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INTERNET GAMBLING PROHIBITION ACT OF 2006

HEARING

BEFORE THE

SUBCOMMITTEE ON CRIME, TERRORISM, AND HOMELAND SECURITY

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

ON

H.R. 4777

APRIL 5, 2006

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INTERNET GAMBLING PROHIBITION ACT OF 2006

WEDNESDAY, APRIL 5, 2006

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CRIME, TERRORISM,
AND HOMELAND SECURITY
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2 p.m., in Room 2141, Rayburn House Office Building, the Honorable Howard Coble (Chairman of the Subcommittee) presiding.

Mr. COBLE. Good afternoon, ladies and gentlemen. The Ranking Member—the gentleman from Virginia, the primary sponsor, just entered the room; and Mr. Scott, the Ranking Member, is on his way. But in the interests of time, I am going to go ahead and give my opening statement and then recognize Mr. Scott when he gets here.

Today, the Subcommittee on Crime, Terrorism, and Homeland Security is conducting a legislative hearing on H.R. 4777, the "Internet Gambling and Prohibition Act of 2006." H.R. 4777 is very similar to legislation that the Judiciary Committee considered and approved during the 107th Congress.

Currently, Federal law is unclear as to whether or not Internet gambling is prohibited by section 1084 of title 18 of the United States Code. H.R. 4777 clarifies the law in this area by prohibiting Internet gambling and updates existing language to bar use of new technologies such as wireless access to gambling sites on the Internet, which were never envisioned when section 1084 was originally drafted in 1961.

The dramatic explosion in Internet gambling raises complex criminal and social issues. From a law enforcement perspective, this new multibillion-dollar industry has attracted organized crime because of the ease by which criminals can launder money and increase illegal revenues without fear of prosecution or even investigation.

Unlike authorized and regulated wagering in the United States, the Internet gambling business is operated in an environment free of regulatory oversight and even a remote possibility of civil or criminal enforcement. As a result, Internet gambling has turned into an industry ripe for organized crime domination.

The rapid growth in this industry also raises other concerns for our communities. Millions of Americans suffer from gambling addiction resulting in financial debt, depression, unemployment, bankruptcy, divorce, homelessness, and in some cases, even suicide.

While the Internet has certainly been a boon for our economy, our productivity and our general welfare, one downside of the Internet has been the ease by which troubled adults and our children gain access to addictive gambling sites. This is a problem which must be addressed in order to protect our communities and our youth.

We are fortunate today to have the original sponsor of H.R. 4777, the distinguished gentleman from Virginia, Representative Bob Goodlatte, to testify and explain the details of his bill. He is the sponsor of past Internet wagering bills and probably knows the issue as well or better than any Member of Congress.

Mr. Goodlatte, as you know, our Subcommittee also has experience in this issue, and we look forward to your testimony.

I just apologized to the distinguished gentleman from Virginia. I was not overlooking him, but in an effort to save time, I gave my opening statement before Mr. Scott got here because we are going to have a vote, I suspect, within an hour, but perhaps a little longer than that. So I hope we can get to the business at hand.

And at this point, I am pleased to recognize the distinguished gentleman from Virginia, the Ranking Member, Mr. Bobby Scott.

Mr. SCOTT. Thank you Mr. Chairman. Mr. Chairman, I noticed that at 1 minute past 2 that you are on the third page of your statement.

Mr. COBLE. If the gentleman will yield, look at the time we saved.

Mr. SCOTT. It is a pleasure to be here, Mr. Chairman; I am pleased to join you in convening this hearing regarding Federal regulation of gambling over the Internet.

I believe that all gambling should be tightly regulated, and it has traditionally been done by the State regulatory responsibilities. It should continue to be so, in my judgment, although it is appropriate for the Federal Government to have a role to assist the States in the total regulatory scheme.

The Federal Government took such a role in 1961 with the Wire Communications Act as a way to assist in the fight against gambling by organized crime syndicates. The Department of Justice contends it can prosecute Internet gambling businesses under that law, but clearly that law was not designed with Internet gambling in mind.

