



Spectrum Gaming Group

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WHITE PAPER:

Internet Gambling Developments in International Jurisdictions: Insights for Indian Nations

Prepared for the National Indian Gaming Association
and Member Indian Nations and Tribes

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Contents

CONTENTS.....	2
I. EXECUTIVE SUMMARY	3
II. INTRODUCTION	11
III. BRIEF HISTORY OF INTERNET GAMBLING.....	12
IV. CURRENT REALITY.....	27
V. PLAYER DEMOGRAPHICS.....	29
VI. INTERNET GAMBLING REVENUE	39
VII. EUROPE	41
VIII. CANADA	47
IX. UNITED STATES	51
X. POKER.....	53
XI. GLOBAL POTENTIAL	55
XII. IMPACTS ON EXISTING OPERATIONS.....	58
XIII. OPPORTUNITIES AND CHALLENGES.....	61
XIV. CONCLUSION	75
XV. ABOUT THIS REPORT	79
XVI. ONLINE RESOURCES	81

Figures

Figure 1: Total number of Internet gambling sites, by quarter 2004-2010	14
Figure 2: Comparison of casino and poker players as of 2007	31
Figure 3: U.K. remote gambling by type of gambling activity	33
Figure 4: By age group, Internet gamblers vs. traditional casino gamblers	36
Figure 5: By education level, Internet gamblers vs. traditional casino gamblers.....	36
Figure 6: Types of online games played among North American Internet gamblers.....	37
Figure 7: Most frequently visited Internet gambling sites by all active gamblers.....	38
Figure 8: Global Internet gambling revenues	39
Figure 9: Global Internet gambling as a percentage of all global gambling revenue	39
Figure 10: Global Internet gambling by product, 2009	40
Figure 11: Global Internet gambling by region, 2009.....	40
Figure 12: European Union member states' approach to Internet gambling, 2008	42
Figure 13: Internet gambling projected revenues if UIGEA were repealed	51
Figure 14: Estimated market for US offshore market	52
Figure 15: Global real-money Internet poker gross revenues.....	53
Figure 16: Real-money Internet poker players by value, April 2010	54
Figure 17: Global Internet penetration rates, 2009	55
Figure 18: Internet users by global regions, 2009	56
Figure 19: Annual gross gaming revenue: European casinos, European online players	59
Figure 20: Annual gross gaming revenue: US commercial casinos, US Indian casinos, US online players...	59
Figure 21: Post-legalization Internet gambling growth in Italy, France Denmark	62

I. Executive Summary

The following are highlights from this report:

- In 2009, Internet gambling generated gross gaming revenue of \$21.7 billion worldwide and \$6.3 billion in the United States.
- The trend in Europe is toward legalization, either through a state-monopoly lottery or through licensing of commercial providers.
- The Unlawful Internet Gambling Enforcement Act has not prohibited Internet gambling in the United States because enforcement does not currently stop access to offshore providers.
- If Internet gambling were permitted in the United States through new federal legislation, such as the bill sponsored by Representative Barney Frank, Internet gambling in the United States would grow from the current \$6.3 billion market to a \$14 billion market with one year of legalization.
- Based upon the experience internationally, Internet gambling in the United States may develop through poker-only legislation at first and Indian nations should be prepared for that possibility.
- The development of the Internet gambling industry in the United States will favor operators who start early, develop expertise, brand recognition and a loyal customer base. Existing land-based casinos with significant brand names and multiple locations may also have an advantage.
- NIGA and its member Indian nations may want to promote restriction of Internet gambling to land-based gambling operators in the United States.
- Because most Indian nations only have a single location and do not enjoy broad brand name recognition, intrastate Internet gambling may be more advantageous for them.
- Several options for development of Internet gambling are available for Indian nations. They include: 1) Start one's own platform; 2) Buy existing software systems; 3) Buy an existing operator; 4) Pool resources and operate as a consortium.

The mass introduction of the Internet in the 1990s ushered in a new era of unprecedented access to information, connectivity and instant communication on a global scale. One result of this was a transformation providing consumers convenience and control of the information and media that they consume. Gambling was a natural beneficiary of the Internet revolution and once introduced to the new medium exhibited rapid growth and worldwide expansion. As with most emergent Internet technologies, gambling incubated and first prospered in the United States. In 2006, the

United States constituted the premier market for Internet gambling, both for casino-style games and poker. Had the ambiguous legal situation surrounding Internet gambling been resolved in favor of the activity at that time, the United States would remain the dominant market globally and US-based companies would now be major players in the global Internet gambling industry.

That scenario did not occur. First, the US government avoided passing any legislation that clearly defined what was legal or illegal. Instead, the US Department of Justice (“DOJ”) relied upon the 1961 Wire Act to establish their position that all Internet gambling is illegal. This position was ambiguous at best, and the DOJ targeted companies or individuals that were engaged only in online sports betting (which is clearly illegal under the 1961 Wire Act). Then, in October 2006, the Unlawful Internet Gambling Enforcement Act (“UIGEA”) was passed as a rider to the Port Security Act. While previous “prohibition” legislation had consistently failed to pass when openly debated, this legislation, which was never debated on the floor in Congress, passed as an attachment to an unrelated “must pass” bill.

Efforts to block Internet gambling in the United States were further fueled by the position held at the time by most commercial land-based operators, which viewed Internet wagering as a competitive threat to their land-based casinos.

The result created a more ambiguous position for the US government, as UIGEA did not define what constituted “unlawful Internet gambling.” UIGEA did not make any gambling activity illegal that was previously legal, and did not make any gambling activity legal that was previously illegal. Its main provisions prohibit Internet gambling operators from accepting money related to any Internet gambling that violates state or federal law, and obliges financial systems to block payments for unlawful Internet gambling, which again, was not defined. The legislation left it up to the US banking and financial services industry to implement and enforce. To the surprise of very few, this attempt at prohibition has not succeeded in eradicating Internet gambling, only in suppressing the behavior and driving the more reputable offshore operators out of the market.

As it stands today, Internet gambling (including poker) is not legal in any state in the United States (with the exception of certain carve-outs for horse-racing), yet the activity continues at levels not far off from pre-UIGEA levels. While many of the premier, publicly traded online operators exited the market after the passage of UIGEA, Americans continue to gamble over the Internet – estimated at \$6 billion annually – with offshore companies that are willing to take the risk, as well as the revenue and profits that go with it.

As a result, no US jurisdiction (national, state, or tribal government) or domestic gaming operator or supplier benefits from the gaming activity in the US market. Currently, the ability of tribal gaming operators to participate in Internet gambling is legally uncertain and, in our opinion, politically risky.

Today, new proposed legislation offers the possibility of legalization of certain forms of Internet gambling, which ultimately will benefit NIGA and its member nations and tribes, as well as the industry as a whole. It promises to establish licensing and regulatory standards; address many concerns associated with the industry, such as money laundering, underage gambling, and problem gambling; and generate significant tax revenue for the federal and state governments.

H2 Gambling Capital projects global Internet gambling gross revenue to be \$30 billion in 2010, which represents about 8 percent of total global gambling gross revenue, and is a 17 percent increase over 2009. Sports- and race-betting is the largest segment of Internet gambling, with 39 percent of the market, followed by casino gaming and poker, both of which account for about 20 percent of global Internet gambling gross revenue. Internet poker generated revenue of \$5 billion in 2009, an annual increase of 27 percent.

Poker played over the Internet continues to expand at double-digit growth rates globally, with the majority of that growth coming from the United States, despite the passage and recent implementation of UIGEA. Global online poker revenues are forecast at \$5.6 billion in 2010, a 14 percent annual increase, and are expected to rise to \$6.7 billion by 2012. Future growth of Internet gambling appears robust, as Internet gambling penetration rates significantly lag overall Internet utilization penetration rates and countries around the world move toward greater liberalization, legalization and regulation.

Europe accounts for 44 percent of global online revenue, followed by Asia with 25 percent and North America with 24 percent. In 2006, prior to the passage of UIGEA, the United States accounted for an estimated 50 percent of Internet gambling revenue worldwide. If Internet gambling is legalized in the United States, there is strong reason to believe that domestic contributions, in any given or legal market segment, would return to approach that level within a few years.

US legalization of Internet gambling is projected to generate more than \$14 billion in gross gaming revenue within a year, rising to \$27 billion within five years, according to H2 Gambling Capital. The inclusion of sports betting would raise these estimates to \$22 billion in year one and \$42 billion by year five. Currently, 2.5 million Americans play online poker and bet \$30 billion annually.

Attempts to prohibit Internet gambling have obviously failed to discourage throngs of American players, as volumes for US-oriented sites have increased 82 percent year to date since 2009. Legalization in the United States would obviously attract established US operators, establish credibility and confidence with existing players, and likely attract new players and generate further growth.

Given the potential for robust continued growth and the probability of legalization in the near future, the question becomes: How should NIGA and its member nations and tribes proceed? The most likely candidate for legalization is online poker because it is already a significant market, is a familiar and hugely popular game in the United States, has the backing of the gaming industry, and will likely generate support in Congress. For Indian nations, preparing for the legalization of Internet poker should become the first priority as it relates to Internet gambling.

Indian nations and tribes will need to decide how best to prepare for and ultimately participate in the US Internet gambling market. There may be opportunities for tribal coalitions to lead a broad-based market strategy and approach, for certain tribes (within a given state, for example) to cooperate with each other on a market strategy and shared product offerings, and for individual tribes to identify and implement their own solutions.

There are existing offshore operators and suppliers who offer highly refined and mature gaming platforms, operating solutions, content and other ancillary systems and solutions that would likely be needed to satisfy US legal and regulatory requirements. It is likely that some of these operators will partner with large US casino companies on an exclusive basis; however, Indian nations and tribes will have a number of product and operational alternatives available for entering the market. Tribal coalitions or individual nations and tribes may choose from a range of alternatives, including those outlined below, although others may emerge based on the final form of legislation:

- Build, deploy and operate a proprietary dedicated solution.
- License a software solution from an existing provider, and deploy and operate it on your own.
- Secure a “white label” solution that would be deployed and operated by an existing provider, and focus your resources on marketing.
- Partner with an existing operator (either through a joint venture or commercial arrangement) to deploy and operate in the United States.
- Buy an existing operator or supplier in order to deploy and operate in the United States.

Each potential solution has its own set of risks, issues, benefits and economic/financial considerations and may be further influenced by whatever legislation ultimately gets passed. Some of the key considerations in evaluating any alternative will be time to market, technical risk, capital risk, licensing, operational, and compliance risk, and economic/financial projections. These are important because the scale and market power of certain existing offshore operators are significant and provide them with potential competitive advantages (time to market, technical, operational, capital, finance/economic), especially in the realm of online poker, where mature, stable, scalable software and infrastructure coupled with broad participation and liquidity are critical.

Depending upon the final results of the legislative process, the tribes should consider partnerships with large offshore operators, at least in regard to poker.

Another potential concern is the prospect of federal authorities assuming wide influence and control over the Internet gambling industry once legalization occurs. This has been the pattern in Europe, where the European Commission has broadly interpreted the European Treaty and repeatedly sought legal action against member state governments when their policies are at odds with European Union regulations. While there may be benefits resulting from the federal government establishing uniform minimum legal, regulatory and licensing standards, this approach is at odds with how gambling is currently conducted in the United States, where at present it is a predominantly states-rights issue. While the federal government is expected to play a role in any new legislation, it would mostly take on oversight of the industry by establishing minimum regulatory and licensing standards, and defining what games are legal, but allowing states and tribal governments to assume jurisdiction, as they do today in the land-based industry.

At the state level, domestic state lottery operators may also present a challenge and become potential competitors to the tribes due to current positioning and strong state government connections. With their existing relationships and established infrastructure and consumer-facing models, they are poised to be competitors in the Internet gambling market. Some companies, such as GTech, already have a full suite of Internet gambling solutions that are operational in offshore markets and could be easily deployed for the US market.

While Internet gambling legalization presents challenges in all these areas, it also offers potential not just in the opportunity for increased revenue but also in the ability to expand product variety and build customer relationships and databases beyond what is currently possible with land-based casino operations. Internet gambling software offers broad product selection, the ability to offer unique games and a diverse

inventory, and online connectivity presents the opportunity to expand the customer base beyond current localities and hours of operation. This ability to extend the customer relationship beyond the walls of the casino environment enables tribal and other land-based operators to extend and enhance their loyalty and rewards programs, which is a significant competitive advantage that the established “Internet only” operators cannot offer.

The prospects for legalizing Internet gambling are uncertain in the near term but very promising long term. Eventually, legalization and regulation will occur, and NIGA should be prepared to offer informed guidance and leadership to its members and to deliver and execute a strategy that will enable NIGA and its member nations and tribes to participate, compete effectively and benefit from the market opportunity. It is our view that Internet gambling should not be considered separate from existing operations, but rather an extension and enhancement to current tribal gaming strategy, positioning, marketing and operations.

Indeed, we believe that Internet gambling can best assist land-based operators – be they tribal or commercial – as a means of broadening the customer base and cultivating new land-based customers. This would be a benefit above and beyond the direct revenue generated over the Internet. As a corollary to that, we suggest that tribes would not be able to realize the optimal benefits of Internet gambling if it evolves strictly as a revenue stream open to any potential licensee, from lotteries to foreign operators.

This report provides the following conclusions:

- The restrictions on Internet gambling introduced by UIGEA have not eliminated the practice; they have only inhibited it. As was the case with Prohibition, gamblers will continue to wager when it is made available to them. In an unregulated market, however, the transactions move offshore or underground. As demonstrated by UIGEA, legislation intended to prevent the transactions has failed in its mission to do so, and has only spawned more creative ways for transactions to be facilitated.
- European states have developed regulatory and taxation frameworks, in many cases under the European Union constitutional umbrella, which have allowed Internet gambling to grow into a legitimate industry, without the issues or adverse affects cited by supporters of prohibition.
- European states offer a variety of successful regulatory models, ranging from partial to complete legalization and open-market to state-monopoly operations. Some of these jurisdictions, like Alderney, have emerged as

model jurisdictions, which the United States may choose to emulate in some form.

- As it stands today, tribal and other legitimate, licensed US commercial gaming operators and suppliers do not have the option of participating in the US market. New proposed legislation would open the door to tribal casinos to participate in the US market where states opt-in, and enable them to make their own decisions about if, when and how to participate.
- The US market represents a tremendous revenue opportunity. It is currently \$6 billion and could grow to as much as \$14 billion in gross gaming revenue within a year of legalization. If Internet gambling becomes legal again in the United States, it is expected that there also will be significant growth opportunities in the market.
- Gaming software platforms, gaming content, payment systems, security and verification systems, operating infrastructure, affiliate, marketing, and loyalty systems, finance, accounting, and reporting systems, analytics, compliance, and other ancillary systems have been developed and refined over time and currently exist in a state of full development and maturity.
- Internet gambling operations pose many of the same operational, compliance and marketing challenges that land-based casinos do. However, they also include added technical challenges and specific online operating expertise that are not typical for land-based casinos.
- Some major offshore online operators, which are in a position to be licensed, are poised to quickly enter the domestic market should legalization occur. Some of these operators are likely to partner with established US land-based gaming operators and suppliers to improve their credibility and speed to market.
- There will be alternatives, as noted earlier, for entering and participating in the US Internet gambling market, each with its own set of risk and reward. Time to market, technical risk, capital risk, licensing, operations and compliance risk, and economic considerations are some of the critical factors to be considered.

Concentrate on poker. Poker likely will be the first form of Internet gambling to be legalized in the United States. It is already a significant market, is a familiar and hugely popular game in the United States, has the backing of influential gaming industry participants, has helped to attract a new generation of potential gaming consumers, and

will likely generate support in Congress and ultimately with states looking to generate new sources of tax revenue. The evolution of Internet gambling has shown that those companies that entered the market early and were first to establish meaningful customer bases and liquidity, were the most successful and dominant companies over the long term. Preparing for, and entering the market with, a poker solution will enable participants to build necessary operating and marketing expertise and provide time to build the necessary integration with existing land-based operations. Other gambling verticals, such as casino, bingo or sports betting, will be available and easily integrated with existing systems from existing providers when and if they are made legal. Additionally, this will serve to establish an online customer base to market those products and services to. This is a model that has played out in the international Internet gambling market and which we believe will evolve the same way in a legalized and regulated US market.

We caution, however, that the advent of Internet gambling in the United States presents potential scenarios that can differ significantly from what has occurred in other markets, particularly because the land-based industry here is so pervasive.

With that in mind, we suggest that land-based operators – including tribal operators – do have inherent advantages in an online world, especially the notion that they are able to identify good customers and incent them with rewards to visit their land-based operations. Pure online operations – including lotteries – do not have that advantage. This advantage needs to be leveraged by tribal operators, and should have a prominent place in any legislative strategy employed by NIGA or its member nations and tribes.

We must also note that most tribal governments are limited to one or perhaps a few locations that are focused on the local adult population as the primary customer base. This business model can prove to be a disadvantage in an online world, where customers can play at any casino and may be tempted to play at casinos that are affiliated with land-based operations in Las Vegas or other resort destinations, at sites that are pure-play online providers, or at sites that offer a more compelling and entertaining gaming experience.

II. INTRODUCTION

The National Indian Gaming Association (“NIGA”) commissioned Spectrum Gaming Group (“Spectrum,” “we” or “our”), an independent research and professional services firm, to undertake an Internet gambling white paper to explore the background and history of Internet gambling, examine the current political and economic situation, review how legalization affected overseas markets in the past, and identify opportunities and threats posed by potential US legalization to the tribes.

This report reviews and summarizes the experience of international jurisdictions and patron demographics with respect to Internet gambling. It demonstrates how Internet gambling has evolved in other jurisdictions and offers appropriate insights into the relevance of this experience as a potential roadmap as to how Internet gambling may evolve in the United States. While we inevitably look at domestic trends, that is not the primary focus of this report.

We add the important caveat – with explanation and illustration – as to how factors that may be unique to domestic gaming may affect this evolution. We also discuss, as appropriate, the relevant political and other factors that could also guide this evolution into various areas.

“Internet gambling” is broadly defined as any monetary wagering transactions conducted over the Internet. This definition includes casino games, poker, sports betting, lottery, bingo and various other games of chance currently available online through gaming websites. This definition may be expanded to include other delivery media, such as mobile or interactive television, in which case it is commonly referred to as remote gambling.

Many of the revenue estimates and projections in this report are provided by [H2 Gambling Capital](#), a reputable London firm that we have found provides credible data for an industry in which facts and figures are too often secret, unverified or not credible.

III. Brief History of Internet Gambling

Early Growth

Internet gambling first became possible in the mid-1990s as the medium matured, technology evolved in the areas of computer graphics and transaction processing, and entrepreneurs began to realize the Internet's potential for gambling. Two key innovations enabled the rapid growth of Internet wagering.¹ First was the development of the first fully operational Internet gambling software in 1994 by Microgaming, a software company now licensed and incorporated in the Isle of Man. Second was the development of encrypted communication protocols in 1995 by Cryptologic, which provided secure online monetary transactions.² Starnet Communications, based in Canada, also began providing Internet gambling software beginning in 1994, as did the Swedish based software developer BossMedia, which was acquired in 2008 by GTech, now a division of Lottomatica Group.³

In 1994, the government of the Caribbean nation of Antigua and Barbuda passed the Free Trade & Processing Zone Act, which created a legal jurisdiction and allowed licenses to be granted to operate online casinos, albeit without any meaningful regulation and enforcement.⁴ The first official online casinos began play for fun operations in 1995, and several sports books, including Interops, Sports Book, and Ladbrokes, put up websites listing odds and providing toll-free telephone numbers for placing bets. The first case of money wagered over the Internet by the general public appears to be the online purchase of International Lottery tickets for a manual drawing that occurred on October 7, 1995, in Lichtenstein.⁵

The title of first online casino is claimed by both The Gaming Club and Intercasino, but the first money wager on casino games is attributed in January 1996⁶ to Intercasino, which was based in Antigua and opened with an initial offering of 18 online games and access to the National Indian Lottery. Intercasino was largely controlled by Cryptologic, whose early success was founded on the back of its exploitation of the US market through Intercasino. A period of rapid expansion ensued as game inventories

¹ Robert Williams and Robert Wood, *Internet Gambling: A Comprehensive Review and Synthesis of the Literature*, University of Lethbridge, Alberta, Canada, August 2007

² *The History of Internet gambling*, 777.com, Online Entertainment, Ltd.

³ onlinecasinoarchives.com, November 15, 2008

⁴ Antigua & Barbuda Investment Authority, www.investantiguabarbuda.org

⁵ Williams and Wood

⁶ Internet gambling.com, 2006

and user interfaces steadily improved. In 1996-97, other Caribbean islands (Netherlands Antilles, Turks & Caicos, Dominican Republic, Grenada, St. Kitts & Nevis) and several Central American countries (Belize, Costa Rica, Panama) began hosting online wagering sites. Starnet Systems began granting licenses to casino operators along with their customized software packages in return for a percentage of earnings, which was used to fund its own betting site, WorldGaming.net. Microgaming soon released the first progressive online slot machine, Cash Splash.⁷ The first Internet bingo site offering cash prizes online was established in 1998.⁸ The first Internet poker room went online in the same year at www.planetpoker.com.

