Gambling Capital, “National Summary Sheet” (April 2011).

¹² 15 U.S.C. §§ 3001, et seq.

¹³ *In re Mastercard International, Inc.*, 313 F.3d 257, 262-63 (5th Cir. 2002) (Wire Act applies only to sports betting); *United States v. Lombardo*, 639 F. Supp. 2d 1271, 12818-82 (D. Utah 2007) (rejecting *In re Mastercard*); Report and Recommendation concerning David Carruthers, *United States v. Kaplan*, No. 4:06CR337CEJ(MLM) at 7 (E.D. Mo., May 7, 2007) (rejecting *In re Mastercard*).

¹⁴ 31 U.S.C. §§ 5361-5367.

¹⁵ 31 U.S.C. § 5362(10)(b), (c).

¹⁶ Superseding Indictment, *United States v. Scheinberg*, No. S3 10 Cr 336 (LAK) (S.D.N.Y. March 10, 2011).

¹⁷ Verified Complaint, *United States v. PokerStars*, No. 11 CIV 2564 (S.D.N.Y. April 14, 2011).

¹⁸ *Poker Scout*, April 16, 2011 & April 17, 2011; “H2’s first take on the fallout from the Poker Stars et al. Indictment,” H2 Gambling Capital, www.h2gc.com, April 18, 2011; Aaron Todd, “Victory poker leaves US market while others jockey for position,” *Casino City Times*, April 19, 2011.

¹⁹ H2 Gaming Capital, May 4, 2011; Weekly Online Poker Traffic Update, *Poker Scout*, April 18, 2011; “Poker Liquidity Drops Following US DOJ Action,” Global Betting and Gaming Consultants, www.gbgc.com, April 18, 2011.

²⁰ “Christie Vetoes Bill to Legalize Internet Gambling,” *New York Times*, March 3, 2011; James Rutherford, “California Dreaming – Update on I-gaming Prospects,” Global Betting and Gaming Consultants, www.gbgc.com, April 9, 2011; Jim Sanders, “Internet gambling bill wins support from major Indian group,” *Sacramento Bee*, February 23, 2011; William Petroski, “Iowa Senate OKs bill for Internet Poker study, casino election rule changes,” *Des Moines Register*, April 20, 2011; Steve Sebelius, “Controversy won’t kill Internet poker bill in Carson City,” *Las Vegas Review-Journal*, April 19, 2011; Justin Jouvenal & Michael Laris, “‘Hot spots’ part of D.C. officials’ plan to allow Internet-based gambling in city,” *Washington Post*, April 13, 2011.

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²² “Internet Gaming Regulatory Review,” GLI Europe, pp. 32-33, April 1, 2011 (“GLI Review”); Gambling Act, 2005 Chapter 19 (Eng.), at §§ 70-71; Isle of Man Online Gambling Regulation Act 2001, § 4; Alderney Gambling Control Commission, Electronic Betting Centre License General Condition 10(b); Alderney eGambling Regulations, § 41 (“fit and proper” test for licensing); Malta Remote Gaming Regulations, S.L. 438.04(8).

- ²³ ORS §§ 462.075, 462.725.
- ²⁴ Lefler interview; Oregon Racing Commission, OAR 462-210-0010.
- ²⁵ E.g., GLI Review, pp. 38-39 (Gibraltar), 69-71 (United Kingdom).
- ²⁶ E.g., “Key Regulatory Responsibilities of the Gaming Policy and Enforcement Branch and their Application to the British Columbia Lottery Corporation,” Gaming Policy and Enforcement Branch, British Columbia Ministry of Public Safety and Solicitor General, March 25, 2008.
- ²⁷ OAR 462-220-0070; Alderney eGambling Regulations, § 175.
- ²⁸ Interviews with Phill Brear, head of Gambling Regulation, Gibraltar Regulatory Authority; Andrew Wilsenach, Chief Executive Officer, Alderney Gaming Commission; Steven Lefler, Gaming Policy and Enforcement Branch, Government of British Columbia; Marco Ceccarelli, Caesars Interactive; Suki Sandhu, IGT Interactive.
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About the Author

David O. Stewart joined Ropes & Gray as a partner in 1989 to begin a litigation group in the Washington, D.C. office. His experience in complex litigation includes appellate and Supreme Court litigation, antitrust and commercial disputes, white-collar criminal defense work, health care law, gaming law and a variety of challenges to government regulation and enforcement.

David has served as principal counsel in federal jury trials, state court trials, administrative proceedings, numerous appeals, and the impeachment trial of Judge Walter L. Nixon, Jr. before the U.S. Senate. David argued before the *Supreme Court* in *Ludwig v. Variable Annuity Life Insurance*, 115 S. Ct. 810 (1995), concerning the power of national banks to sell annuities, and also argued for the petitioner in *United States v. Nixon*, 506 U.S. 224 (1993).

David lectures to professional groups on topics including antitrust, gaming law, health care law, money laundering, cable television litigation, and white-collar criminal issues.

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AMERICAN GAMING ASSOCIATION

1299 Pennsylvania Avenue, NW

Suite 1175

Washington, DC 20004

202-552-2675

www.americangaming.org