While I appreciate the desire of my distinguished colleague, the gentleman from Virginia, Mr. Goodlatte, to update the ability of the Department to address illegal gambling in today's context, I do not believe that H.R. 4777 is likely to be effective in doing so.

Regulating anything over the Internet is problematic, even desirable. Most law enforcement is local or jurisdictional based. The Internet has no jurisdiction, and as a result, I suspect that even if we were successful in closing down business sites physically located in the United States, or in countries where we can get cooperation, because of the nature of the Internet and the ingenuity of people using it, the approach of H.R. 4777 will ultimately be ineffective.

As we hear from our witness panel, this bill will create an enforcement nightmare for financial institutions because they would be required to look up and stop illegal gambling transactions. Iden-

tifying Internet gambling activities will be very difficult, if not impossible. While some companies may be able to identify some gaming transactions by codes used, such enforcement efforts can easily be thwarted. A business can have one code for payment purposes, but may be engaged in several activities, including Internet gambling.

A casino, for example, may have a hotel or gambling. A foreign company may have a hotel, a casino, Internet gambling, an e-cash or an electronics payment system; or any outside escrow agent can relocate to another country and, therefore, evade enforcement mechanisms in the bill altogether. With some Internet gaming activities being legal, how would a financial institution distinguish between them and legal activities?

Furthermore, we should not overestimate the cooperation we may get from other countries. According to Christiansen Capital Advisers, Internet gambling Web sites brought in over $14 billion worldwide last year, which is up from 8 billion the year before. That number is expected to almost double to 24 billion by 2010.

Presently, over 85 foreign governments allow some form of gambling online. That number is likely to grow as well. So what governments are likely to cooperate with us in prosecuting businesses they authorize to operate? And even if we are successful in getting cooperation from some countries, we would be simply increasing the profit opportunities for uncooperative countries, especially those with whom the United States does not have normal diplomatic relations.

This bill does not prohibit Internet gambling; it prohibits running the Internet gambling operation. If we want to be effective in prosecuting illegal gambling over the Internet, we should prosecute the individual gamblers. A few sting operations and the word would get around that if you gamble on the Internet, you will be caught. And so long as individuals can gamble over the Internet with impunity, a market will be provided for them which the regulatory scheme in this bill will not stop.

For example, Mr. Chairman, we prohibit the sales of illegal drugs. But we see that as long as there remains a demand for drugs, we have only limited success in the war on drugs. But if we took the approach in this bill in enforcing drug laws, we would be prosecuting the seller, but not the buyer and have even less effect than we have now.

Since we are not talking about prohibiting gambling on the Internet, but simply prohibiting the operation of the illegal gambling site in jurisdictions that the FBI can get to, I believe that there are more effective regulatory approaches than the approach offered in H.R. 4777. However, the approaches must be developed to take into account the technology and State policies with respect to gambling and Internet gambling practices and preferences.

This is the effect of the bill authored by the full Committee Ranking Member, Mr. Conyers, last year, H.R. 1223. It established a commission that would study the issue and make recommendations for a regulatory environment for Internet gambling that would be controlled by the individual States. States do tend to prohibit individuals from gambling, so Internet gambling can both be

effective—can be effective in individualized States and individualized to each State.

Under the bill's regulatory scheme, if Nevada opted to allow Internet gambling within its borders, it could. If Utah prohibited individuals from that State from gambling over the Internet, it probably could, and that would be enforceable by the Federal Government and by the States that allow gambling as well as the States—as well as the State of Utah, because in the fullness of time, a gambler could be required to provide a mailing address in order to get paid.

If protection of the public is the goal of regulating Internet gambling, it is much more likely that those who choose to gamble over the Internet will do so under a licensed, regulated entity under the Conyers approach than under 4777. First, the consumer in a State where Internet gambling was legal would have confidence that if they win, they will be paid by the licensed, regulated operation.

A consumer would have no similar confidence in fly-by-night offshore Casino.com. As a result, from a licensed, regulated Internet gaming activity would drive business from the less reputable businesses, and they would essentially drive them out of business.

Another significant result is that States that choose to authorize Internet gambling can tax it. At a time when unauthorized gambling is flourishing—as I said, over $14 billion with over half of it originating in the United States—and when most States are cash strapped, those States that have chosen to authorize regulated gambling could receive much-needed revenue from both the operators and the winners while contributing to the control of the industry and protection of the gambling public.