Eurobet in the United Kingdom began offering online sports- and race-betting in 1996.⁹ Centrebet, located in the Northern Territory of Australia began offering online sports betting in 1996 and three more sports books were in operation by the end of 1997.¹⁰ The National Lottery of Finland was granted a license to operate online lotteries in 1996¹¹ and the Coeur d'Alene Tribe in Idaho opened an online lottery in 1997. Canada became an important incubator for Internet gambling when on June 10, 1996, the Kahnawake Gaming Commission was formed to license and regulate online casinos and to enforce gaming fairness standards. The Commission is based in the Mohawk Territory of Kahnawake, a community of 8,000 Mohawk tribal members located on the south shore of the St. Lawrence River near Montreal.¹²

During 1997, Internet gambling experienced such explosive growth, increasing from an estimated 15 sites at the end of 1996 to more than 200 by the end of 1997.¹³ By the end of 1998, there are approximately 700 online casinos in operation, processing real-money wagers (as opposed to play-for-fun wagers) in several currencies and producing annual revenues estimated between \$835 million to \$1 billion, with US players contributing two-thirds of the total revenue. By the end of the millennium, the figure had grown to an estimated \$2.2 billion.¹⁴

In the decade since it first became feasible, the industry boomed at such a rate that today there are an estimated 42.8 million unique, real-money Internet-gambling

⁷ Internet Gambling History, Online Casino Project. <http://onlinecasinoproject.com/internet-gambling-history.html>

⁸ Williams and Wood

⁹ Eurobet, 2007

¹⁰ *Netbets: A review of Internet gambling in Australia*, Report for the Select Committee on Information Technologies. Senate Information Technologies Committee, March, 2000

¹¹ R. van der Gaast, "Finland: Internet gambling Update," September, 2001

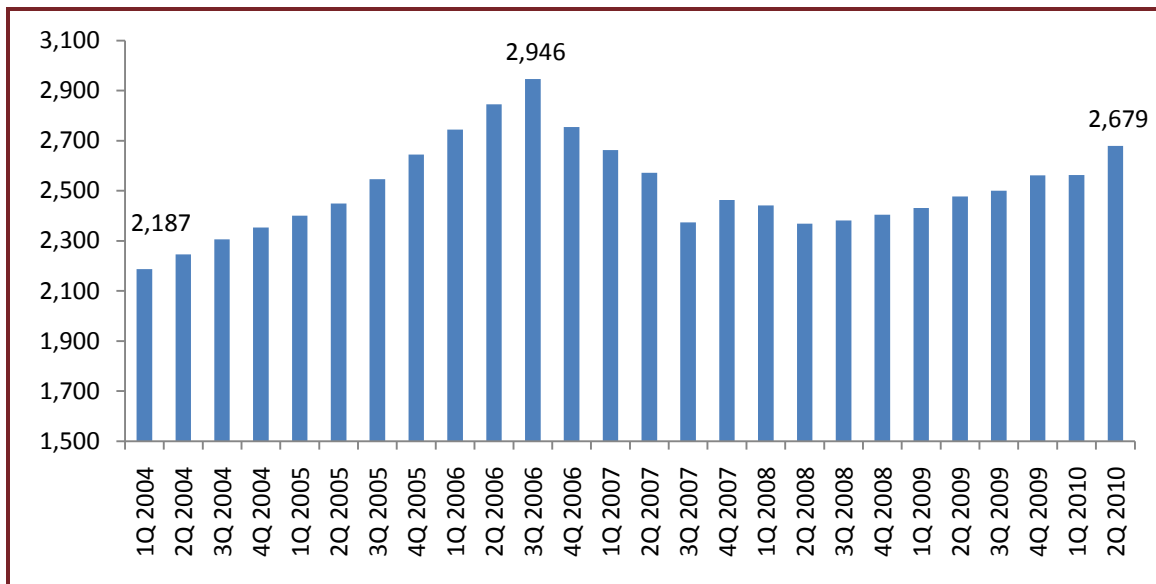
¹² *Kahnawake*, Murray Marshall Internet Gambling Report, Fifth Edition.

¹³ Schwartz, 2006

¹⁴ Hammer, R.D. (2001). "Does Internet gambling strengthen the US economy? Don't bet on it". *Federal Communications Law Journal*, 54(1), 103.

accounts worldwide and, as of June 30, 2010, some 2,679 Internet gambling sites in operation.¹⁵

Figure 1: Total number of Internet gambling sites, by quarter 2004-2010



Source: H2 Gambling Capital

While revenue data vary, conservative estimates have the industry growing from less than \$1 billion in revenue in 1997 to \$10.9 billion in 2006, the year in which UIGEA passed in the United States, which forced the exit of many of the larger online operators from the US market. At that point, however, the table had been set for most of the current dominant online operators who on the back of the US market were able to achieve levels of scale, expertise and financial success that enabled them to move into new markets with relative ease and maintain their business models. The Internet has truly revolutionized gaming, allowing gamblers to instantly place wagers on an incredible variety of games and events at any time of day from the comfort of their own homes.

Legal Backlash

The fact that US players were accounting for the majority of Internet gambling revenues began to draw attention from US lawmakers by the late 1990s. In 1997, a Republican senator from Arizona, John Kyl, drafted the first of several bills to ban Internet gambling. Called the Internet Gambling Prohibition Act, the bill intended to

¹⁵ H2 Gambling Capital

make the marketing and sale of betting-related goods and services to US citizens illegal. It did not pass, however, and online wagering continued to thrive.

Canada began a similar crackdown on the industry when the Royal Canadian Police raided Starnet offices in Vancouver on the premise that Starnet's email server based there constituted an illegal extension of betting activities under the Canadian Criminal Code. Starnet was later fined \$100,000 for its involvement in Internet gambling.¹⁶

As opposition to Internet gambling intensified, Kyl revised the Prohibition Act, but the bill failed to pass the US Congress a second time. A third revision of the bill by Virginia Republican Bob Goodlatte also failed to pass in the US House of Representatives.

In Australia, the Northern Territory Government in 1999 granted the first and only online casino license to Lasseters, a land-based casino located in Alice Springs, and other territory governments mulled their own Internet gambling legislation. In early 2000, Norfolk Island and other Australian states and territories had modeled Internet gambling legislation and regulation after the Northern Territory, and in some cases had issued licenses to prospective operators. However, in late 2000, largely because the states and territories could not agree on cross-state tax remuneration and could not come to agreement with the federal government on taxes and responsible gaming provisions among other issues, the Australian government put into effect the Interactive Gambling Moratorium Act, which prohibited any online casino or sports book formed and in operation after May 2000 against operating from Australian soil. In 2001, the Australian government passed the Australian Interactive Gambling Act banning online casinos and sports books offering services to Australian citizens. Lasseters today remains the only online casino operating from Australia, as it was already operating under a valid license; it can still operate offshore but cannot take bets from Australians.

From 2001 onward, Internet gambling was marked by legislation and lawsuits. The United States still sought to end Internet gambling, whereas the United Kingdom did all it could to make it a legalized and profitable venture, particularly for its licensed land-based sports books, many of which have emerged as leading online operators on the basis of their strong existing customer bases and government support.

¹⁶ Internet Gambling History, Online Casino Project. <http://onlinecasinoproject.com/internet-gambling-history.html>

Worldwide Expansion

In the face of the legal backlash, successful Internet gambling sites began to take action to become more respectable and establish what they hoped would be legitimate operations and business and gaming practices by hiring such accounting firms as PricewaterhouseCoopers to audit gaming software and ensure fair payout percentages. They also began to develop player-loyalty and rewards programs, many of them linked to land-based gaming or business operations, as Internet gambling continued to expand. Many of the top software providers were taken public in 2005 and early 2006 at the height of the market and are traded on major exchanges worldwide.

After four years of operations, Cryptologic reported approximately 680,000 players had used its software to make betting-related financial transactions.¹⁷ Also after public offerings, PartyGaming, Playtech and 888.com emerged not only as some of the largest Internet gambling companies, but in terms of revenue and earnings some of the largest gaming companies – land-based or online. PartyGaming, for example, was valued at \$8.5 billion at the time of its 2005 initial public offering, and its recent merger with bwin International makes it one of the most formidable gaming companies in the world – and gives it the strength and capital to potentially move in to land-based gaming.

By 2001, the estimated number of patrons who have gambled online neared 8 million and Internet gambling became truly global. Argentina, which licensed its first online casino, was followed soon after by the UK territories Isle of Man, Alderney and Gibraltar, which began issuing licenses to companies to operate Internet gambling websites. In Africa, Sun International Hotels used Boss Media software to build an online version of its casino, licensed and operated out of the Isle of Man. Europe-based online casino operators became surprised by the strength of business in Asia and began actively marketing to the region. Cassava Enterprises, operating the popular Casino-On-Net site from Antigua since 1997, incorporated in Gibraltar and set up a new subsidiary in 2003 titled 888.com after the lucky numbers in Chinese culture.¹⁸

Global Internet gambling revenue for offshore companies was estimated to be \$5.9 billion in 2008 from players in the United States and \$21.0 billion from players worldwide, according to H2 Gambling Capital.¹⁹

¹⁷ Internet Gambling History, Online Casino Project. <http://onlinecasinoproject.com/internet-gambling-history.html>

¹⁸ 888Holdingsplc.com

¹⁹ *Internet Gambling Fact Sheet*, American Gaming Association, 2010.

United Kingdom

In England there was less opposition to online betting, and early in 2001 the British Channel Islands legalized online betting, putting protocol standards of licensing applications in place. It is important to note the emergence of both Alderney and the Isle of Man, in 2000 and 2001, respectively, as universally recognized “legitimate” gambling jurisdictions, particularly as it related to the licensing and participation of US land-based gambling companies.

In 2001, the Isle of Man government was one of the first jurisdictions in the world to introduce legislation specifically designed to benefit gambling and Internet gambling firms and fully protect customers. It implemented sufficiently credible licensing, regulation, testing and enforcement, which attracted and enabled MGM Mirage to become the first US land-based casino company to launch an Internet gambling business, focused solely on legal markets, with the full support of the Nevada Gaming Control Board and other jurisdictions in which they were licensed. MGM Mirage ultimately pulled out of the market because restrictive player-acquisition and marketing policies did not enable the company to build sufficient scale to support its operations. This was an important milestone, however, in that the company proved that it could, with the support of its also-licensed US software supplier WagerWorks, conduct Internet gambling legally and credibly in a manner sufficient to satisfy US land-based regulators. Following further recent changes, the licensing and regulatory controls are now more responsive to the needs of the Internet gambling industry.

The Alderney Gambling Control Commission was established in May 2000, and led by Chief Executive Officer André Wilsenach, a former South African land-based regulator, chose to model its regulatory and licensing infrastructure after the Nevada and South African land-based regulatory models. WagerWorks, a US-based gaming systems and content developer now owned by International Game Technology, was the first Alderney licensee and worked closely with the Nevada Gaming Commission as it approached the business and enabled significant publicly traded licensees (BSkyB, World Poker Tour, Virgin, Rank Group, Paddy Power and others) to operate online casinos. By way of its credible regulatory infrastructure, player protection policies and favorable tax structure, Alderney has established itself as perhaps the leading Internet gambling jurisdiction and has attracted the premier Internet gambling operators and suppliers as licensees.

Later in 2001, the Gambling Review Report was released, which supported the legalization of all types of Internet gambling in the United Kingdom. This led to the UK Gambling Bill, a comprehensive piece of legislation legalizing online betting while

allowing more land-based casinos and betting operations. Culture Secretary Tessa Jowell took a major role in revising the bill, imposing strict regulations and high standards for all UK gambling operations. The objectives of the Gambling Act were threefold:

- a) “Preventing gambling from being a source of crime or disorder, being associated with crime or disorder or being used to support crime.
- b) “Ensuring that gambling is conducted in a fair and open way, and
- c) “Protecting children and other vulnerable persons from being harmed or exploited by gambling.”²⁰

A non-profit self-regulatory organization, the eCommerce Regulation and Internet gambling Enforcement (“eCOGRA”)²¹ was established in the United Kingdom in 2003 by Microgaming, bwin and 888.com to provide compliance and advisory services, offer certification to online betting sites, and mediate player disputes. While eCOGRA was somewhat self-serving for its founders, it was helpful in consulting on the drafting of the UK Gambling Act and lobbied for its passage in Parliament.

Approval of the UK Gambling Act²² in April 2005 established Internet gambling as a legitimate industry within the European Union and highlighted the United Kingdom as a model for other jurisdictions contemplating Internet gambling. The Act created the UK Gambling Commission to oversee all regulation enforcement in the areas of licensing online casinos, preventing underage/problem gambling and organized crime, and ensuring gaming fairness through software testing and accreditation, and the publication of game odds and monthly payout percentage reports.

In addition to issuing and monitoring operating licenses, the UK Commission issues codes of practice, investigates and prosecutes illegal offenses and advises the Secretary of State for Culture, Media and Sport. Under the UK Gambling Act, both Alderney and the Isle of Man were “white listed” as it applied to remote gambling, enabling their licensees (many of whom are UK licensed online sportsbooks and land-based operators) to continue to operate from those jurisdictions and market their services to the UK. Unlike the situation in the United States, legalization enabled existing gambling operators with operations in the online sector, including the likes of Eurobet, William Hill and Ladbrokes, to bring their online operations onshore into the United Kingdom, Alderney and Isle of Man.

²⁰ Gambling Act 2005, Part I, Section I

²¹ www.ecogra.org

²² UK Gambling Act, Office of Public Sector Information, National Archives

United States

In the United States, Internet gambling developed and flourished for a decade in a state of limbo in which it was not considered strictly legal or definitely illegal. This ambiguous situation prevented the development of any major US-based, domestic operators while dissuading established casino companies from entering the market. As a result, potential US-based licensees (both operators and suppliers), were at a technical, product and operational disadvantage relative to offshore operators who by then had many years of experience and fully mature, stable and market leading software and infrastructure.

The Federal Interstate Wire Act²³ was passed in 1961 as one of a series of anti-racketeering laws, aimed specifically at suppressing organized bookmaking activities. This law made it illegal to place wagers on live events over phone lines, and experts argued whether it could also be applied to Internet wagering. The majority of legal opinion held that it did not and the US Court of Appeals for the Fifth Circuit ruled in November 2002 that the Federal Wire Act prohibits electronic transmission of information for sports betting across telecommunications lines but affirmed a lower court ruling that the Wire Act “‘in plain language’ does not prohibit Internet gambling on a game of chance.” Until the passage of UIGEA in 2006, the DOJ largely relied on its interpretation of the Wire Act to establish its position that all Internet gambling is illegal, despite the Fifth Circuit ruling. It is generally believed that the DOJ has not tested this ruling because it did not want to establish any further precedent as it related to casino and other forms of “non-sports wagering” online, and has only pursued cases against companies that operated or helped to facilitate online sports betting.

The anti-Internet gambling lobby grew more powerful in the new millennium and influenced Congress to pressure large US-based search engines, such as Google and Yahoo, to cease advertising for Internet gambling companies. Casino City countered by filing a lawsuit against the US government, claiming its First Amendment rights to free speech were violated, but the case was thrown out after multiple appeals.²⁴ Today, online advertising for casino sites flourishes on television, radio, print and even at land-based casino events such as the World Series of Poker, albeit for “.net” sites that are “free-play” sister sites to the “cash-play” offshore gambling sites.

In 2001, Nevada passed legislation that allowed the Nevada Gaming Commission, working with the Nevada Gaming Control Board, to adopt regulations governing the

²³ US Code, Chapter 50 - Gambling, Legal Information Institute, Cornell Law School

²⁴ *Internet Gambling History*, Online Casino Project, 2007

licensing and operation of Internet gambling in the state. The law required Nevada regulators to study Internet gambling systems and determine if the proper technology and security measures existed to regulate it and prevent access by minors. Even though Nevada regulators found that Internet gambling could be adequately controlled, they also were required to determine if Internet gambling could be operated in compliance with federal law. In 2002, the US Department of Justice advised Nevada of its view that federal law currently prohibits gambling over the Internet, including casino-style gambling. As a result, Nevada put its efforts on hold until the issue is resolved by the US government.

While Nevada took steps to legalize Internet gambling, other states took an opposite approach. Illinois, Indiana, Louisiana, Massachusetts, Oregon, South Dakota and Utah passed laws expressly banning Internet gambling within their borders. Additionally, attorneys general in Florida, Kansas, Minnesota, Oklahoma and Texas have issued opinions that Internet gambling is illegal in their states.²⁵

Unlawful Internet Gambling Enforcement Act (UIGEA)

The Unlawful Internet Gambling Enforcement Act²⁶ was passed in October 2006 by attaching it as a rider to the “must pass” Safe Port Act. The objective of this law was to suppress Internet gambling by attacking the payment mechanisms used to make deposits, place bets and withdraw funds on the thousands of offshore Internet gambling sites in operation. The law did not render illegal any form of wagering that had been legal or vice versa. Its intent was rather to develop a means of enforcing existing law.

Rather than attempt to reach offshore operators by strengthening US anti-gambling laws, the legislation made it illegal for banks, credit card companies or similar institutions to process financial transactions for Internet gambling sites. It effectively prevented credit card companies and banks from processing fund transfers for Internet gambling transactions. The bill is notable for what it does *not* do: It does not update the federal Wire Act of 1961 to specifically apply to all forms of Internet gambling; does not resolve the dispute between the US Justice Department and the Fifth Circuit Court on whether the Wire Act applies to all forms of Internet gambling; does not resolve whether the US horse racing industry is legally entitled to an exemption from a ban on Internet gambling; and does not resolve whether Native American tribes retain the right to operate Internet gambling sites regardless of federal restrictions. Essentially, the bill

²⁵ American Gaming Association website, Industry Information Fact Sheets: Internet Gambling, 2010

²⁶ H.R. 4411:Internet Gambling and Enforcement Act, Govworks.com

maintains the status quo in the United States, never clearly defining exactly what is legal or illegal online wagering.²⁷

While UIGEA targets illegal Internet gambling by attempting to cut off its payment mechanisms, the issue of Internet gambling remains a states-rights issue.

UIGEA preserves the right of each state to determine and enforce its own policies prohibiting or regulating gambling. However, as noted with the case of Nevada, it is unlikely that any state will attempt to make Internet gambling legal and implementing a licensing and regulatory infrastructure enabling Internet gambling until the US government clarifies its position and, specifically, provides legislation making it legal to do so. We and other observers closely following this process anticipate that any new federal legislation would still enable states to opt-in, or opt-out, effectively enabling them to establish their own policies and maintaining the states-rights position regarding gambling that exists today.

Although the law remains ambiguous, after passage of this bill, most large, eCOGRA-certified and publicly traded Internet gambling operators voluntarily withdrew from the US market and implemented geographic sourcing software to prevent US residents from gambling on their sites. While this caused a tremendous impact to the operations and financial results of many of those companies, it only marginally impacted the play of US residents who migrated to other offshore providers that were willing to take the risk of continuing to market to US players. PokerStars and Full Tilt Poker were two examples of companies that chose to stay in the US market, and as a result are now two of the largest, most dominant poker networks in the world.

Because the law remains ambiguous, US authorities began a crackdown on sports betting operators and alternative-payment providers and imposed sanctions on offshore gaming companies (which began even before the passage of UIGEA), activities which now are interpreted as clearly illegal. This caused Antigua and Barbuda to open a case with the World Trade Organization (“WTO”), which denied US appeals and rules the US government to be in noncompliance with WTO trade policy because the legislation retains carve outs for Internet gambling, including lotteries, horseracing and fantasy sports betting.

In 2007, Antigua requested permission to retaliate and asked for the right to suspend \$3.4 billion worth of US intellectual property rights annually. The United States challenged Antigua’s estimate, claiming the true value would have been \$500,000. The WTO agreed to authorize the suspension and settled on a figure of \$21 million annually.

²⁷ American Gaming Association, Industry Information Fact Sheets: Internet Gambling, 2010

As of yet, Antigua has not introduced legislation that would allow the suspension of intellectual property rights held by US firms, largely due to the damage it would do to their reputation internationally. The ultimate resolution of this case is being closely watched by US movie, music, software and pharmaceutical industries, which have a stake in preventing a precedent-setting act of IP rights suspension.²⁸

UIGEA went into effect in mid-2007, allowing a 270-day period for financial institutions to develop enforcement measures. The legislation was supported by the National Football League and other major sports organizations, as it specifically did not target fantasy sports (provided they are not gambling), but was opposed by the banking industry, which was saddled with enforcement duties. The European Parliament²⁹ noted “the Act has a remarkable genesis in that it was (a) never debated by the Senate before being passed into law, and (b) was constructed as a late addendum (Title VIII) to a completely unrelated piece of legislation, namely the Safe Port Act.” Professors Robert Williams and Robert Wood of Lethbridge University, Canada, observed that in practice, the UIGEA bites providers rather than consumers,³⁰ and that Internet gambling continues because only 50 percent of all Internet gambling sites refused to take wagers from players located in the United States after full enforcement of the law in 2007.

The Federal Reserve and Department of the Treasury released the final regulations in November 2008 but still did not state a clear definition of what is considered “illegal Internet gambling.” The final rule places the enforcement burden on financial institutions, such as banks and credit card companies, but instructs financial institutions not to spend time looking at individual credit card transactions, but rather to perform “due diligence” to make sure that their commercial customers are not in the Internet gambling business. They must undertake the same “know your client” processes that they already use to prevent money laundering. The final regulations went into effect on January 19, 2009, and companies originally had until December 1, 2009, to comply. However, just days prior to when the regulations would have gone into effect, the Department of the Treasury and the Federal Reserve Board extended the compliance date to June 1, 2010.³¹

²⁸ Isaac Wohl, United States International Trade Commission, “The Antigua-United States Internet gambling Dispute,” *Journal of International Commerce and Economics*, July 2009,

²⁹ Robert Young and Jonathan Todd, “Internet gambling, Focusing On Integrity And A Code Of Conduct For Gambling,” European Parliament, Policy Department, Economic and Scientific Policy, November 2008

³⁰ Williams and Wood

³¹ American Gaming Association, Industry Information Fact Sheets: Internet Gambling, 2010

Internet Gambling Regulation and Enforcement Act (IGREA)

House Financial Services Committee Chairman Barney Frank referred to UIGEA as the "one of the stupidest pieces of US legislation ever passed."³² Subsequently, Frank spearheaded efforts to delay or defeat UIGEA, drafting the Internet Gambling Regulation and Enforcement Act ("IGREA") in April 2007, two months prior to UIGEA enforcement, and a series of similar proposed legislation culminating in the current bill before the House, HR 2267 – the Internet Gambling Regulation, Consumer Protection, and Enforcement Act.³³ The pending legislation would license and regulate Internet gambling and allow states and tribal governments to assume jurisdiction. It would establish a federal regulatory and enforcement framework under which Internet gambling operators could obtain licenses authorizing them to accept bets and wagers from individuals in the United States.

A companion bill, the Internet Gambling Regulation and Tax Enforcement Act of 2009, was introduced by Representative Jim McDermott, a Democrat from Washington. Under this bill, any establishment licensed under IGREA would be required to pay a 2 percent fee (i.e., federal tax) on all deposits. In addition, the bill would increase the protections against tax cheating. Passage of these bills is not expected prior to the November mid-term elections, and final passage is uncertain, but this legislation promises to generate sufficient debate and attention to force some action on the part of the United States to address and liberalize policy regarding Internet gambling and for the first time set national standards and realize tax revenues.

We believe that the impetus for the passage of legislation legalizing and regulating Internet gambling stems primarily from the potential for \$42 billion in tax revenue over 10 years. The prospects for this incremental tax revenue, given challenging fiscal situations both at the federal and state levels, have caused numerous state and federal legislators to rethink their positions regarding Internet gambling and come out in support of legalization and regulation.³⁴ Additionally, new legislation now has the support of influential gaming companies and industry organizations such as Harrah's Entertainment, which has taken the land-based industry lead in supporting and driving legislation, and the American Gaming Association ("AGA"), which has recently changed its stance with regards to Internet gambling from "opposed to" to either "neutral" or "supportive," to be determined on a case-by-case basis depending upon the nature of the proposed legislation.

³² Jerry Garner, "Can Barney Frank Save Internet gambling?" Associatedcontent.com, April 27, 2007

³³ Govtrack.com

³⁴ Sewall Chann, "Congress Rethinks Its Ban on Internet Gambling," *New York Times*, July 28, 2010

The AGA's position is as follows:

"American Gaming Association has followed the issue of Internet gambling since the mid 1990s. Historically, AGA members have questioned the adequacy of technological safeguards to prevent money laundering, underage gambling and participation by residents of jurisdictions where it is deemed illegal. After considerable study, however, our concerns about technology have been eliminated by advancements in the field, and the AGA believes that the technology now exists to properly regulate Internet gambling with appropriate law enforcement oversight and to provide appropriate consumer protections for individuals gambling online. However, the AGA also believes that existing laws do not adequately protect the millions of Americans who gamble online every day.

"Thus, the AGA acknowledges that a properly regulated legal framework for Internet gambling is the best way to protect consumers. The AGA also believes that Internet gambling operators and suppliers should be held to the same level of probity to which AGA members adhere in their traditional land-based operations. The AGA will continue its policy of putting any gaming legislative proposal through three tests: 1) The legislation must not create competitive advantages or disadvantages between and among legal commercial casinos, Native American casinos, state lotteries and pari-mutuel wagering operations; 2) No form of gaming that currently is legal shall be made illegal; and 3) The legislation must respect fundamental states' rights in an appropriate manner. Decisions on whether to support, oppose or remain neutral on individual pieces of legislation will be made by the AGA board on a case-by-case basis."³⁵

Poker

The first Internet poker room, planetpoker.com, opened in 1998, but it was in 2003 that online poker experienced a tremendous rise in popularity, especially in the United States.

First, online poker was the perfect application for the Internet. The Internet enabled people to connect and participate remotely, and the more people that participated, the larger the variety of games became available, and the potential winnings and tournaments grew accordingly.

³⁵ American Gaming Association website, Industry Information Fact Sheets: Internet Gambling, 2010, http://www.americangaming.org/Industry/factsheets/issues_detail.cfv?id=17; accessed September 1, 2010

Next, PartyPoker pioneered online poker tournaments in 2001, which proved to be enormously successful and have been emulated by nearly every other online poker site since then. On the back of this, PartyPoker emerged as the most dominant poker provider (pre-UIGEA) and has reaped the marketing value ever since.

Finally, in late-2001, the World Series of Poker (“WSOP”) was first televised on ESPN and in 2002 the World Poker Tour (“WPT”) made its debut on the Travel Channel in the United States. This not only created huge interest in tournament poker by creating broad-based consumer awareness but also gave poker sites an advertising platform enabling them to reach tens of millions of people. As a result, those sites offering big-money tournaments started to see a huge increase in player participation. The culmination of all this was in 2003, when Chris Moneymaker, an “Internet-trained” poker player, won the \$2.5 million main event in the 2003 World Series of Poker. Broadcast on ESPN and supported by advertising from PartyPoker, it made poker a household name. WSOP and WPT broadcasts on cable networks improved poker’s public image and it became a legitimate sporting competition in many consumers’ eyes, and the major online poker sites became prominent advertisers and promoters.

Up until this point, online poker was played primarily on sites focused on US consumers. But with the media attention, opportunities for advertising and enormous growth, Europe and other markets began to take notice. Ladbrokes launched its online poker site in 2002, with Microgaming, focusing on the UK and Scandinavian markets. It proved surprisingly popular and soon many other European sports betting companies made efforts to enter the market.

With proven success on both sides of the ocean, a wave of new poker sites were launched, many of them under the network model, in which the network provider was able to introduce and aggregate, play from multiple sites. This model allowed the big Internet gambling firms to get into the poker business far more quickly than if they tried to develop their own software. It also meant that they could offer their player bases a variety of attractive games, tournaments and prizes as a result of the liquidity derived from the network.

In 2004, Full Tilt Poker was launched, fronted by some of the biggest names in poker, including Chris Ferguson and Howard Lederer, who were also involved in developing the software. Involving professional players proved to be a successful strategy, and Full Tilt took full advantage of it with televised endorsements by the pro players. As a result, Full Tilt emerged as one of the largest most successful poker

offerings.³⁶ By 2005, there had emerged a handful of dominant poker sites and networks that accounted for the majority of online poker revenue in the United States and internationally, which largely remained intact until the passage of UIGEA.

The legality of online poker in the United States remains questionable, as some industry organizations and legal experts argue that it is a game of skill rather than a game of chance, where players use their skill to assess the cards and other players actions in order to win and where players wager against each other instead of against the house. The US Department of Justice maintains the position that the online game is illegal and has prosecuted several important firms. After passage of UIGEA in 2006, some of the most successful online poker operators, including PartyGaming, exited the online US poker market. In 2009 PartyGaming agreed to pay a penalty of \$105 million as part of a "non-prosecution agreement" with the DOJ. Neteller and others have reportedly reached similar settlement stemming from their participation in the US market.

The exit of PartyPoker, 888.com, Paradise Poker, Cryptologic and others from the US market left an opportunity for other companies willing to take the legal risk of continuing to operate in the US market to take advantage of the forfeited market share. PokerStars and Full Tilt Poker, privately held firms backed by US residents, with a willingness to take on the risk, emerged as and continue to be the dominant providers for US players.

PokerStars, the largest Internet gambling company globally in terms of the number of players, said in a statement: "Since UIGEA by its terms did not alter or amend existing federal, state or tribal gambling laws, and since PokerStars' long standing position is that it has at all times operated in a lawful manner in the United States, June 1st will bring about no change to PokerStars' philosophy with respect to its US customs."

So far, neither company has been sanctioned or been the public focus of any DOJ action. It remains to be seen how or if they will be able to be licensed or participate in the US market once legislation passes making online poker legal. In spite of UIGEA, the US online poker industry continues to service at least 2.5 million Americans who play and bet \$30 billion annually.³⁷

³⁶ *Internet Gambling History*, Online Casino Project, 2007

³⁷ *Legal Deadline Ups Ante For Online Poker*, by Nathan Vardi, *Forbes.com*, June 1, 2010

IV. Current Reality

Operators

As of June 30, 2010, there were 2,679 Internet gambling websites owned by 665 different companies.³⁸ The breakdown of sites by sector shows 865 online casinos, 616 poker rooms, 516 sports- or race-betting sites, 426 online bingo sites, and 187 other/lottery sites.³⁹ **(See “Resources” at the end of this report for links to directories of Internet gambling operators, jurisdictions and software providers.)**

Many Internet gambling companies create multiple websites and brands or offer and operate “white label” sites to third parties while in exchange for a share of the revenue generated from the marketing of the those sites. While a minority of operators have developed proprietary software that they operate for their own benefit, the majority utilize commercial software made available by third-party suppliers or operators. As of 2007, the most prevalent of these third-party sites and providers included Playtech (177 sites), Microgaming (169 sites), Electracade (115 sites), 24hNetwork (98 sites), Net Entertainment (93 sites), and World Gaming (105 sites).⁴⁰

Given the large number of sites and operators, and owing to the operational, liquidity and financial benefits generated by scale and participation in multiple markets, we expect that there will be significant consolidation in the industry. With the legalization of the US online market, this consolidation may accelerate among companies that are able and interested in participating in the United States. This is particularly true among large casino operators and suppliers that seek to acquire or otherwise partner with existing operators and suppliers to speed their time to market and secure certain operating expertise and infrastructure. On July 29, 2010, Gibraltar-based PartyGaming announced plans to merge with Australia-based bwin International, a merger that would result in the world’s largest publicly traded gambling company, with a stock value of \$3.3 billion at current prices and combined revenues of €631 million (\$885.6 million).⁴¹

³⁸ H2 Gambling Capital

³⁹ Ibid

⁴⁰ CasinoCity.com

⁴¹ Simon Zekaria, “PartyGaming, Bwin Plan Gambling Merger,” *Wall Street Journal*, July 30, 2010

Jurisdictions

As of 2010, there are approximately 80 international jurisdictions⁴² regulating Internet gambling in at least one form of wagering. These include more than 40 accredited jurisdictions that certify sites in multiple types of Internet betting. It should be noted that some of these jurisdictions license offshore online casinos but do not permit their own residents to gamble online.⁴³ It is also important to note that certain jurisdictions merely issue licenses to operate in exchange for a fee as compared to a relative few that have implemented credible, US land-based style, licensing and regulatory frameworks. The following jurisdictions have the most number of active licenses:

1. Malta – 378
2. Netherlands Antilles – 303
3. Gibraltar – 260
4. Costa Rica – 219
5. Kahnawake (within Canada) – 203

(See “Resources” at the end of this report for directory links for Internet gambling jurisdictions.)

⁴² “Internet gambling Jurisdictions,” Casinocity.com

⁴³ “*Internet Gambling History*,” Online Casino Project, 2007

V. Player Demographics

The total number of people currently gambling online is estimated to be between 14 million and 23 million. The estimates break down the geographic participation to be between 28 percent and 35 percent (4 million) of US citizens (in 2006 prior to full enforcement of UIGEA); 49 percent (7 million) Asia/Pacific; and 23 percent from Europe; with the United Kingdom accounting for one-third of the European total.⁴⁴

Internet gambling penetration appears to be low but is increasing rapidly relative to broader Internet penetration estimates. In Europe, which has emerged as the premier market for Internet gambling since the passage of UIGEA, the penetration rate appears to average approximately 6 percent. The 2007 British Gambling Prevalence Study found that 6 percent of the population had gambled online, up from only 0.2 percent in the 1999 survey.⁴⁵ As of 2009, the Internet gambling penetration rate in the United Kingdom is 10.6 percent.⁴⁶ Meanwhile, the prevalence for Internet gambling is higher among men (9 percent) than women (3 percent) in Great Britain. In the United States, the penetration rate was found to be between 3 percent and 4 percent⁴⁷ prior to the passage of UIGEA. We believe that this low penetration rate holds promise for sustained future growth in both of these significant markets, fueled by increasing Internet penetration and utilization of mobile handheld devices.

Research consistently shows that Internet gambling behavior is more prevalent among men – usually on the order of 65 percent to 90 percent male – depending upon the gaming sector and the jurisdiction.⁴⁸ Internet sports books are the most predominantly male, while Internet casinos display a higher proportion of females. For poker, male dominance may be changing as females increasingly participate in events such as the WSOP. Research also shows that Internet gamblers tend to be younger. This is particularly true of such traditional casino card games as blackjack and baccarat, and especially for poker. An eCOGRA survey conducted in 2007 found the strongest representation of poker players in the 26-35 age group, but casino players were more strongly represented in the 46-55 age category.⁴⁹ Internet bingo displays higher-than-

⁴⁴ American Gaming Association, *2006 State of the States*

⁴⁵ British Gambling Prevalence Survey 2007, UK Gambling Commission

⁴⁶ *Survey Data on Remote Gambling Participation*, UK Gambling Commission, September, 2009

⁴⁷ American Gaming Association, *2006 State of the States* 2006

⁴⁸ Williams and Wood

⁴⁹ eCOGRA (2007b), "An Exploratory Investigation into the Attitudes and Behaviours of Internet Casino and Poker Players," January 2007.

average age and higher-than-average female representation among Internet gambling websites.

Socioeconomic status for Internet gamblers is consistently higher than for the general population. The demographics of Internet users are well documented and show consistently higher education, employment and income levels than the population as a whole, and online gamblers (by definition Internet users) reflect those attributes. A 2006 American Gaming Association study found that 61 percent had at least a college degree; 41 percent earned more than \$75,000 annually, and almost all of them use the Internet for other activities.⁵⁰

It should also be noted that Internet gamblers also reflect a higher-than-expected proportion of handicapped or disabled players, and online gamblers are more prevalent in locations where Internet access is available but which are remote from land-based casinos, implying that issues of access, physical environment and availability may play a role in Internet gambling motivation.⁵¹

While available research on Internet gambling behavior is scarce, the existing studies show that roughly half of all online gamblers place bets on at least a weekly basis and use multiple sites for wagering.⁵² On average, they gamble five hours per week, with a small minority gambling more than 20 hours per week.⁵³ Nine of 10 gamble from a computer located in their own residence while about 4 percent admit to gambling online from the workplace on a regular basis.⁵⁴

The largest known study of Internet gamblers was a 2007 online survey commissioned by eCOGRA and conducted by the International Gaming Research Unit and Nottingham Trent University.⁵⁵ This online study of 10,865 self-selected players from a total of 96 countries showed that the preferred time for Internet gambling to be evening (72 percent), followed by late night (53 percent), and that the typical Internet casino player is likely to:

- Be female (55 percent)
- Be age 46-55 years (30 percent)
- Play 2-3 times per week (37 percent)

⁵⁰ American Gaming Association, *2006 State of the States*

⁵¹ Wood, R.T. and Williams, R.J. (2007b). *Internet gambling: Prevalence, demographics, and behavior*.

⁵² *International Gambling Studies*, R. Wooley, 2003

⁵³ Wood, R.T. and Williams, R.J. (2007a), "Problem gambling on the Internet: Implications for Internet gambling policy in North America," *New Media & Society*

⁵⁴ Ibid

⁵⁵ *Internet Gambling: a secondary analysis of findings from the 2007 British Gambling Prevalence Survey*, Nottingham Trent University, 2008

- Have played for 2-3 years (22 percent)
- Play from home (90 percent)
- Have visited more than six Internet casinos in the preceding 3 months (25 percent)
- Play one to two hours per session (27 percent)
- Wager between \$30-\$60 per session (18 percent)⁵⁶

The typical Internet poker player is likely to:

- Gamble two to three times per week (27 percent)
- Gamble between one and two hours per session (33 percent)
- Play one (24 percent) or two (24 percent) tables at a time
- Play both cash games and tournaments (34 percent)
- Play at minimum stake levels of \$0.50 to \$2.00 (61 percent)
- Wager between 6 percent and 10 percent of their bankroll at a single table at any one time (23 percent)⁵⁷

The 2007 eCOGRA study also showed that, while play time is similar, casino players are more female and older on average while poker players are predominantly male and younger.⁵⁸ However, as the sector matures, recent studies indicate a growing proportion of female poker players wagering online.⁵⁹

Figure 2: Comparison of casino and poker players as of 2007⁶⁰

eCOGRA 2007 Survey	Poker Player	Casino Player
Gender	Male (73.8%)	Female (54.8%)
Age	26-35 (26.9%)	46-55 (29.5%)
Play Time	2-3 hours per week (26.8%)	2-3 hours per week (37%)
Play Session	1-2 hours (33.3%)	1-2 hours (27%)

Accurate demographic data on American Internet gamblers are thin in the public sector after 2007 due to the ambiguous legality of the practice since passage of UIGEA.

⁵⁶ *Internet Gambling: a secondary analysis of findings from the 2007 British Gambling Prevalence Survey*, Nottingham Trent University, 2008

⁵⁷ Ibid

⁵⁸ Ibid

⁵⁹ Proprietary research

⁶⁰ Ibid

An unattributed study of self-selected poker site community members published in 2008⁶¹ supports the eCOGRA data and shows a US player population that is:

- Heavily male (70 percent)
- Comparatively young (81 percent under 60 with 31 percent 40-49 and 30 percent 50-59)
- Relatively well educated (29 percent high school graduate, 33 percent some college, 32 percent college or graduate degree)
- Moderate annual income (54 percent under \$60,000)
- Usually married (70 percent), with more than half (51 percent) having no children living in the home.

The same study shows a wide geographical distribution among US players with 30 percent in the South, 25 percent in the Midwest, 21 percent in the Northeast, 10 percent Central, and 13 percent Pacific West.⁶² The primary reasons for playing online poker are the exciting contest of skill and strategy between players followed by the lure of winning.⁶³ Length of play appears comparable for Americans, with 38 percent playing 1-2 hours and 27 percent playing for four hours.⁶⁴

Further analysis of the 2007 British Gambling Prevalence Survey⁶⁵ shows that when compared to land-based gamblers Internet gamblers in the United Kingdom are more likely to be young adult males, single, relatively well-educated, unmarried, and working in professional or managerial jobs. Land-based gamblers split evenly on gender in this survey while online gamblers were two-thirds male. The strongest representation for age among land-based gamblers was in the 45-64 age group, while more than half of all Internet gamblers (55 percent) were under 34. Consistent with the younger age finding, Internet gamblers were also more likely to smoke (36 percent vs. 27 percent) and consume alcohol during a typical play session than land-based gamblers.⁶⁶ British Internet gamblers are most likely to play, in descending order of frequency, the national

⁶¹ Poker Demographics, Universityofonlinepoker.com

⁶² Ibid.

⁶³ Proprietary research

⁶⁴ Poker Demographics, Universityofonlinepoker.com

⁶⁵ *Internet Gambling: a secondary analysis of findings from the 2007 British Gambling Prevalence Survey*, Nottingham Trent University, 2008

⁶⁶ Ibid

lottery; spread-betting on horses, dogs or soccer; poker; casino games; bingo; soccer pools; and slot machines.⁶⁷

Figure 3: U.K. remote gambling by type of gambling activity⁶⁸

	2006	2007	2008	Sept. 2009
National Lottery	5.3%	6.2%	7.1%	8.2%
Betting (horses, greyhound, football)	1.9%	2.4%	2.4%	3.0%
National Lottery Scratch cards	n/a	n/a	2.4%	2.5%
Poker rooms / tournaments	2.2%	1.6%	1.7%	2.0%
Other lotteries	1.3%	1.2%	1.7%	1.7%
Casino-type games	1.1%	1.1%	1.0%	1.1%
Bingo	0.7%	1.1%	1.1%	1.0%
Football pools	0.7%	0.8%	0.7%	1.0%
Gaming machines (slots)	1.2%	0.8%	0.9%	0.9%
Keno/virtual sports & other games	0.5%	0.5%	0.5%	0.9%
Betting exchange	n/a	n/a	0.7%	0.8%
Other	0.6%	0.6%	0.7%	0.6%
Don't know/can't remember	0.3%	0.4%	0.3%	0.3%

Constructing a demographic profile from all of the above data indicates that, generally, the youngest gamblers are likely to be sports bettors and table games players, followed by poker, and lastly by slot machines and bingo. Men are more likely to bet on sports, play poker, and play table games while women tend to play slots, bingo or other games of skill, such as Mahjong.