The overwhelming portion of those who buy—who play the numbers buy legal lottery tickets, which are regulated and taxed and actually pay lower odds compared to the illegal numbers operations. For the same reason, people will choose to gamble over Internet—who choose to gamble over the Internet will patronize legal domestic Web sites even if they have to pay taxes on the winnings.

I believe we should regulate Internet gambling, but we should do so effectively. We should not subject any single business sector to the sole or principal responsibility of doing the bulk of the enforcement work, whether it is the banking industry in this bill or the Internet service industry, as we tried in prior bills. There are ways to regulate Internet gambling effectively, and a study commission to develop those ways is the best way to come up with them.

And, again, Mr. Chairman, I thank you for holding the hearing and look forward to the testimony.

Mr. COBLE. I thank the distinguished gentleman from Virginia.

We have been joined by the distinguished gentleman from Utah. While not a Member of the Subcommittee on Crime, Terrorism, and Homeland Security, he is a Member of the full Judiciary Committee. And we have been joined, as well, by the distinguished gentleman from Michigan, the Ranking Member of the full Committee.

And, Mr. Conyers, if you have a statement, I will be glad to recognize you.

Mr. CONYERS. Thank you, Mr. Chairman and Members of the Committee and our distinguished witnesses here.

I think we have to come far more specifically to grips about the issues raised, particularly by the gentleman from Virginia, Mr. Bobby Scott.

Now, gambling is going on now; it is out of the barn, so to speak. But when you start doing something as futile as carve-outs and a ban on racing, you are on a slippery slope that is going to create more problems.

Let me just make a few points, and I will probably not use my full 5 minutes.

First, this measure claims to ban all forms of online gambling, yet specifically exempts betting on horse racing, pay-to-play fantasy sports, State-owned and -operated lotteries. And so, we are doing a picking and choosing of which gambling activities to sanction while disapproving many others; and I will be looking carefully to find out how we arrived at the decision of which gambling will be sanctioned and which won't.

Number two, the bill is not likely to lead to any meaningful reduction in the current number of Americans that place bets on line. Isn't that what the legislation ought to be about? Major financial service organizations already employ the bill's main enforcement mechanisms, and Americans can easily circumvent those prohibitions by using third-party payers or even foreign banks.

Third, by eliminating a customer's access to the U.S. financial services industry, this bill may inadvertently make worse the most pressing dangers posed by the Internet gambling industry. After all, credit cards play a vital role in determining an individual bettor's wagers and tracking potential earnings and losses. By prohibiting their use, we effectively lose access to this key information.

And finally, the bill proposes to establish a complex regulatory system for banks that is unworkable. It is all but impossible to comply with. And under the provisions of the bill, banks would be asked to determine whether a transaction occurring online was illegal or legal based upon the type of gambling activity involved and where the location of the transaction occurred, and whether or not the transaction involved interstate commerce.

Now, let's be real, my friends. If we really want to gain effective control of the online gambling industry, we must regulate it. Establishing a partial ban, allowing some forms of gambling to continue without the benefit of adequate checks and balances only will make the current situation much worse.

And I thank you, Chairman Coble, for allowing me to get these remarks in before our witnesses start their commentary.

Mr. COBLE. I thank the distinguished gentleman from Michigan.

Gentleman, it is the practice of the Subcommittee to swear in all witnesses appearing before it; so if you would, please stand and raise your respective right hands.

[Witnesses sworn.]

Mr. COBLE. You may be seated.

Let the record show that each of the witnesses answered in the affirmative.

We have four distinguished witnesses with us today. Our first witness is the Honorable Bob Goodlatte, whom I have previously mentioned. Representative Goodlatte serves the Sixth Congressional District in the State of Virginia and was first elected to the

Congress in 1992. He is currently cochairman of the Congressional Internet Caucus. He was selected by Speaker Hastert to serve on the House Republican Cybersecurity Task Force.

Prior to serving in the Congress, Representative Goodlatte was a partner in the law firm of Bird, Kinder & Huffman, and he is an alumnus of Bates College and the Washington and Lee School of Law in Virginia.