It should be noted however, that women are strongly represented in certain table games, such as roulette, and that women are increasingly attracted to Internet poker, as evidenced by the growing number of female celebrity poker players and the increasing proportion of female players.⁶⁹ While insufficient data exist to construct a scale charting demographics by online game type, it is possible to opine that income levels generally increase through online lottery, bingo, poker, slots and table games. Further information will become available when the results of the 2010 British Gambling Prevalence Survey are released early in 2011, and if Internet gambling regulations are

⁶⁷ "Survey Data on Remote Gambling Participation," UK Gambling Commission, September, 2009

⁶⁸ Ibid

⁶⁹ Simon Prodger, "Women Are Increasingly Attracted to Online Poker," Victor Chandler Poker.com

eased in the future it will be easier to conduct targeted quantitative studies to provide this information.

The most popular games identified in the Wood and Williams 2007 study are blackjack (28.3 percent), slot machines (25.2 percent), video poker (15.7 percent), bingo (12.1 percent) and sports betting (6.2 percent). Favorite online casino games in the US market as measured by the AGA study in 2006 are blackjack (78 percent), video poker (65 percent), slot machines (60 percent), roulette (37 percent), craps (29 percent), Pai Gow poker or Let It Ride (24 percent), and baccarat (18 percent). For poker players the favored game is overwhelmingly Texas Hold 'Em.⁷⁰

The reasons people wager online are the same as in land-based operations: The primary motivation is the excitement and fun of gambling, supported by the possibility of winning. Usually players play for the fun and entertainment value, not the profit motive. Poker players, however, act more frequently on the profit motive, believing that their skills will enable them to defeat inferior players.

The primary attraction for gambling on the Internet is convenience, defined as the ability to easily gamble at any time of day from the convenience of one's own home. Other influential attributes include perceived better payout rates, a wide variety and range of available gaming options, the availability of games without land-based equivalents, faster play speed, lower minimum bets (or play-for-fun capability), anonymity and privacy, multi-lingual services, and the ability to easily switch venues and play on multiple sites.

Anonymity is an interesting psychological factor, as players can maintain a greater sense of privacy or even pretend to be someone else online, such as feigning that they are members of the opposite sex in order to gain a perceived advantage in poker. Conversely, Internet gambling and online poker in particular, benefit from the increasing popularity of social networking. Many sites offer real-time chat capabilities so that players may converse through instant messages while they play. This unlikely combination of anonymity and connectivity functions to the advantage of Internet gambling behavior. As social networking has established itself as an important and popular function in the way people use the Internet and interact with each other, "social gaming" has become an enormously successful form of entertainment and revenue generator for its providers. While online poker utilizes elements of the social network, in the future Internet gambling will become increasingly integrated with social networks, improving the entertainment value of the gaming experience, and enabling operators to tap into the massive user communities that have been established.

⁷⁰ American Gaming Association, *State of the States* 2006

What players seek in an online casino site are lucrative bonuses, the widest variety and selection of gaming options, a trustworthy reputation, crisp and appealing graphics, reliable software operation and Internet connectivity, ease of navigation, efficient deposit processes, and speedy and convenient cash-out processes. More experienced casino players also look for responsive customer call-center support, and such players' club benefits as comps, loyalty bonuses and cash back for play.⁷¹

Poker players look for sites with liquidity, meaning a large player base for the ability to easily find games and tournaments that fit their budget and gaming profile. In poker, more experienced players, or "sharks," look for the presence of large numbers of inexperienced players, i.e., "little fish," who are easier to beat and represent a profit opportunity. Players also look for robust software, the ability to play multiple tables, and fast cash-out capability. In addition, individual preferences for tournaments, betting limits, and particular games or game rules often determine poker site preference.⁷²

The North American Internet Gambler

The available research comparing US Internet gamblers and US land-based casino gamblers is thin and largely outdated. This is understandable, as we believe organizations that would commission or execute such surveys, along with survey respondents themselves, may be reluctant to be identified with an activity that has effectively been illegal since October 2006 (the passage of UIGEA).

We can, however, provide some valid comparison data and also behavioral findings that we believe are useful today in understanding Internet gamblers in the United States and North America. The AGA, as reported in its 2006 *State of the States*, undertook a special survey in which it provided some comparisons of Internet gamblers and traditional casino gamblers.

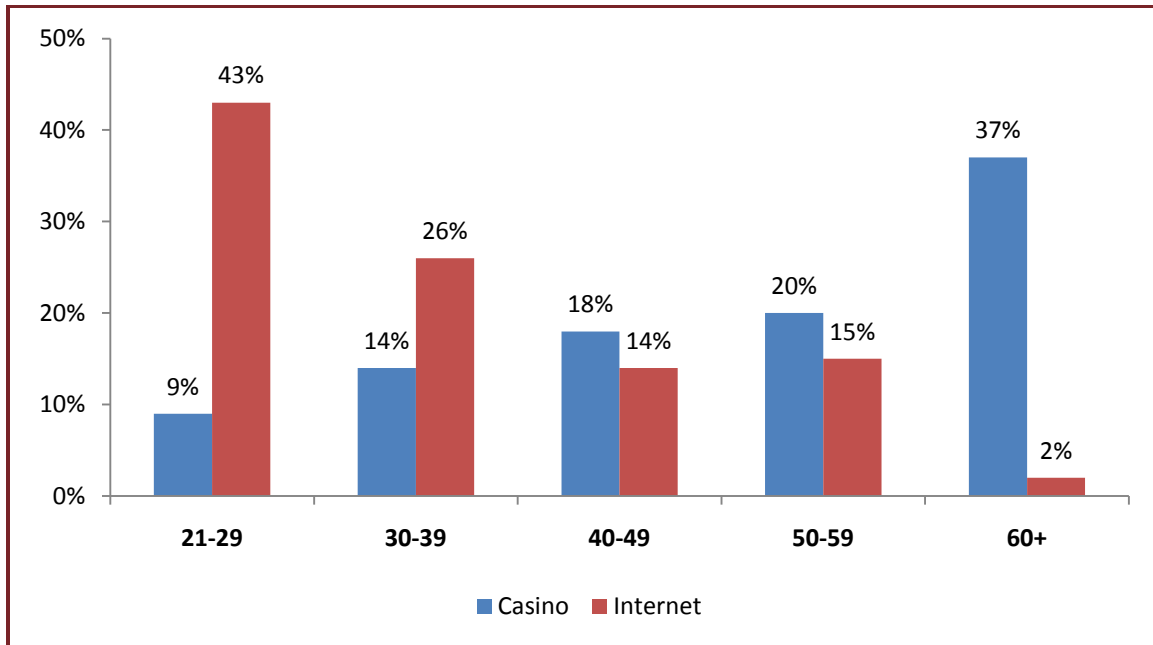
The AGA found that Internet gamblers were 68 percent male, vs. 53 percent male for traditional casino gamblers. Other comparative findings that may still have relevance today are shown in the following charts.

First, we see that Internet gamblers are significantly younger than traditional casino gamblers:

⁷¹ Proprietary research

⁷² Proprietary research

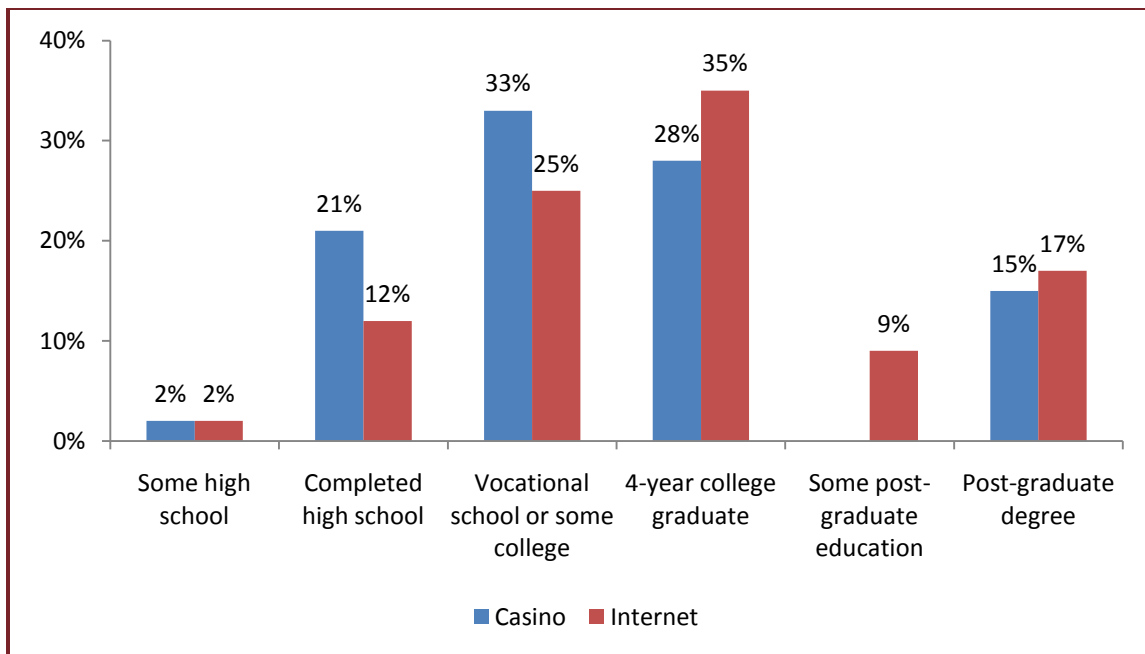
Figure 4: By age group, Internet gamblers vs. traditional casino gamblers



Source: American Gaming Association *State of the States* 2006

Next, we see that Internet gamblers are more likely to have a four-year college degree or higher level of education than traditional casino gamblers:

Figure 5: By education level, Internet gamblers vs. traditional casino gamblers

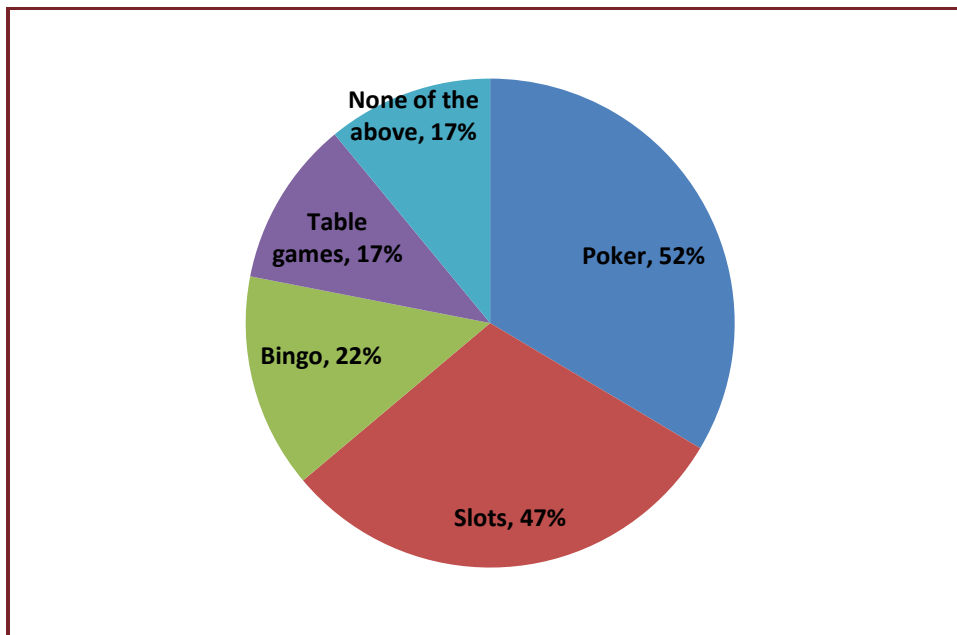


Source: American Gaming Association *State of the States* 2006. Note that the survey for traditional casino gamblers did not include an option for "some post-graduate education."

Although we could find no valid, current comparative data for the amounts spent on gambling among Internet patrons and casino patrons, Ypartnership found that the median (excluding zero) amount spent on gambling per day-trip North American “active gambler” to a casino was \$200 per trip. The same study found that the mean (i.e., average) amount bet per online session by North American Internet active gamblers was \$90.10.⁷³

In North America, 35 percent of active gamblers visited an Internet gambling site during the previous 12 months. Among those who have gambled on the Internet, their favorite game is poker.

Figure 6: Types of online games played among North American Internet gamblers

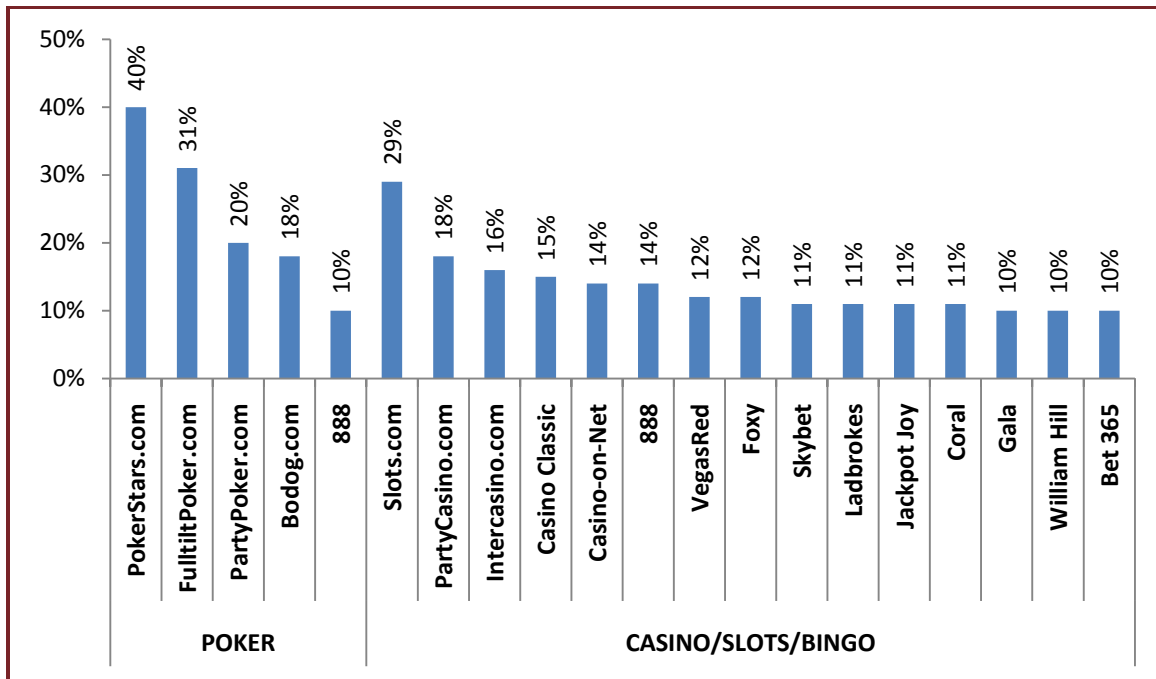


Source: 2010 Active Gambler Profile

⁷³ Ypartnership, *2010 Active Gambler Profile*, pages 139 and 145. The remainder of the data in this chapter section are taken from the most recent edition of the *2010 Active Gambler Profile*, an annual survey conducted by Ypartnership of Orlando, FL, for WMS. The survey of 2,851 US gamblers and 601 Canadian adults includes only “active gamblers,” or those who had visited a casino of any kind (land-based or online) at least once in the previous 12 months. A video overview of the *2010 Active Gambler Profile* is available through WMS at <http://www.wmsactivegamblerprofile.com/>.

Internet gamblers' preferences for poker are further illustrated in the next chart, which shows the most frequently visited Internet gambling sites by all active gamblers, segmented by poker and casino/slots/bingo games. Note that PokerStars.com is, by far, the most visited Internet gambling site, followed by FullTiltPoker.com and then Slots.com.

Figure 7: Most frequently visited Internet gambling sites by all active gamblers



Source: 2010 Active Gambler Profile

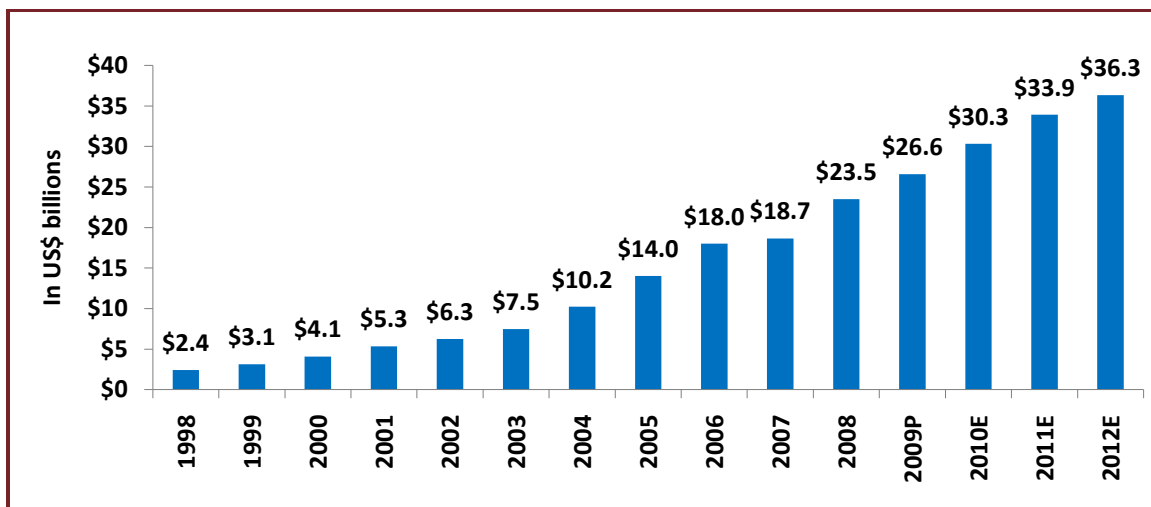
On the subject of legalizing Internet gambling, 39 percent of North American active gamblers are in favor, 39 percent have no opinion and 22 percent are opposed.⁷⁴

⁷⁴ Ypartnership, 2010 Active Gambler Profile, p. 85

VI. Internet Gambling Revenue

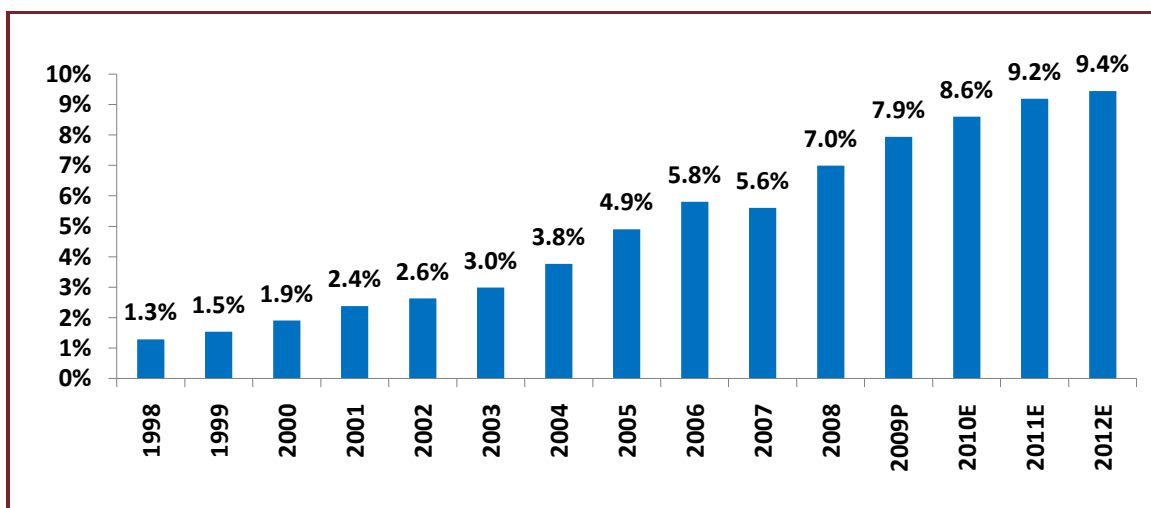
In 2010, H2 Gambling Capital projects global Internet gambling revenue to be \$30.3 billion, a 14 percent year-over-year increase.⁷⁵ Globally, Internet gambling is estimated to represent approximately 8.6 percent of all gambling revenue worldwide in 2010 and is expected to grow to 9.4 percent of global gaming revenue by 2012.⁷⁶

Figure 8: Global Internet gambling revenues



Source: H2 Gambling Capital

Figure 9: Global Internet gambling as a percentage of all global gambling revenue



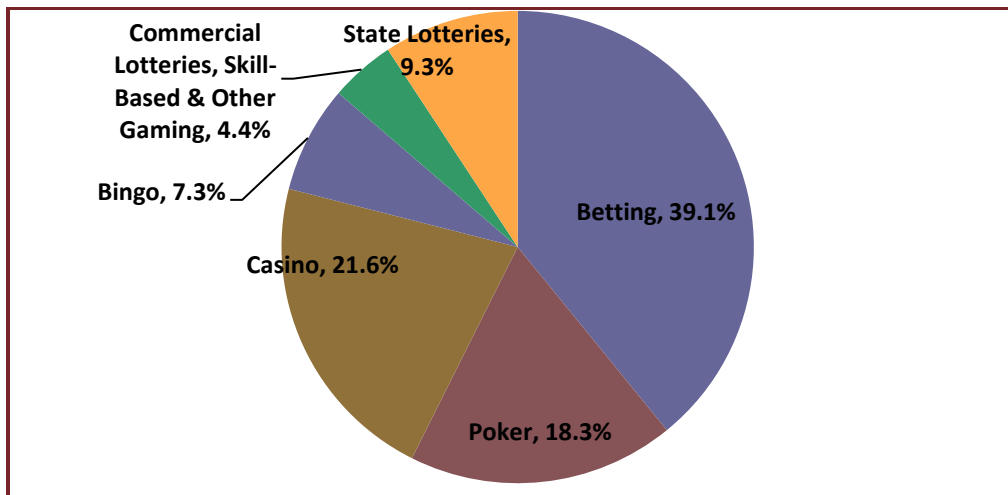
Source: H2 Gambling Capital

⁷⁵ H2 Gambling Capital

⁷⁶ Ibid

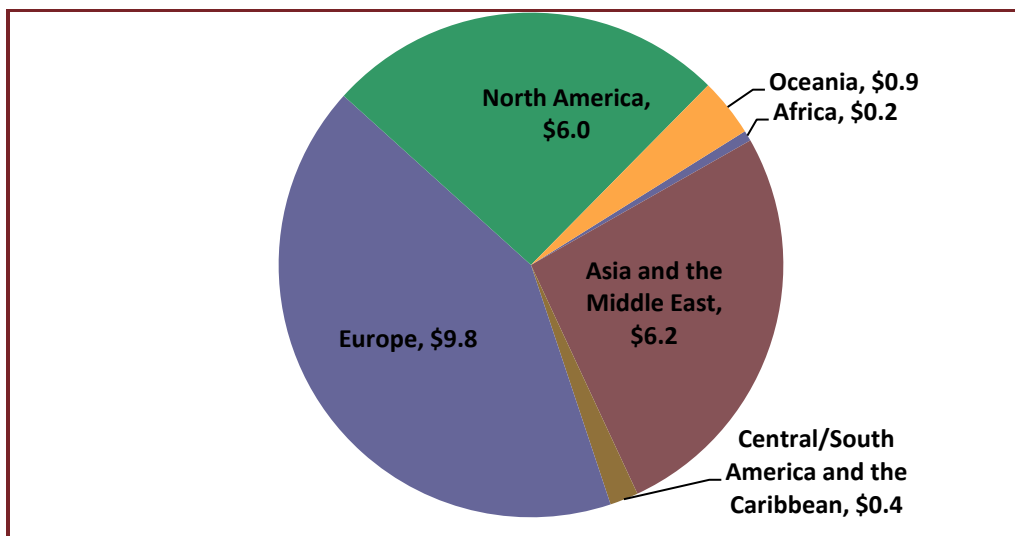
Sports- and race-betting (collectively identified as “betting”) dominate the worldwide market, as shown in the following chart:

Figure 10: Global Internet gambling by product, 2009



Source: H2 Gambling Capital

Figure 11: Global Internet gambling by region, 2009



Source: H2 Gambling Capital. Amounts in billions

Europe has been the dominant region since the passage of UIGEA, accounting for 44 percent of global revenue, followed by Asia (25 percent), and North America (24 percent). Prior to UIGEA passage, North America had been the dominant market, accounting for 50 percent of global Internet gambling revenue in 2006. It is expected that the US market would resume that position again if UIGEA is reversed.⁷⁷

⁷⁷ H2 Gambling Capital

VII. Europe

Europe has become the biggest Internet gambling market in the world, accounting for an estimated \$12.5 billion of the industry's \$29.3 billion total revenue this year.⁷⁸ Fully 10.9 percent of European gambling is expected to be interactive in 2010, with the highest proportions found in the Nordic countries (mid-20 percent ranges), 17 percent to 18 percent in the United Kingdom, and 7 percent to 8 percent in Italy.⁷⁹

European Internet gambling revenue totaled €8 billion in 2009, representing 10.9 percent of all European gambling revenue, and is expected to grow to €9.7 billion by the end of 2010, a 12 percent increase, according to H2 Gambling Capital. Italy is the greatest contributor to European Internet gambling revenue, accounting for 24 percent, followed by the United Kingdom (14 percent), Spain (12 percent), Germany (12 percent), and France (11 percent). These six nations account for 76 percent of all European Internet gambling revenue, with Greece, the Netherlands, Sweden, Ireland and Finland making up almost all of the remainder. European adults have an average annual individual gambling spend of more than €200, with the highest spend per-person coming from Italy, Finland, Ireland and Spain.⁸⁰

The majority of European Union states – 20 of the 27 members – either actively or passively allowed Internet gambling as of 2008 and trends indicate that all member states will have regulated interactive gambling by 2015. A fully open and regulated European Internet gambling market could be worth €22.5 billion of a €100 billion total gambling market by 2015.⁸¹

⁷⁸ *European Governments Hit Jackpot With Online Poker*, James McDonald, July 31, 2010

⁷⁹ H2 Gambling Capital

⁸⁰ H2 Gambling Capital

⁸¹ H2 Gambling Capital

Figure 12: European Union member states' approach to Internet gambling, 2008⁸²

Actively Allow	Passively Allow	Actively Prohibit	Passively Prohibit
Austria	Bulgaria	Germany	Lithuania
Belgium	Cyprus	Greece	Netherlands
Denmark	Estonia	Romania	Slovenia
Finland	Hungary	Czech Republic	
France	Ireland		
Italy	Luxembourg		
Latvia	Poland		
Malta	Portugal		
Slovakia	Spain		
Sweden			
United Kingdom			
TOTALS: 11	9	4	3

The global economic recession has increased the attraction of regulated Internet gambling as a source of tax revenue for cash strapped European governments. Regulation may also persuade more of the major operators located in the tax-friendly venues of Gibraltar, Isle of Man, Alderney and Costa Rica to move operations, jobs and the resulting tax revenues to European countries. Denmark and France have recently followed the Italian model and liberalized their Internet gambling restrictions. Switzerland, Spain, Greece and Germany are considering full liberalization policies. A closer look at several European nations and their approach to Internet gambling will be helpful to demonstrate how liberalization can affect national markets.

France

France recently liberalized its Internet gambling policies, allowing private companies to offer online sports betting just in time for the World Cup tournament.⁸³ In the first month after France chose to regulate the industry and issue operating licenses, gamblers opened more than 1.2 million new accounts, betting nearly \$108 million (€83 million) on licensed sites.⁸⁴ That nearly doubled the amount legally wagered online in the comparable period a year earlier, when state-run betting sites were the only option.

The numbers are expected to increase with the start of legal online poker, which was illegal. French poker players currently make up about 5 percent of the world market

⁸² Europe Economics from gamblingcompliance.com and SICL, 2008

⁸³ Eric Pfanner, "Europe Unleashes Internet gambling to Fill Coiffers," *New York Times*, July 28, 2010

⁸⁴ James McDonald, *European Governments Hit Jackpot With Online Poker*, July 31, 2010

despite the fact that the country only had a limited, state-run gambling entity. Similar to the United States, many online poker players chose to play at popular offshore sites such as Poker Stars and Full Tilt Poker, which were willing to take the legal risk and market to French citizens. The French government has not disclosed the amount of tax revenue that liberalization has generated, but the boost in wagering lifted that nation to the fifth ranking for European Internet gambling revenue over the past three years, and 2010 revenue is currently estimated at €585 million.⁸⁵

Companies that want to operate legally in France must secure a local license, abide by French regulations and agree to pay French taxes. While unlicensed sites continue to operate in France, regulators have threatened a number of operators with prosecution. Some operators have withdrawn from the French market rather than meet what they say are onerous restrictions. Betfair, a London-based sports betting "exchange" (which lets people to bet on odds set by other gamblers instead of a by a bookmaker), believes the French legislation is unfair because it taxes all transactions rather than overall winnings. Users of betting exchanges sometimes employ multiple, offsetting bets on a single game, and under the French system the operator is taxed on all of them.⁸⁶

Italy

At the beginning of this decade, Italy had some of the strictest laws against Internet gambling in all of Europe. As a result, the European Commission took legal action against Italy in 2006 regarding unfair trade practices proscribed by European Union Treaty in 2003. Beginning in 2008, Italy began to liberalize its policies by legalizing Internet sports betting and low-stakes online poker. In 2009, Italy authorized higher-stakes poker, as well as Internet casinos offering such games as roulette.⁸⁷ The Italian government has openly declared its intention to raise revenue from Internet gambling and linked new legislation to a fund-raising package for the Abruzzo region, which was struck by an earthquake last year. The partial liberalization propelled Italy to the first ranking for European Internet gambling revenue over the past three years, with 2010 gross gambling revenues estimated to be €1.25 billion.⁸⁸ As a result of its liberalization policy, Italy generated approximately €150 million in tax revenues in 2009.

⁸⁵ H2 Gambling Capital

⁸⁶ *Europe Unleashes Internet gambling to Fill Coffers*, Eric Pfanner, New York Times, July 28, 2010

⁸⁷ Ibid

⁸⁸ H2 Gambling Capital

Germany

Germany is the only major European country that actively prohibits Internet gambling, even though full, land-based casino gaming is legal in all 16 states. Internet gambling was outlawed by the Interstate Gambling Treaty, which was signed into law January 1, 2008. Section 4.4 of the treaty clearly and specifically states that “The organizing and arranging of public games of chance on the Internet is prohibited”⁸⁹ and allows states to block online betting websites, prevent money transfers and outlaw advertising. The treaty is widely viewed as a protectionist policy for the land-based casino industry. As in the United States, the legislative ban has not extinguished Internet gambling, only suppressed it, but the law has prevented the government from collecting tax revenue from citizens who continue to wager online. Recent Internet gambling estimates rank Germany as the fourth highest revenue generator in Europe over the past three years, accounting for 12 percent of the European market (€80 billion) in 2010.⁹⁰

The European Commission has requested that Germany reconsider the law, which contradicts European Union (“EU”) legislation regarding Internet gambling and is at odds with other EU regulations promoting cross-border competition, especially Article 49 of the European Union Treaty. The law expires in 2012, and the German Federation requires the agreement of all 16 *Länder* (states) to introduce new legislation. In 2009, the state of Schleswig-Holstein came out against the law, so it appears probable that the measure will expire quietly in 2012 or face substantial modifications if the states can agree. We found that full legalization would increase Internet gambling revenue in Germany on the order of 10 percent to 20 percent in year one and given the size of its economy, Germany could easily rival the United Kingdom in Internet gambling revenues within two years of full legalization.

Sweden

Sweden allows Internet gambling under a state monopoly model. Internet gambling was authorized in 2002 for non-profit associations running lotteries for public benefit. In 2003, the state-controlled operator Svenska Spel was authorized to begin offering casino games and the racing industry operator ATG was authorized to allow Internet wagering on harness racing.⁹¹ In 2005, Svenska Spel was further authorized to offer online poker, which launched in March 2006. This company is the sole operator of

⁸⁹ Europe Economics from gamblingcompliance.com and SICL, 2008

⁹⁰ H2 Gambling Capital

⁹¹ Europe Economics from gamblingcompliance.com and SICL, 2008

Internet casino and poker gambling through exclusive licensing by the government, creating an effective monopoly in violation of Article 49 of the European Union Treaty.

Legalized Internet gambling is popular in Sweden, which ranked eighth in European gross gambling revenue over the past three years,⁹² despite having only the 13th largest population in the European Union. In the case of Sweden, the monopoly situation does not appear to have had a detrimental effect on Internet gambling participation, although it could be argued the market could be bigger under a non-monopolistic model. The lack of robust competition may have inhibited revenue growth to some degree because Sweden has not demonstrated revenue growth on the order of Italy or the United Kingdom. As with Germany, the European Commission is questioning the monopoly ownership but it is clear that the single operator under government auspices has not reduced problem gambling. Problem gambling rates in Britain and Sweden, as measured by the British Gambling Prevalence Survey 2007,⁹³ are similar – approximately 0.5 percent to 0.6 percent of the general population. This is in spite of the fact that Svenska Spel utilizes special analytic software to identify problem gamblers through their betting patterns and block gambling advertising to identified problem gamblers.⁹⁴

United Kingdom

The United Kingdom has the most liberal arrangements for Internet gambling in the European Union.⁹⁵ As noted earlier, the Gambling Act was passed in 2005 with the clear aim of creating a unified regulatory framework to replace the patchwork of previous regulation, some of which dates to the 19th Century.⁹⁶ The new law established a Gambling Commission to regulate all forms of gambling in Great Britain, including over the Internet. Liberalization of all forms of Internet gambling has generated a wide variety of operator and supplier market participants, offering a vast array of betting alternatives, gambling games, and services over the Internet, interactive television, and on mobile devices. The Gambling Act made it legal for operators to base their online operations in the United Kingdom and was a precursor for several of the largest international gambling providers, such as 888.com and PartyGaming, to take up London headquarters and go public on the London Stock Exchange. The United Kingdom now ranks second among European countries in terms of estimated Internet gross gambling

⁹² H2 Gambling Capital

⁹³ British Gambling Prevalence Survey 2007, September 2007, National Centre for Social Research

⁹⁴ Europe Economics from gamblingcompliance.com and SICL, 2008

⁹⁵ Europe Economics from gamblingcompliance.com and SICL, 2008

⁹⁶ http://www.opsi.gov.uk/acts2005/ukpga_20050019_en_2

revenue over the past three years and has an Internet gambling penetration rate of between 17 percent and 18 percent.⁹⁷

The UK government drew up a “white list” of approved jurisdictions, including Alderney and the Isle of Man, so that both domestic online sports betting operators holding bookmaking licenses in the United Kingdom and other offshore operators could continue to operate and market online casino, bingo and other verticals from those jurisdictions legally to UK residents, provided that they adhere to specified regulatory standards.⁹⁸

While the UK legislation prevents unapproved Internet gambling sites from advertising in the United Kingdom, certain European jurisdictions outside the EU zone were white-listed, including Tasmania, Gibraltar, Isle of Man and Alderney. Other offshore jurisdictions such as Antigua and Kahnawake were conspicuously left off the list owing to their lack of credible regulation and enforcement and the types of operators they had attracted and licensed. The UK legislation and its White List partner jurisdictions have stimulated the growth of domestic operators and the United Kingdom now ranks sixth on the list of jurisdictions in terms of number of current operators.

Liberalizing the rules for Internet gambling has not created substantial tax revenue for Britain, however, because the Gambling Act does not require operators to obtain a license and pay taxes in Britain.⁹⁹ As a result, many operators and sites have continued to serve British gamblers from more tax advantageous jurisdictions, such as Gibraltar, Alderney and Isle of Man. Two big British betting companies, Ladbrokes and William Hill, moved their online operations to Gibraltar last year to take advantage of lower taxes for their non-sports betting online operations.

⁹⁷ H2 Gambling Capital

⁹⁸ Europe Economics from gamblingcompliance.com and SICL, 2008

⁹⁹ Eric Pfanner, “Europe Unleashes Internet gambling to Fill Coffers,” *New York Times*, July 28, 2010

VIII. Canada

The legalization and control of gambling in Canada lays with the 10 provincial governments. Canada's Criminal Code, created in 1892, sets forth the parameters under which gambling can occur. It has undergone a number of revisions that resulted in the federal government ceding control of gambling to the provinces in 1985.

In 1969, the Criminal Code was amended to allow both federal and provincial governments to conduct lotteries, setting up a "protracted struggle" between the federal government and the provinces over gambling revenue. In 1985, the code was changed to delegate to the provinces the "exclusive authority" to manage and conduct lotteries, including games conducted via a computer, video device or slot machines.¹⁰⁰ By 1985, provincial governments in Quebec, Manitoba, Alberta, Saskatchewan, British Columbia and the Atlantic provinces had all authorized lottery operations.

The conflict between the federal government and the provinces began after the federal government established the Olympic Lottery Corporation in 1973 to support the 1976 Montreal Olympics. The election victory of the Progressive Conservatives in 1985 resulted in an agreement that put the federal government out of the lottery business. The provinces agreed to pay the federal government a one-time fee of \$100 million to support the 1988 Calgary Olympics and \$24 million annually, thereafter, a figure that is adjusted each year based on the Consumer Price Index.¹⁰¹

Five provinces, through their lottery corporations, offer patrons the opportunity to purchase lottery tickets online. They are British Columbia and the Atlantic provinces of New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador (the two areas comprise one province). Prince Edward Island offers electronic keno.

On July 15, 2010, British Columbia launched North America's first government-run Internet casino through the British Columbia Lottery Corporation ("BCLC"). The launch, however, proved embarrassing, as BCLC's www.PlayNow.com website was shut down within hours after some users were accidentally given access to other people's accounts. The Privacy Commissioner, and the Gaming Policy and Enforcement Branch allowed the BCLC to relaunch the site on August 19. It experienced technical glitches due to overwhelming demand, forcing it to stay off line for much of the relaunch day, as customers could not log onto their accounts. The site has been operational since August

¹⁰⁰ "The Legalization of Gambling in Canada," The Law Commission Canada, p. 4

¹⁰¹ Ibid

20.¹⁰² Customers can gamble on roulette, blackjack, baccarat, red dog and Sic Bo. The site also offers slot machine play and video poker.¹⁰³

British Columbia turned to Internet gambling as a new revenue source to close an expected C\$1.7 billion deficit this fiscal year.¹⁰⁴ The BCLC is working to secure an agreement with lottery officials in Quebec and the Atlantic provinces to allow residents in those provinces to wager on the BCLC site.¹⁰⁵

British Columbia residents gamble C\$100 million online annually, according to BCLC lottery officials, who expect to capture much of that money through their new online casino offerings.

Under Canada's Criminal Code, only provinces can operate computer-based lottery schemes.¹⁰⁶ Thus, it bars charitable organizations and private-sector companies from operating Internet gambling enterprises. Any online operation cannot take bets from residents of other provinces without the consent of the other provincial governments.

Despite the Criminal Code restrictions, the Quebec-based Kahnawake Mohawk First Nation has operated extensive Internet gambling sites with impunity since the late 1990s. Located south of Montreal, the Kahnawake Mohawk First Nation asserts that it is a sovereign nation, and is not subject to Canadian law.¹⁰⁷ The Kahnawake Mohawk nation established the Kahnawake Gaming Commission ("KGC") to license and regulate Internet gambling operators; it now licenses 55 such operators, who control more than 200 gambling websites through servers located on its reservation. Operators pay an annual \$25,000 licensing fee, and a \$5,000 licensing fee for each key license.¹⁰⁸ Patrons from around the world wager on table games, poker and sporting events.

Federal and provincial authorities have taken no action to halt the Kahnawake Mohawk nation operations despite the fact that they appear to operate in violation of Canadian law. It is our understanding that most of their licensees operate in violation of

¹⁰² Chad Skelton, "Glitches not security issues, corporation says," *Vancouver Sun*, August 21, 2010

¹⁰³ PlayNow.Com, https://www.playnow.com/playnow?action=GoCat&cat_id=2 (accessed September 1, 2010)

¹⁰⁴ Chad Skelton, "Glitches not security issues, corporation says," *Vancouver Sun*, August 21, 2010

¹⁰⁵ Ibid

¹⁰⁶ The Legalization of Gambling in Canada, The Law Commission Canada, p. 61

¹⁰⁷ Kahnawake Gaming Commission web site, Frequently Asked Questions, <http://www.gamingcommission.ca/faq.asp>, (accessed September 2, 2010)

¹⁰⁸ Spectrum interview with KGC representatives, August 31, 2010

US law by marketing to and accepting wagers from US citizens. One of its licensees, Ultimate Bet, acknowledged a cheating scandal in May 2008 that resulted in the use of an unauthorized software code that allowed perpetrators to obtain hole card information during live play. The KGC ordered Ultimate Bet to refund \$22,000 to players, and fined the company \$1.5 million.¹⁰⁹ The commission noted that it has “no authority to determine criminal culpability or civil liability.”

The Alexander First Nation near Edmonton announced in 2007 that it, too, planned to offer licenses to companies to establish Internet gambling sites in a data center on its reservation, similar to the operation of the Kahnawake Mohawk nation. But the plan was abandoned after Alberta officials threatened to prosecute Alexander First Nation officials.

The Canadian Gaming Association conducted an extensive survey in March to measure public sentiment toward Internet gambling. The survey, which involved 1,724 respondents, found that:

- 50 percent supported Internet gambling with government regulation
- 12 percent supported Internet gambling without government regulation
- 38 percent wanted it banned altogether

The study concluded that “security and legitimacy” are big barriers for non-players.¹¹⁰

Meanwhile, Quebec and Ontario are expected to soon enter the Internet gambling market. Loto-Quebec plans on launching a 24-hour, seven-day-a-week Internet gambling site sometime this fall. It will offer Texas Hold 'Em poker, Caribbean Stud poker, baccarat, roulette, Sic Bo and various types of blackjack. The patron payout percentage of all games combined must be at least 83 percent. The rake for Texas Hold 'Em will be limited to 5 percent.¹¹¹

Ontario Lottery and Gaming chair Paul Godfrey said on August 10, 2010, that the Crown Corporation would spend the next 18 months consulting on Internet gambling

¹⁰⁹ Kahnawake Gaming Decision, Ultimate Bet investigation press release, September 29, 2008, <http://www.scribd.com/doc/6325516/Kahnawake-Gaming-Commission-Imposes-Sanctions-on-Ultimate-Bet-with-Regard-to-Cheating-Incidents-092908>, (Accessed September 2, 2010)

¹¹⁰ Internet Gaming in Canada, Public Perception and Behaviour, Canadian Gaming Association, April 2010, p. 8

¹¹¹ Loto Quebec web site, <http://lotoquebec.com/corporatif/nav/en/about-loto-quebec/what-we-do/online-gaming>, (Accessed September 1, 2010)

with a goal of offering Internet gambling in 2012. Ontario anticipates that an online presence could generate an additional \$400 million in revenue.¹¹²

Saskatchewan is “very interested” in the idea of Internet gambling.¹¹³ Ken Cheveldayoff, the minister who oversees the Saskatchewan Gaming Corp., said the province is “cautiously” looking at the possibility. He told CBC News that his concern is properly monitoring Internet gambling. He said there is no timeline for a decision.

Nova Scotia’s finance minister, Graham Steele, told CBC news on August 25, 2010, that the province may launch its own gaming website to capture some of the gambling money that is going to unregulated offshore sites. The provincial government is expected to release a report in the fall that will outline its overall gambling strategy.¹¹⁴ The Atlantic Lottery Corp. is already developing plans for an Internet gambling site for Nova Scotia and other Atlantic provinces. It is possible that one of the provinces associated with the Atlantic Lottery could offer Internet gambling while another would not. One of the members, Newfoundland and Labrador, is opposed to Internet gambling. Premier Danny Williams told AHN News in a wire story dated August 19, 2010, that his province is already too heavily dependent upon gaming revenue, and has no interest in offering it. But industry officials told us that that the pressure would be strong to do so if other provinces throughout Canada offer Internet gambling.

¹¹² Robert Benize, “Internet gambling coming to Ontario,” *The Star*, <http://www.thestar.com/news/canada/article/845919--online-gambling-coming-to-ontario>, (Accessed September 1, 2010)

¹¹³ CBC News, <http://www.cbc.ca/canada/saskatchewan/story/2010/08/10/sk-online-gambling-1008.html>, August 10, 2010

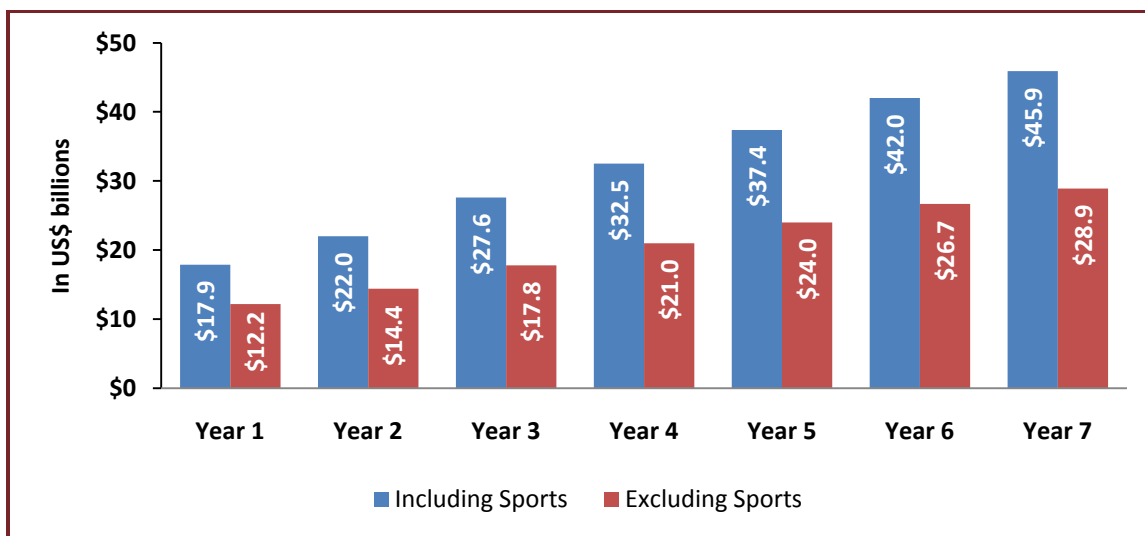
¹¹⁴ CBC News, <http://www.cbc.ca/canada/nova-scotia/story/2010/08/25/ns-online-gambling.html>, August 25, 2010

IX. United States

Prior to the passage of UIGEA in 2006, the United States represented the dominant Internet gambling market in the world. According to H2 Gambling Capital, post-UIGEA Internet gambling revenue for offshore companies was estimated to be \$5.9 billion in 2008 from players in the United States, and \$21.0 billion from players worldwide.¹¹⁵ Offshore operators are currently generating an estimated \$105 billion in handle and \$5.1 billion in gross gaming revenues from the US market. It has been estimated that from the time UIGEA was signed in 2006 to the end of the current year, approximately \$5 billion in tax revenue and 33,480 full-time-equivalent (“FTE”) job years would have been generated had the law legalized Internet gambling along the lines of the European model as opposed to making it illegal for banks to process transactions.

Were UIGEA to be repealed this year and new legislation passed making non-sports-betting Internet gambling legal, H2 Gambling Capital estimates that the US market would generate a potential gross win of \$14.4 billion in the first year, rising to \$26.7 billion by 2015. If sports betting were included, these figures would increase to \$22.0 billion in year one and \$42.0 billion by year five. As is currently the case in Europe, the greatest potential revenue opportunity in the United States is concentrated among a few states, with 75 percent of the earning potential estimated to come from 10 states, led primarily by California and New York, followed by Texas, Florida, Illinois, Pennsylvania, New Jersey, Ohio, Massachusetts and Michigan.

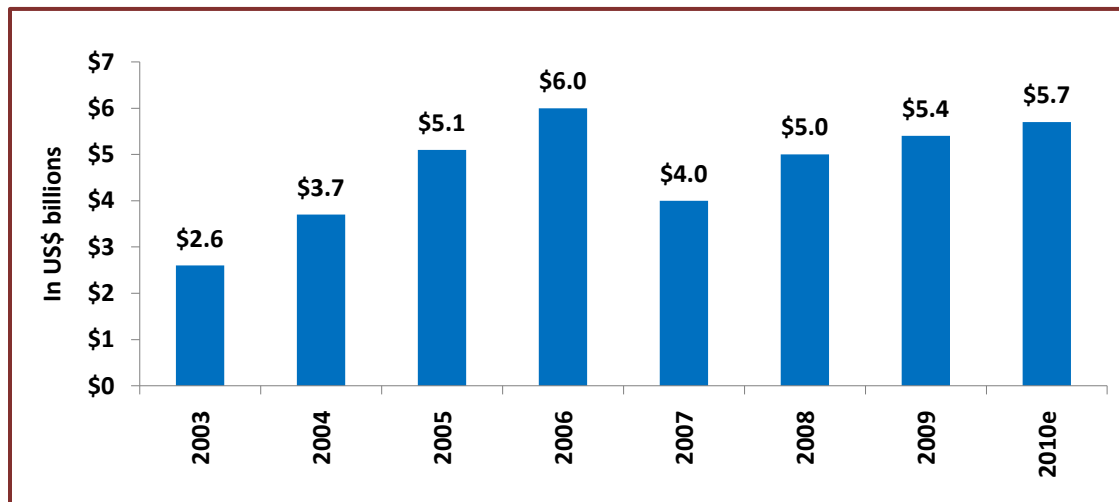
Figure 13: Internet gambling projected revenues if UIGEA were repealed



Source: H2 Gambling Capital

¹¹⁵ H2 Gambling Capital

Figure 14: Estimated market for US offshore market



Source: H2 Gambling Capital

Full legalization, including sports betting, in the United States would produce total gross gambling expenditures of \$94 billion over the first five years, which in turn would generate just under 159,750 FTE job years (an annual average of 19,420 direct/12,530 indirect) and \$57.5 billion in domestic tax revenues over that period. Partial legalization with no sports betting would generate gross expenditures of \$67 billion over the first five years and in turn would create approximately 127,350 FTE job years (an average of 15,850 direct/9,620 indirect per annum) and \$30.8 billion in domestic tax revenues.¹¹⁶

¹¹⁶ Earl Burton, "New Study Indicates U.S. Internet gambling Regulation Would Add Jobs, Tax Revenue," PokerNewsDaily.com, April 20, 2010, via <http://www.pokernewsdaily.com/new-study-indicates-us-Internet-gaming-regulation-would-add-jobs-tax-revenue-9972/>

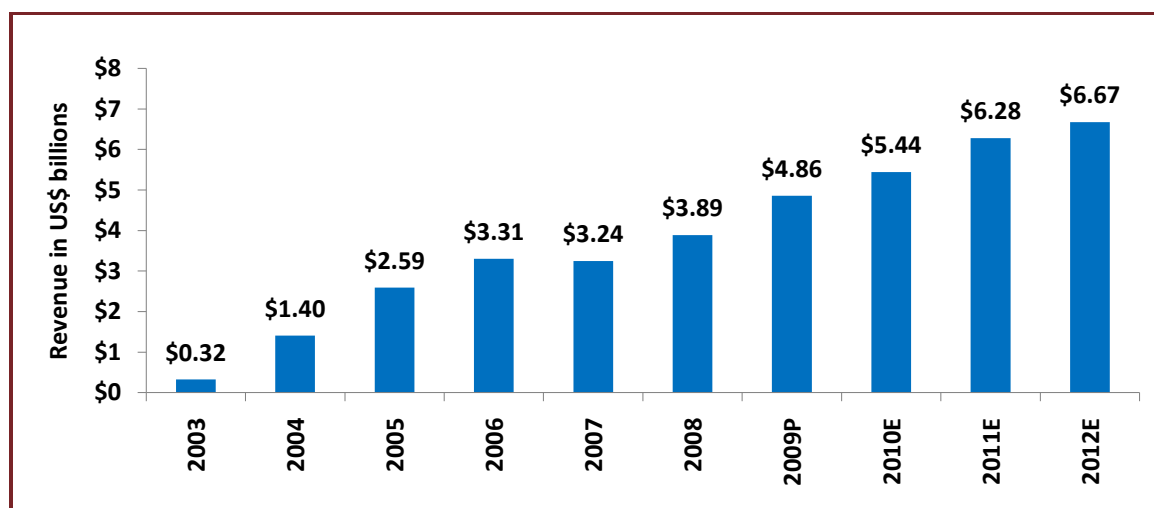
X. Poker

Global Internet poker generated rake and tournament fees of \$4.91 billion in 2009, an annual increase of 26.8 percent over 2008 revenues. Global poker revenue for 2010 is forecast at \$5.6 billion, a year-over-year increase of 14.1 percent, and is projected to rise to an estimated \$6.7 billion by 2012.¹¹⁷

US poker players and offshore operators willing to take on the legal operating risk have largely disregarded the ambiguous UIGEA prohibition as new and innovative payment mechanisms have been implemented to circumvent the law. Player volumes for US-oriented sites have increased 82 percent to date since 2009, while non-US sites have remained relatively flat. Poker Stars and Full Tilt Poker held 30 percent of US players when PartyGaming and others withdrew from the market post-UIGEA and have since increased their share to almost 60 percent due to their continued marketing efforts and the desire for broad liquidity on the part of players.¹¹⁸

The vast majority of poker players (over 90 percent) – wager very small amounts (micro stakes) – an average pot size of \$11.44 and the average tournament buy-in is \$1.65.¹¹⁹ An estimated 115,000 poker players are typically online at any given time with more than 21,000 tables open and an average of 5.4 players seated. Peak play times are typically between 6 p.m. and midnight local time for any given market.¹²⁰

Figure 15: Global real-money Internet poker gross revenues



Source: H2 Gambling Capital

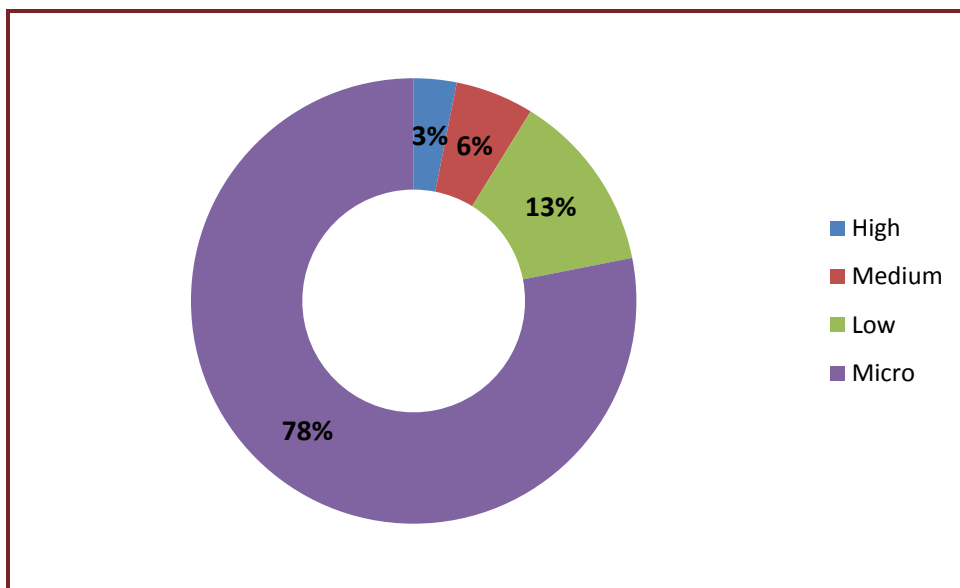
¹¹⁷ H2 Gambling Capital

¹¹⁸ Ibid

¹¹⁹ Ibid

¹²⁰ Ibid

Figure 16: Real-money Internet poker players by value, April 2010

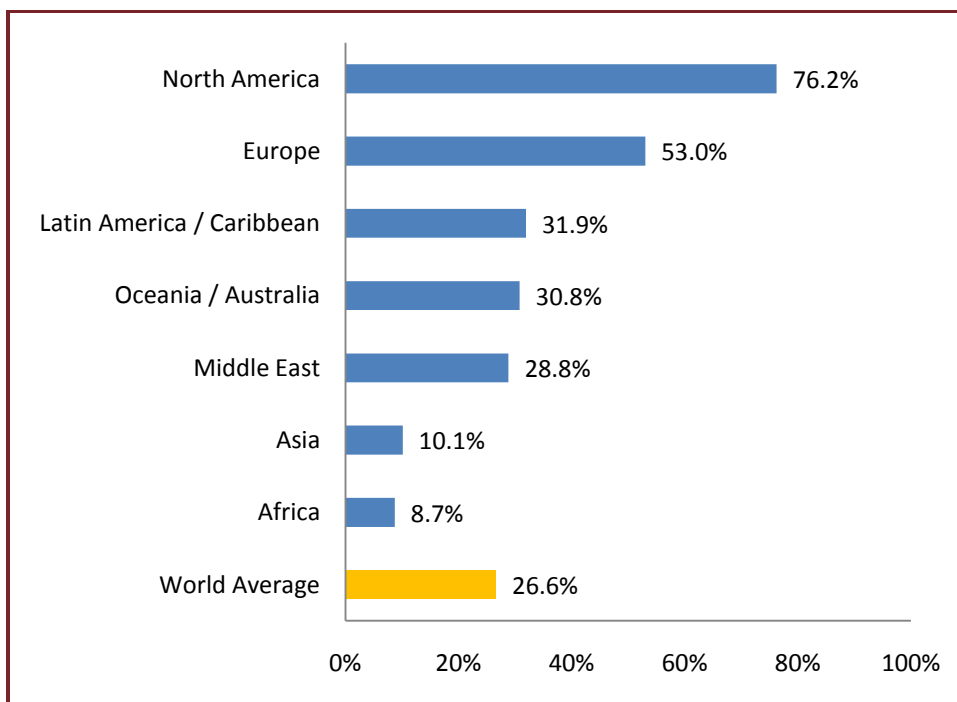


Source: H2 Gambling Capital

XI. Global Potential

In terms of the number of users, the Internet represents a huge potential market for gaming. Worldwide, there are nearly 2 billion people using this medium for information, communication, commerce and entertainment. The largest number of Internet users is found in Asia, followed by Europe and North America. Internet penetration rates, by comparison, are highest in North America, Oceania/Australia, and Europe. The disparity between Internet penetration rates (world average 28.8 percent as of June, 2010) and Internet gambling penetration rates indicates the potential for continued expansion in Internet gambling, particularly in the United States. For example, as of June 30, 2010, the European market displays an Internet usage penetration rate of 58.4 percent¹²¹ while Internet gambling penetration is only approximately 6.0 percent in those countries where it has been measured (i.e., the United Kingdom and the Netherlands in 2007). The United Kingdom exhibits an Internet penetration rate of 82.5 percent as of June 30, 2010, but as of the most recent measurement in the British Gambling Prevalence Survey in 2007, Internet gambling penetration was only 6 percent.¹²² The 2010 iteration of this survey is underway but has not yet been reported.

Figure 17: Global Internet penetration rates, 2009

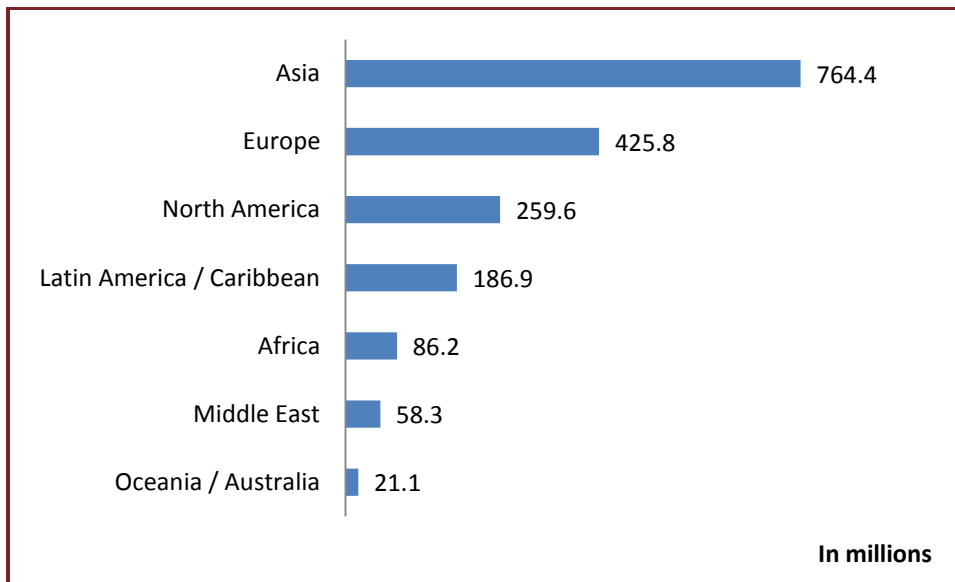


¹²¹ Internet World Stats, www.Internetworldstats.com

¹²² *British Gambling Prevalence Survey 2007*, September 2007, National Centre for Social Research

Source: H2 Gambling Capital

Figure 18: Internet users by global regions, 2009



Source: H2 Gambling Capital

Another measure of Internet gambling potential has been the rise of social networking and the subsequent proliferation of “social” and casual gaming integrated with these social networking sites. It is widely reported that Facebook, for example, has more than 500 million users worldwide, with over 100 million monthly US users. MySpace, Twitter, Bebo, Hi5 and others have also established significant user bases. The number of companies offering social and casual games to users on these social networks have also proliferated and are projected to generate more than \$1 billion in virtual goods and advertising revenue in 2010.¹²³

Zynga is perhaps the most relevant of these companies, as it has been operating a highly successful poker application, integrated with Facebook. Zynga Poker is a pay-to-play game, in which users buy chips to participate in the game. As it stands today, however, the users are not able to cash out their chips, and the chips have no value outside of the game, itself, thus it does not constitute gambling. Users merely play for the social aspects of the game and are only rewarded with the recognition of their play on leaderboards.

Despite these limitations, Zynga Poker has attracted more than 40 million monthly unique active users on Facebook alone, has exceeded 250,000 concurrent users, and is reported to generate more than \$200 million in annual revenue from the

¹²³ Justin Smith and Charles Hudson, “Inside Virtual Goods,” *The US Virtual Goods Market 2009-10*

game. As Internet gambling, particularly poker, becomes legalized, it is likely that potential operators will look to emulate the success of Zynga Poker and other social and casual game providers by seeking to integrate with social networking sites and exploit the huge pool of potential online gamblers. The impressive pool of active participants these companies have attracted further points toward the incremental potential and ongoing growth opportunities for Internet gambling in the United States.

XII. Impacts on Existing Operations

A critical concern in assessing the introduction of Internet gambling in any market or jurisdiction is the potential impact it may have on established gaming operations. For the purposes of this report, we will assess the potential cannibalization of revenue generated by land-based casinos. Undoubtedly, many casino patrons also play online, and some have switched their play primarily to websites, but the macro evidence demonstrates that the introduction of Internet gambling has little impact on the land-based casino industry.

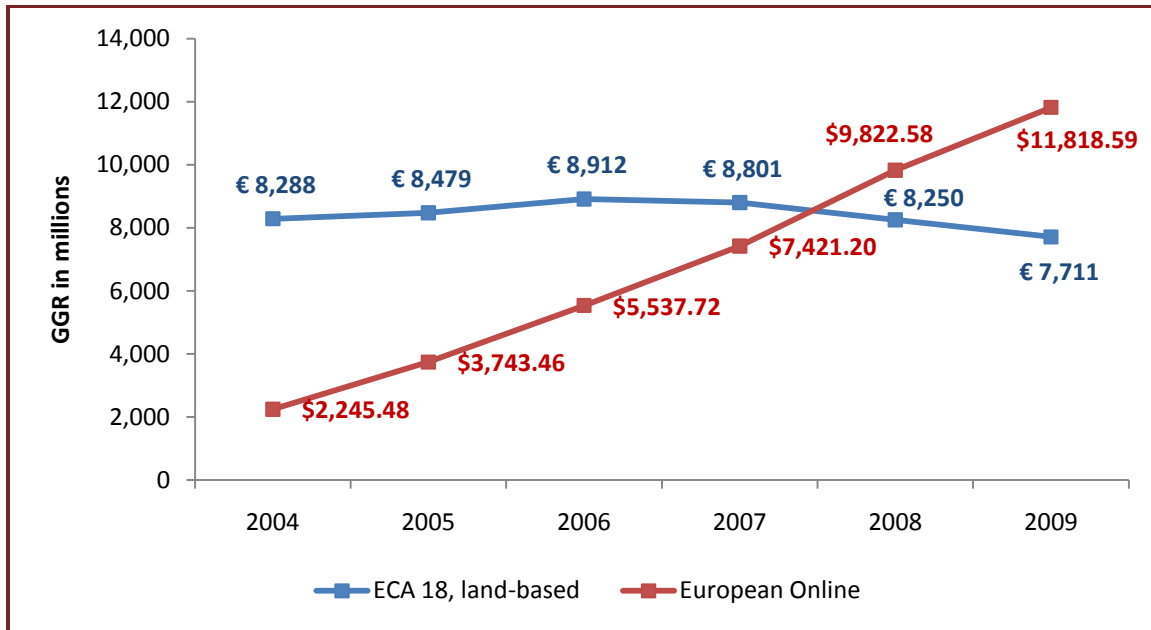
First, we look at the annual casino revenue of European land-based casinos¹²⁴ vs. the annual Internet-gambling revenue generated by players in Europe (see following chart). Land-based revenue in 2009 declined 7 percent from its peak in 2006, whereas Internet gambling revenue more than quadrupled since 2004. While it may be tempting to blame the decline in land-based revenue on the dramatic growth in Internet gambling, note that the start of the decline in land-based gaming coincided with the recession and the implementation of national laws that banned smoking in casinos (as well as other indoor public and work places). Additionally, there was a proliferation of FOBTs (fixed-odds betting terminals) in the United Kingdom and retail video lottery terminals throughout Europe, both of which also impacted casino revenue.

Our contacts with land-based casino operators throughout Europe have indicated that while Internet gambling may have “nibbled” at their growth, the obvious culprits have been the poor economy and the anti-smoking laws. (The smoking prevalence rate in Europe is 30 percent, with the range among member European countries used in our analysis being 18 percent to 37 percent.¹²⁵ Anecdotally, European operators tell us that the smoking rates among casino patrons are higher than for the general public.)

¹²⁴ Using the 18 European Casino Association countries that were members throughout the six-year reporting period.

¹²⁵ British Heart Foundation; <http://www.heartstats.org/datapage.asp?id=4661>; accessed September 3, 2010.

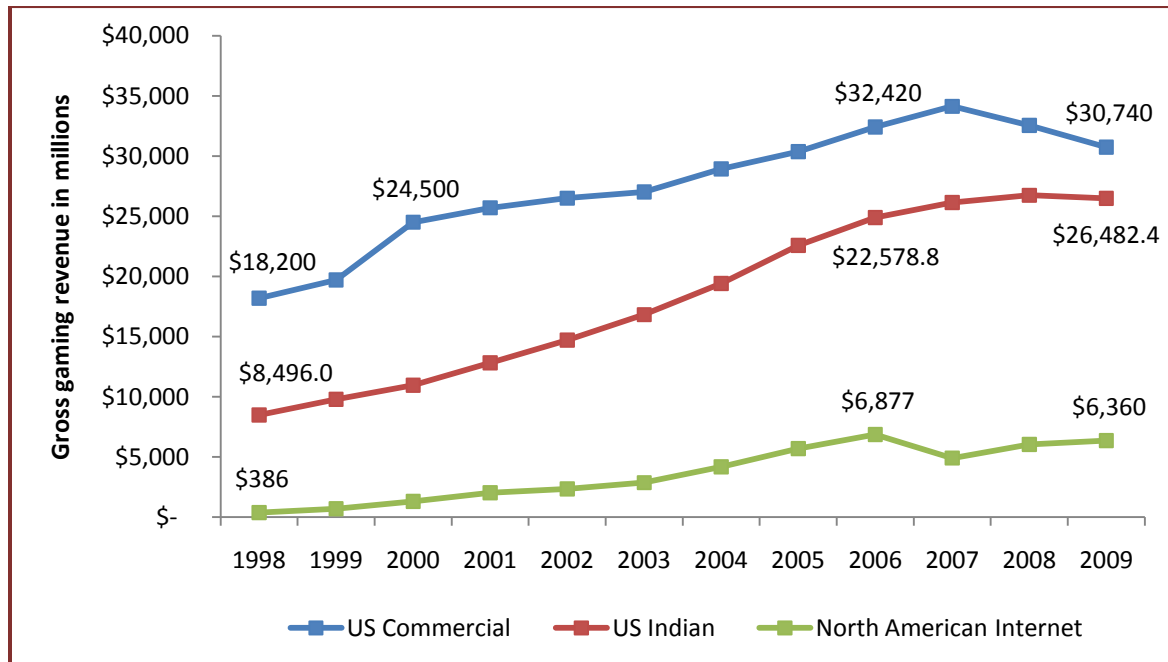
Figure 19: Annual gross gaming revenue: European casinos, European online players



Sources: European Casino Association, H2 Gambling Capital. ECA data before 2004 are unavailable. Note that ECA reports in Euros, H2 Gambling Capital in US dollars.

Next, we look at the impact of Internet gambling on revenue on operations in the United States.

Figure 20: Annual gross gaming revenue: US commercial casinos, US Indian casinos, US online players



Sources: American Gaming Association, National Indian Gaming Association, H2 Gambling Capital

Although dwarfed by the land-based numbers, it is important to note that – during the last decade (2000-09) – Internet gambling revenue from players in North America grew by 384 percent while gambling revenue from US land-based casinos (commercial and Indian combined) still grew by 61 percent, for a compound annual growth rate of 4.9 percent, despite the recession.

It is also important to note that, prior to the passage of UIGEA in 2006, North American players accounted for up to 41 percent of the global Internet gambling market (in 2004 and 2005). Even after the passage of UIGEA, North American players accounted for between 24 percent and 26 percent of the market.¹²⁶

Finally, in Europe and North America, despite the impact of the global recession and the passage of UIGEA in the United States, the introduction of Internet gambling has served to help grow the combined (Internet and land-based) market. In Europe, using current exchange rates, the combined market grew from \$16.98 billion in 2006 to \$21.72 billion in 2009, while in North America the combined market grew from \$61.88 billion in 2006 to \$63.58 billion in 2009. We believe this demonstrates the upside potential of land-based operators to enter the Internet gambling arena.

¹²⁶ H2 Gambling Capital

XIII. Opportunities and Challenges

There is too much uncertainty regarding the details of prospective US legislation, or when it might pass, to draw firm conclusions or make definitive recommendations for how NIGA and its member nations and tribes should proceed. However, we can definitively say that the legalization and regulation of Internet gambling in the United States represents a tremendous strategic and revenue opportunity for tribal gaming organizations. While the current proposed legislation only expressly prohibits any licensee from accepting wagers on sporting events, with the exception of pari-mutuel racing as permitted by law, it is widely anticipated that any legislation that is ultimately passed into law will a) have a provision that enables the federal government, among its other powers, to establish which games are legal on an ongoing basis, and b) at the time of passage, limit those games that are legal to only include online multi-player poker (video poker would be excluded as would other forms of “casino” gambling and sports betting).

Even if the legislation is limited to only poker, the current market in the United States is projected to be \$1.15 billion in gross gaming revenue in 2010, which represents 22.1 percent of the global market. With the passage of legislation legalizing poker in the United States, and assuming the United States can return to its pre-UIGEA market share levels of 50 percent, the revenue opportunity could grow to as much as an estimated \$3.1 billion in 2012.¹²⁷ And this is not taking into account incremental growth factors such as improved credibility for the industry resulting from regulation; relaxed restrictions on payment mechanisms; the market participation of more credible, recognized US brands; the introduction and integration with more sophisticated, appealing, land-based rewards and loyalty programs; or the potential for integrating with and leveraging the massive pool of potential online players belonging to social networks.

We can look to Italy, France and Denmark to support our belief that with the introduction of legislation legalizing and regulating Internet gambling in the United States that the US market will return to its prior overall share of the global Internet gambling market for poker, and exhibit significant growth opportunities. In 2009, each of those countries introduced new legislation legalizing and regulating Internet

¹²⁷ H2 Gambling Capital

gambling, and as a result the online gross gaming revenue in each of those countries has grown significantly and is expected to more than double by 2012.¹²⁸

Figure 21: Post-legalization Internet gambling growth in Italy, France Denmark

		2008	2009	2010E	2011E	2012E	CAGR '09-12
ITALY							
Active Accounts	(000s)	1,383.7	1,907.1	2,993.9	3,200.8	3,519.3	16.6%
GGR	(US\$M)	\$554.9	\$941.3	\$1,603.7	\$1,791.5	\$2,093.4	22.1%
FRANCE							
Active Accounts	(000s)	1,353.9	1,434.2	2,648.5	3,502.5	3,274.0	22.0%
GGR	(US\$M)	\$534.0	\$617.7	\$1,110.6	\$1,311.4	\$1,444.7	23.8%
DENMARK							
Active Accounts	(000s)	322.4	420.4	597.7	878.2	972.5	23.3%
GGR	(US\$M)	\$154.7	\$211.7	\$296.8	\$454.8	\$508.2	24.5%

Source: H2 Gambling Capital

The question is not whether there is an opportunity for NIGA and its member nations and tribes, but rather when and how is the best way to participate. Ultimately, we believe that Internet gambling will be an integral part of any gaming companies marketing strategy, product portfolio and growth potential, so we will not be considering the “do not participate” alternative.

When looking at when and how to participate, there are a number of “lessons learned,” projections and conclusions that we can draw from the evolution of Internet gambling both globally and in the United States and which we can use to inform potential “when and how” scenarios for tribal gaming organizations. And with that, there will be challenges for each “when and how” scenario that we can identify and offer alternatives for addressing.

As noted above, at this point, we are assuming that any US Internet-gambling legislation passed will initially include only poker. It is our belief that any operator, whether land-based or strictly online, that is able to establish a successful presence in the online poker market will be able to easily add and integrate other Internet gambling verticals like casino, sports betting and bingo if and when they are made legal in the United States. This has been the model internationally, and there are numerous international and US suppliers and online operators that will be prepared to facilitate that transition and growth into other game types as they become legal. Thus, in discussing alternatives and challenges, our focus will be on poker.

¹²⁸ H2 Gambling Capital, February 2010

One significant consideration will be the question of who will be able to be licensed. There are all manner of potential participants in the US online industry, ranging from US land-based casinos and suppliers (including tribal gaming organizations), international land-based casinos and suppliers, US and international online operators and suppliers, and potential start-ups wishing to enter the industry. In evaluating who may or may not be licensed, past practices in marketing to, and accepting online play from, the United States, and companies' responses to the passage of UIGEA are key considerations. In our view, there are three tiers of companies that may be participants in the US online industry:

- **White:** Never Participated in the US online market and have generally been in compliance, directly or indirectly, with US gaming jurisdiction regulations. We believe these companies will be licensable and include land-based casinos and suppliers both internationally and in the United States, online operators and suppliers both internationally and in the United States, certain lottery and other companies that desire to enter the online market, and potential startup companies looking to operate in or supply the market.
- **Gray:** Companies that exited the US market after the passage of UIGEA. Although licensability remains to be determined under any minimum standards established by federal legislation, or in the licensing and regulatory position established by any opt-in states, we believe that certain of these companies may be licensable. Because these companies willingly exited the market after UIGEA definitive legislation was passed, they have exhibited behavior demonstrating their willingness to comply with US law. Additionally, some of these companies, like PartyGaming, voluntarily negotiated non-prosecution agreements regarding their past practices, and paid significant fines. Companies on this list would also include 888.com and Cryptologic, among others. Companies in this group that participated in US-based online sports betting, which is generally agreed to be illegal even pre-UIGEA, would likely not be licensable.
- **Red:** Companies that continued to participate in the US online market after the passage of UIGEA. These companies have demonstrated their unwillingness to comply with US law and will likely face steep challenges to become licensed. The passage in committee of the Internet Gambling Regulation, Consumer Protection, and Enforcement Act included the following amendments¹²⁹:

¹²⁹ Overview Of Key House Financial Services Committee Amendments To The Frank Internet Gambling Bill H.R. 2267, August 2010 (No. 5), Blank Rome, LLP

Amendment requiring each applicant for a license to self-certify, under penalty of perjury, that the applicant has, throughout its history, "not committed an intentional felony violation of Federal or State gambling laws" and "has used due diligence to prevent any U.S. person from placing a bet on an internet site in violation of Federal or State gambling laws."

Amendment adding to the list of persons not suitable for licensure: (i) anyone who, since the passage of the Unlawful Internet Gambling Enforcement Act in 2006, knew or should have known that they were owning, operating, or participating in any illegal Internet gambling activities (including taking wagers, paying winnings, advertising, or making payments to any illegal Internet gambling website); (ii) anyone who has received assistance from, or provided assistance to, anyone who has previously accepted bets or wagers from persons located in the United States in violation of Federal or State law; and (iii) any entity which acquires from another entity that has previously accepted bets or wagers from any individual in violation of United States law (a) such other entity, (b) the customer list of such other entity, or (c) any equipment or operations of such other entity.

Amendment requiring the Secretary of the Treasury to keep a list of illegal sites for purposes of assisting banks with blocking illegal transactions in compliance with the Unlawful Internet Gambling Enforcement Act.

These amendments generally have broad industry support, particularly from land-based licensed casino operators and suppliers. Companies affected by the proposed amendments include numerous offshore operators, and most certainly include all of the operators currently offering online poker in the United States. Most conspicuous of these companies, in our opinion, are PokerStars and Full Tilt Poker, the largest poker operators in the United States and globally. It is uncertain what impact any US legislation will have on the two companies and whether otherwise licensable companies will have the opportunity to license or acquire their player bases, technology, intellectual property or other assets for use in the US online market.

The licensing issue is important because if the bill and its amendment pass as they stand today, this would effectively eliminate all of the current operators serving the US market, and create a huge void to be filled by new licensable providers. A void that will enable – based on current and historic precedent – a

handful of large successful operators to dominate the market and, at a minimum, secure the bulk of the 2.3 million estimated 2008 active online poker players.¹³⁰ This will set those companies up well for the longer term, because their initial cost of player acquisition will be low, the initial liquidity that they establish will enable them to compete more effectively, both from a strategic and a cost standpoint, for incremental new players, and they will be best positioned with their large customer bases to offer new products, like casino or sports betting, when and if they become legal.

The biggest challenge facing the industry and potential participants in the US online poker market remains unanswered, and that is: Which jurisdictions will be made available for licensed operators? We believe that the current thinking is that there will be some federal government oversight in establishing minimum licensing, regulatory, and operating standards, and that it will be left to each state to opt-in or opt-out and establish its own licensing and regulatory infrastructure.

This poses a few issues that remain unanswerable at this time. First, is whether there will be significant differences in regulatory standards that are adopted by each participating jurisdiction. While federal standards could help alleviate this issue, the possibility remains that there are significant differences among the jurisdictions, which could pose licensing, operational and compliance challenges, not unlike the land-based gaming industry.

Second, it is not clear how sovereign tribal nations and their gaming entities will be treated under any new legislation. It is likely, however, that tribal organizations in those states that opt-in will have the opportunity to be licensed and participate in the market to the same extent as any other potential licensee and operator in that state.

Third, the question of how to prevent unlicensed, offshore operators from continuing to market to US residents remains unanswered and represents a challenge for the federal government, the state, and the industry as a whole. The gray market participants or illegal participants have the potential to retain significant market share, thereby diminishing the number of potential players and liquidity available to legal, licensed online operators, and impacting both the revenue and tax potential, all of which are important considerations for the successful implementation and ongoing operations of the online poker market in the United States.

Finally, and probably most importantly, the possibility of a fragmented market could impact the success of the market as a whole and its participants. There are only a

¹³⁰ H2 Gambling Capital

handful of individual states that have the population and potential player base necessary to generate the participation and liquidity that is critical for success and to compete against established online operators. If players do not have continual access to a wide variety of games and tournaments, dependent upon sufficient liquidity, they may not be enticed to play on those sites or switch from their current sites, regardless of legality. It is also not clear whether legal licensees in one state may be able to market to accept play from players in other opt-in states or international jurisdictions. And even if that is the direction legislation takes, there are a number of technical, operational, player protection and tax issues that would need to be addressed. Despite these issues, we expect that the issues will be addressed and that an interstate model will ultimately be implemented.

This may or may not bode well for tribal casinos, as interstate Internet gambling could prove to be less advantageous to tribes than an intrastate model would. We believe that most tribal operators are limited to one, or perhaps a few, locations that are focused on the local adult population as the primary customer base. This business model can prove to be a disadvantage in an online world, where customers can play at any casino anywhere, and may be tempted to play at casinos that are affiliated with established brand-name land-based operations in Las Vegas or other resort destinations, with pure-play Internet gambling providers, or with the sites that provide the most compelling and entertaining gaming experience.

The rationale for this is that in an intrastate model, marketing efforts by tribal casinos could be focused on the local population and existing customer base, which is more likely to value and benefit from loyalty and rewards programs that we believe will be a competitive advantage for land-based operators. While it makes sense to try to leverage any capital investments made in the products, services, and operating infrastructure by marketing to players outside the “home” market, we believe it will be a less-compelling consumer proposition and more difficult and expensive to attract, acquire, and retain players outside of the home market. And the competition will be greater. In an intrastate model, the market would be more insulated from competition that may have stronger brands, more compelling content, bigger marketing budgets or more capital.

That being said, an intrastate-only model may not be viable for certain markets, especially for poker. Poker success is dependent upon establishing and offering sufficient liquidity such that the player has a wide variety and selection of games, stakes, tournaments and prizes at any given time. This is not as critical for casino games (with the exception of progressives and other multi-player dependent games), where the player plays against the house and can play their favorite game at any time regardless of

any other player activity. Thus, under an intrastate model, certain states may not be able to provide enough player liquidity to enable potential operators to offer a compelling product offering to attract players from other sites, even if those sites are illegal offshore sites.

As noted above, at an industry and market level, we can look to the evolution of Internet gambling, both in the United States and internationally to help inform us about the critical success factors and answer part of the “when and how” question.

First and foremost, historically in every market, Internet gambling success is predicated on technical, operational and marketing competency and expertise. Internet gambling operations pose many of the same operational, compliance and marketing challenges that land-based casinos do. However, they also include added technical challenges and specific online operating expertise that are not typical for land-based casinos. Internet gambling systems, software and infrastructure must be leading edge, mature, stable, scalable, secure and continually updated and advanced. Internet gambling transactions are cash transactions, just as they are in land-based casinos, and players and regulators will not tolerate poor quality, inefficiencies in the experience, disruption in play or any type of errors. Additionally, the online experience is largely defined by the quality of the entertainment experience. In this respect the best executed, best quality, most entertaining games, content, and experience are critical to success. Historically, from the player perspective, switching costs are minimal and the player will gravitate toward the best service and experience.

Lastly, marketing competency and expertise are also critical. Obviously, acquiring, rewarding and retaining players – as with land-based casinos – are key elements to establishing customer loyalty, building and maintaining critical mass and liquidity, and generating sufficient revenues and profits. Historically, leading online operators have been innovative in developing sophisticated marketing programs that have enabled them to establish a competitive advantage over other industry participants. These have included cash-back and discounting programs, free credits and deposit-matching and bonus programs, and affiliate marketing programs and networks. For online poker, the introduction of poker networks, the tournament model with significant prize pools, and the ability to qualify for land-based tournaments, such as WSOP and WPT, were innovations that enabled PartyPoker and others to establish their dominance.

The most significant marketing advantage that US land-based and tribal casinos can bring to bear is their existing loyalty and rewards programs. The ability to establish an online relationship with new and existing players, and offer them rewards that are redeemable in land-based casinos, will greatly enhance the player experience and entice

them to play at sites where they can qualify and redeem rewards at places that are of value and familiar to them. Integrating online reward and loyalty programs with existing land-based systems and programs will likely be a critical factor for success.

All of these factors are important, because without them, an online operator cannot and will not be able to establish the necessary player base and liquidity required to succeed, particularly with online poker. In every instance and in every market during the evolution of Internet gambling, those companies that have been able to deliver the best experience, build or tap into large player bases and create significant liquidity early in the market have been the ones to emerge as the most successful, most dominant, most profitable and most able to broaden their offering and extend into new markets. This is why we advocate that NIGA and its member nations and tribes focus initially on Internet poker. Once legislation passes, and assuming that the legislation legalizes only online poker initially, it is the companies that establish themselves early – i.e., those who achieve first-mover status - in the legalized US market that will emerge as the best positioned for long-term success.

Early in the evolution of Internet gambling, the most successful companies achieved their success on the back of appealing to the significantly large US market, despite its questionable legality. While most of the companies offered casino and sports betting, the ones that early on acquired the largest player bases were the most successful. These companies included Microgaming, Cryptologic/Intercasino, Golden Palace, BoDog.com and others. Their early success in the US market, due largely to their technological, operating and marketing abilities, allowed them achieve scale, financial success and penetrate new and emerging markets globally.

Later on, in the early part of the millennium, came the large, land-based sports books primarily from the United Kingdom. Sports betting was perfectly suited as an online application as it offered bettors much better convenience, the ability to better manage their accounts, and access to data and information that enhanced the betting experience. When they brought their business online, they were able to immediately leverage their large land-based player membership and establish significant liquidity and scale. Companies such as Ladbrokes were early market entrants, leveraged their land-based business and significant member base to create a formidable online business, and then used that success to expand into online casino gaming, poker, bingo, fixed odds, and other gaming verticals. These companies continue to be dominant today, particularly in European market.

Finally, there was the poker revolution. PartyPoker was an early entrant and innovator whose introduction of tournament play for significant prize pools and aggressive mass-media marketing enabled it to acquire significant numbers of players

and establish, above and beyond any competitor at the time, the liquidity that has proved so important to online poker success. Other savvy market participants followed suit, some of them creating poker networks in order to establish liquidity for their players, and those companies remain dominant operators today. Just as with the early online casinos and sports books, these companies have been able to leverage their scale and success to introduce new gaming verticals and enter new markets ahead of other competitors, further establishing their leadership positions.

If there is one takeaway from the evolution of Internet gambling that is most important, it is that those companies that entered the market early, and were first to establish meaningful customer bases and liquidity, were the most successful and dominant companies. We believe that this will hold true for the US market, as well. Particularly for online poker, as has been the case at different times in other Internet gambling markets, a handful of early poker operators and suppliers will emerge as the most dominant market participants.

The legalization of US online market will mark the next important phase in the evolution of Internet gambling, and there will be certain other critical success factors uniquely relevant to the US market that will be important for NIGA, its member nations and tribes, and other companies wishing to participate in the US market. These include, but are not limited to lobbying efforts to help influence the final provisions of any new online legislation; early collaboration with and preparation for licensing in any likely opt-in states; and the identification, selection, and implementation of the most appropriate partners, technology, product, and operating solutions for any desired market timing or strategy.

Given our belief that the history and evolution of Internet gambling will hold sway as the US online market becomes legalized, the final “when and how” questions to be answered are what is the right time to enter the market, and what is the right product solution to enter the market with. From a market timing perspective, we believe there are two strategic alternatives for NIGA and its member nations and tribes to consider: The first would be to take an “early market entry” approach to become one of the early, dominant players. The second would be to take a “wait and see” approach – to let the market establish the early winners and losers, and then partner with the most successful appropriate online poker providers and participants.

The selection or development and implementation of the most appropriate online poker software platform, content, payment systems, security and verification systems, operating infrastructure, affiliate, marketing, and loyalty systems; finance, accounting and reporting systems; and analytics, compliance and other ancillary systems will be highly important for achieving market success. While building out one or more of

these components and integrating them together for market deployment is one alternative, all of these systems and components have already been developed and refined over time by online poker operators and suppliers, and currently exist in a state of full development, maturity, and operation in markets throughout the world, including the United States. Some of these companies, major offshore operators and suppliers that are in a position to be licensed, are poised to exploit the domestic market should legalization occur.

While some may try to go it alone, others are likely to partner with established US land-based gaming operators and suppliers to quickly and more effectively get licensed in jurisdictions that open up and to benefit from the US established casino brands, regulatory experience, and US-based marketing experience and loyalty programs. For each of the market-timing approaches – enter the market early or “wait and see” – there will be a number of alternatives for entering and participating in the US Internet gambling market, each with their own set of risk and reward that will have to be evaluated by NIGA and its member nations and tribes. Time-to-market, development risk, technical risk, capital risk, licensing, operations, and compliance risk, and economic considerations are some of the critical factors that would have to be considered. Following, we look at some of the alternatives for each market timing approach.

Under the enter-the-market-early approach, it will be important to develop or secure, and implement fully functional, market leading solutions to effectively compete with other potential, established market participants. Again, under this approach it will be critical to attract and build a significant player base to create the necessary liquidity and resulting scale needed to be successful. The alternatives for this approach would include:

- Build, deploy and operate your own dedicated solution:
 - This approach is probably the most risky, but has the potential to offer the greatest reward. First, there is tremendous value in owning and controlling your own software, systems, intellectual property and infrastructure. These systems can be used for your own use, as well as be leveraged to provide a product solution for other third parties. In the case of Indian nations and tribes, a system and product solution could be developed to support the online efforts of multiple tribal gaming concerns or a coalition of potential tribal gaming operators in any given opt-in state. The development of these systems and product solutions, and the implementation and operation of the resulting product solutions are not trivial.

This approach has probably the longest time to market, would require significant upfront capital investment and technical expertise, requires shepherding the resulting solution through the regulatory and certification process, and carries the most development and technical risk. The main benefits are complete control over the product development, both initially and ongoing, and the highest potential financial return in that there are no other significant third-party participants to share in the revenue and profits.

- License a software solution from an existing provider, and deploy and operate it on your own:
 - This is an attractive alternative in that it has the potential to speed the time to market; the product solution, features and functionality could be customized; and it eliminates many of the risks associated with developing and implementing your own product solution. The regulatory and certification process would still have to be undertaken, however, and depending on the nature of the licensing agreement, there would still likely be some amount of significant upfront capital investment required for the product solution and to deploy the necessary systems and operating infrastructure. Under this scenario, the licensor would also likely be entitled to ongoing royalties and development fees, so the potential return may not be as great. And some control is lost over the ongoing product development and refinement.
- Secure a “white label” solution that would be deployed and operated by an existing provider, and focus your resources on marketing:
 - Under this option, the selection of an appropriate partner is critical. It must be one who is certain to be licensed as both an operator and supplier, and who has the experience and ability to get its product solutions certified and maintain operating compliance. Under this scenario, most, if not all control over the product features and functionality are lost, except for the player-facing look and feel. And similar to land-based revenue sharing arrangements for progressive or brand-based slot machines, there would likely be a significant revenue sharing component with the white-label provider, likely to be 25 percent and 35 percent of net gaming revenue. This alternative could be highly attractive, however, as it greatly speeds time to market and eliminates nearly all of the other risks. The other benefits are that it would provide

shared liquidity with other white-label sites hosted by the provider if desired, allow tribal gaming entities wishing to enter the market to easily create a network of online tribal gaming sites, and perhaps more importantly, allow those entities to focus their capital and resources on marketing and player acquisition.

- Partner with an existing operator (either through a joint venture or commercial arrangement) to deploy and operate in the United States:
 - As mentioned earlier, there are a number of existing, successful online operators who are likely to partner with established US land-based gaming operators and suppliers to quickly and more effectively get licensed in jurisdictions that open up and benefit from the US established casino brands, regulatory experience, and US-based marketing experience and loyalty programs. Many NIGA member nations and tribes clearly fit this profile and there is an opportunity for them to take this approach. Again, many of the risks under this alternative are mitigated or eliminated. There would likely be more involvement and control in tailoring the product solution for specific markets and established consumers. And tribal gaming organizations would benefit from the experience, operating and marketing expertise of the partner. Capital requirements and financial considerations would obviously be dependent on the negotiations and terms of the agreement, but it is likely that a larger portion of the net gaming revenue or profits would be lost under this scenario.
- Buy an existing operator or supplier in order to deploy and operate in the United States:
 - There are numerous potential acquisition candidates, ranging from start-ups, to smaller operators and suppliers, to larger operators and suppliers, and potentially for unlicensable entities that may be looking to sell technology, intellectual property and other online assets. This approach would carry many of the same benefits as the build-it-yourself option, while the risk profile would be dependent on the nature of the target company. This approach would likely require the largest upfront capital commitment, but the time to market, control aspect, and downstream economics could equate to an attractive investment prospect. This alternative could also be used to support multiple tribal gaming entities,

a coalition of tribes in a given state, or perhaps even a national tribal network in order to help build liquidity.

Under the wait-and-see approach, it would also be important to develop or secure, and implement fully functional, market leading solutions to effectively compete with other potential, established market participants. And most of the alternatives would be the same. However, with the added benefit of time, NIGA and its member nations and tribes would have the luxury of narrowing their potential alternatives to include only those who have established success in the marketplace. Under some alternatives, the “wait and see” approach would likely be more expensive both in upfront capital requirements and downstream financial considerations, while other alternatives may actually become less expensive.

- Build, deploy, and operate your own dedicated solution.
 - This is probably not a good alternative for the wait and see approach as its benefits and time to market considerations are more applicable for an early market entry
- License a software solution from an existing provider, and deploy and operate it on your own.
 - The risks and benefits of this alternative remain the same, and over time there will likely be more software solutions to choose from, including those who have demonstrated success with their product offerings.
- Secure a “white label” solution that would be deployed and operated by an existing provider, and focus your resources on marketing.
 - Again, the risks and benefits remain the same, with the exception that there will likely be companies to choose from that have already been licensed and have demonstrated success in the market place. There is also the potential for pricing pressure to occur as these “white label” providers compete for licensees and the solution may be had for more attractive financial terms and considerations.
- Partner with an existing operator (either through a JV or commercial arrangement) to deploy and operate in the United States.
 - The risks under this approach will be further mitigated over time and there will likely be opportunities to partner with operators or suppliers who have demonstrated market success and looking to further leverage their investments in product solutions and operating infrastructure. The

benefits would remain largely the same, while the financial considerations could actually improve as the potential partners would be in a better position to consider deals on the basis of marginal incremental revenues and costs.

- Buy an existing operator or supplier in order to deploy and operate in the United States:
 - While there will always be potential acquisition candidates, the cost of this alternative could become prohibitive, particularly if the candidate has demonstrated any sort of success in the US market.

XIV. Conclusion

The Internet gambling industry has established itself as a viable, credible, profitable and important strategic segment of the overall gaming market worldwide. The regulation of Internet gambling in the United States represents a tremendous strategic and revenue opportunity for tribal gaming organizations and other potential participants looking to establish their business online in the US market, build online consumer relationships with existing and new customers, and enhance and grow their business. Although current proposed legislation only expressly prohibits any licensee from accepting wagers on sporting events, with the exception of pari-mutuel racing as permitted by law, it is widely anticipated that any legislation that is ultimately passed in to law will initially make only online multi-player poker legal. Based on historical perspectives and the evolution of Internet gambling, the timing and approach for participating in the US market is critical to success. The benefits of entering the market early, including securing a large initial customer base and player liquidity, coupled with the historical prospects and economic benefits for establishing and leveraging early success and scale, must be weighed against the risks associated with the different early market entry alternatives. At the same time, the benefits of taking the “wait and see” approach and alternatives must be weighed against settling for a secondary and less financially rewarding position in the market, albeit likely successful and beneficial.

In our view, there are few definitive threats or risks to tribal casinos and operations posed by the legalization of Internet gambling, particularly poker, in the United States. Ultimately, we believe that Internet gambling will be an integral part of any gaming company’s marketing strategy, product portfolio and growth potential. Not participating in this market in the long run is an alternative that we would not necessarily endorse, and we believe it will become a common product offering for all US-based gaming operators where it is legal.

The introduction, evolution, and maturity of Internet gambling have served to grow the global gaming market and have not adversely affected traditional land-based gaming revenues or markets on their own. There are rational explanations for that phenomenon, particularly in light of the notion that land-based gaming offers a social aspect that is not available in an online forum. In many cases, the presence of Internet gambling has revolutionized traditional land-based markets and, in the case of online poker, was the catalyst for significant growth in land-based poker rooms and the magnet for attracting a new generation of potential gaming customers.

Whatever risks or threats that exist for land-based tribal gaming organizations today will likely continue in the future, regardless of and unaffected by any potential

legislation legalizing Internet gambling in the United States. If anything, the prospect of legalized Internet gambling in the United States, will serve to minimize the impact that illegal offshore operators have on tribal gaming operations today, and serve to provide an incremental, strategic growth opportunity for entities wishing to participate in the US online market.

We caution, however, that the advent of Internet gambling in the United States presents potential scenarios that can differ significantly from what has occurred in other markets, particularly because the land-based industry here is so pervasive.

With that in mind, we suggest that land-based operators – including tribal operators – do have inherent advantages in an online world, especially the notion that they are able to identify good customers and incent them with rewards to visit their land-based operations. Pure online operations – including lotteries – do not have that advantage, although some have established commercial partnerships, 888.com and Harrah’s Interactive for example, to try to bridge the gap. This advantage needs to be leveraged by tribal operators, and should have a prominent place in any lobbying strategy employed by NIGA or its member nations and tribes.

We must also note that most tribal operators are limited to one or perhaps a few locations that are focused on the local adult population as the primary customer base. This business model can prove to be a disadvantage in an online world, where customers can play at any casino, and may be tempted to play at casinos that are affiliated with land-based operations in Las Vegas or other resort destinations.

With that in mind, we suggest that interstate Internet gambling could prove to be less advantageous to tribes than an intrastate model would.

As mentioned throughout this paper, there is too much uncertainty regarding the details of prospective legislation, or when it might pass, to draw firm conclusions or make definitive recommendations for how NIGA and its member nations and tribes should proceed. And it is unclear exactly how sovereign nations, tribal gaming operators, and their state compacts will be treated under any potential legislation, either for legislation that has been proposed, or new legislation that may be introduced. Thus, the main threat to NIGA and its member nations and tribes is the unknown. In order to minimize or eliminate any potential threats as it pertains to potential legislation, and to maximize tribal gaming organizations strategic and revenue opportunities going forward, we recommend and endorse getting more heavily involved with the legislative process, sooner rather than later. By getting involved, with lobbying, industry participation or other means, Indian nations and tribes will have the opportunity to help define the laws, licensing and regulatory standards, taxes, and

operating requirements that will define and impact its online and business opportunities on a forward basis.

Over the next 12 to 14 months, we also recommend establishing a dialogue and partnering with the states that tribal gaming entities operate in, particularly those states that may elect to opt-in under any potential legislation legalizing Internet gambling in the United States. By participating with the states to help define their licensing and regulatory framework, NIGA member nations and tribes will be better prepared and ahead of the game for securing licenses, getting potential partners approved and or licensed, and getting product solutions certified. We also believe that NIGA and its member nations and tribes should also carefully consider its market entry strategies and alternatives.

There is an opportunity for NIGA and its member nations and tribes to provide leadership and direction in forming a broad-based tribal gaming strategy for the online market, for helping its member organizations work together and collaborate on the best approach for entering the market, potentially to help establish a national tribal Internet gambling network that could benefit all of its member tribal operators who wish to participate in the online market, and to potentially help facilitate online tribal gaming coalitions for certain states with multiple operators.

NIGA and its member nations and tribes should also take the opportunity – now – to start evaluating the pros and cons of the “early entry” vs. “wait and see” market-entry approaches, as well as start identifying and analyzing the possible alternatives outlined above for each approach. There are benefits and risks for either approach, and there are benefits and risks that must be assessed for each of the alternatives. Entering the online industry is not an “if you build it, they will come” proposition. Internet gambling operations pose many of the same operational, compliance, and marketing challenges that land-based casinos do. However, they also include added technical challenges and specific online operating expertise that are not typical for land-based casinos. Identifying, evaluating and selecting the right alternatives and approach will be critical for NIGA member nations and tribes for entering and succeeding in the online marketplace.

Finally, concentrate on poker. We believe that poker will likely be the first form of Internet gambling to be legalized in the United States. While long-term revenue potential for poker is not as great as for casino and other forms of gaming, it is already a significant market, as well as a familiar and hugely popular game in the United States, and has the backing of influential gaming industry participants, and has helped to attract a new generation of potential gaming consumers, and will likely generate support in Congress and ultimately with states faced with the decision of opting-in to any potential

new regulation. The evolution of Internet gambling has shown that those companies that entered the market early, and were first to establish meaningful customer bases and liquidity, were the most successful and dominant companies over the long term. We believe that this will hold true for the US market, as well, particularly if poker is legalized first. As has been the case at different times in other Internet gambling markets, a handful of early poker operators and suppliers will emerge as the most dominant market participants.

Preparing for and entering the market with a poker solution will enable participants to build necessary operating and marketing expertise and provide time to build the necessary integration with existing land-based operations and loyalty and rewards programs and systems. Other gambling verticals, such as casino, bingo and sports betting, will be available and easily integrated with existing systems from numerous existing operators and suppliers when and if they are made legal. And there will be an established customer base to market those products and services to. This is a model that has played out in the international Internet gambling market, and which we believe will evolve the same way in the legalized and regulated US market.

XV. About This Report

This report was prepared by Spectrum Gaming Group, an independent research and professional services firm founded in 1993 that serves private- and public-sector clients worldwide. Our principals have backgrounds in operations, economic analysis, law enforcement, regulation and journalism.

Spectrum holds no beneficial interest in any casino operating companies or gaming equipment manufacturers or suppliers. We employ only senior-level executives and associates who have earned reputations for honesty, integrity and the highest standards of professional conduct. Our work is never influenced by the interests of past or potentially future clients.

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Recent private-sector clients include Elad Properties, Harrah's Entertainment, Morgan Stanley, the Pokagon Band of Potawatomi Indians, and the Seneca Nation of Indians. Recent public-sector clients include the Massachusetts Office of Housing and Economic Development, the Connecticut Division of Special Revenue, Broward County (FL), the West Virginia Lottery Commission, the New Jersey Casino Reinvestment Development Authority, the Atlantic City Convention and Visitors Authority, the Singapore Ministry of Home Affairs, Rostov Oblast (Russia) and the Puerto Rico Tourism Company.

We maintain a network of leading experts in all disciplines relating to the gaming industry, and we do this through our offices in Atlantic City, Bangkok, Guangzhou, Harrisburg, Hong Kong, Las Vegas, Macau, Manila and Tokyo.

Disclaimer

Spectrum Gaming Group has made every reasonable effort to ensure that the data and information contained in this study reflect the most accurate and timely information possible. The data are believed to be generally reliable. This study is based on estimates, assumptions, and other information developed by Spectrum from its independent research effort, general knowledge of the gaming industry, and consultations with the Client and its representatives. Spectrum shall not be responsible for any inaccuracies in reporting by the Client or its agents and representatives, or any

other data source used in preparing or presenting this study. The data presented in this study were collected through the cover date of this report. Spectrum has not undertaken any effort to update this information since this time.

Some significant factors that are unquantifiable and unpredictable – including, but not limited to, economic, governmental, managerial and regulatory changes; and acts of nature – are qualitative by nature, and cannot be readily used in any quantitative projections.

No warranty or representation is made by Spectrum that any of the projected values or results contained in this study will actually be achieved. We shall not be responsible for any deviations in the project's actual performance from any predictions, estimates, or conclusions contained in this study.

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This study is qualified in its entirety by, and should be considered in light of, these limitations, conditions and considerations.

XVI. Online Resources

We believe that NIGA and its member nations and tribes might find the following online information resources useful as it contemplates entry into Internet gambling. Spectrum makes no representation as to the accuracy or timeliness of the information on these websites.

- **4OnlineGaming** www.4online-gambling.com

Advocacy site for Internet gambling legalization that offers information on government positions regarding Internet gambling worldwide.

- **American Gaming Association** www.americangaming.org/assets/files/studies/

Gaming industry organization offering comprehensive casino sector information, news updates, and research studies. *Internet Gambling Fact Sheet* is concise source for legal history and recent developments.

(www.americangaming.org/Industry/factsheets/issues_detail.cfv?id=17)

- **Casino City Online** www.online.casinocity.com

Casino City Online offers popularity and site number rankings for 2,346 online casinos and gambling sites based on independent monitoring of online users. Also a good source for Internet gambling jurisdictions, software providers, site operators and payment methods.

- **eCOGRA** www.ecogra.org

Non-profit, London-based gaming industry organization established to set standards for the Internet gambling industry. Organization offers certification to qualifying operators, data analysis, a monthly newsletter, and a dispute resolution process for players.

- **History of Internet gambling** www.777.com/articles/the-history-of-online-gambling

Brief history of interactive gambling posted on aggregator site.

- **iGaming News** www.igamingnews.com

Internet gambling news service posted by Casino City.

- **Inside Bet** www.insidebet.com

Good source for jurisdictions, software providers, operators, and networks. Site provides gambling guides for players in a wide variety of online casino and poker games. Similar to Casino City but not as comprehensive.

- **Internet World Stats** www.Internetworldstats.com

Extremely comprehensive information and statistics on worldwide Internet usage, population statistics, and Internet market research data for over 233 individual countries and world regions.

- **Online Casino Archives** www.onlinecasinoarchives.com

Good source for news, press releases, and historical information. Good press coverage of many European personalities and social history of casino gambling.

- **Internet gambling History** www.onlinegambling.com/online-gambling-history.htm

Brief history of interactive gambling posted on aggregator site.

- **Internet gambling Project** www.onlinecasinoproject.com

Fairly good source for history of Internet gambling up to 2007.

- **UK Gambling Commission** www.gamblingcommission.gov.uk

Government commission established to regulate domestic gambling. Site provides comprehensive information on the British interactive and land-based gaming industry and ongoing research studies including the *British Gambling Prevalence Survey*.

- **University of Online Poker** www.universityofonlinepoker.com/poker-demographics.html

Website features charted results of online poker player survey published in 2007.