And the statement about you, Mr. Goodlatte, is missing a conspicuous ingredient. You also serve as Chairman of the House Agriculture Committee, unless there has been a change that is not known to me.

Our second witness is Bruce Ohr, Chief of the Organized Crime and Racketeering Section at the Justice Department. Previously, Mr. Ohr served as Assistant U.S. Attorney for the Southern District of New York and Chief of the Violent Gangs Unit in that office. He also worked as an associate at Ohr, Harrington and Sutcliffe. Mr. Ohr received his undergraduate and law degrees from Harvard.

Our third witness is Mr. John Kindt, Professor at the University of Illinois School of Law. Previously, Professor Kindt was employed in several State and Federal Government positions, and he also has served as a Senior Fellow at the London School of Economics.

Professor Kindt's research has resulted in over 30 articles in the areas of legalized gambling's economic impacts. He has earned several graduate degrees in law and business, including an MBA, a JD and an SJD.

Our fourth witness is Mr. Sam—sir, help me with your surname.

Mr. VALLANDINGHAM. Vallandingham.

Mr. COBLE. Mr. Vallandingham is Vice President and Chief Information Officer at the First State Bank. And headquartered where, Mr. Vallandingham?

Mr. VALLANDINGHAM. Barboursville, West Virginia.

Mr. COBLE. Thank you, sir. Prior to serving in this capacity, Mr. Valling—try me one more time.

Mr. VALLANDINGHAM. Vallandingham.

Mr. COBLE. It is really not that difficult—worked as Data Security Officer and Vice President of the Mortgage Department. He is also a member of the Independent Community Bankers of America where he serves on the Payments and Technology Committee.

He was awarded his undergraduate degree from Florida State University and his graduate degree from Louisiana State University.

Gentlemen, it is good to have each of you with us. And as I previously informed you, there will be a vote upcoming. We comply with the 5-minute rule here, as you all have previously been told. And when you see the amber light illuminate on the panel in front of you, that is your 1-minute warning.

And then, when the red light appears, that is when the ice on which you are skating has become very thin. We will not unduly punish you; however, at that point, if you could wrap up, we would be appreciative.

Now, Mr. Goodlatte, I am told that you have another engagement at what time?

Mr. GOODLATTE. Three o'clock, but I need to leave before that.

Mr. COBLE. We will start with you and you can depart, and if we are still going, you are welcome to come back.

Mr. Goodlatte, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE BOB GOODLATTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. GOODLATTE. Thank you, Mr. Chairman, for inviting me to testify before this Subcommittee on this very important issue.

Gambling on the Internet has became an extremely lucrative business. Numerous studies have charted the explosive growth of this industry, both by the increases in gambling Web sites available and via industry revenues. Internet gambling is now estimated to be a $12 billion industry, with approximately 6 billion coming from bettors based in the United States. It has been reported that there are as many as 2,300 gambling sites.

Virtual betting parlors have attempted to avoid the application of United States law by locating themselves offshore and out of our jurisdictional reach. These offshore fly-by-night Internet gambling operators are unlicensed, untaxed and unregulated, and are sucking billions of dollars out of the United States. In addition, Internet gambling can serve as a vehicle for money laundering by organized crime syndicates and terrorists.

Contrary to what many in the gambling community would lead you to believe, gambling is not a victimless activity. In fact, the negative consequences of online gambling can be more detrimental to the families and communities of addictive gamblers than if a bricks-and-mortar casino were built next door.

The anonymity of the Internet makes it much easier for minors to gamble online. Furthermore, online gambling can result in addiction, in bankruptcy, divorce, crime and moral decline just as with traditional forms of gambling, the cost of which must ultimately be borne by society.

In fact, I have been contacted by a constituent in my district whose son fell prey to an Internet gambling addiction. Faced with insurmountable debt from Internet gambling, he took his own life. Unfortunately, financial ruin and tragedy are not uncommon among online bettors.

Traditionally, States have had the authority to permit or prohibit gambling within their borders. With the development of the Internet, however, State prohibitions and regulations governing gambling have become increasingly hard to enforce as electronic communications move freely across borders.

Currently, Federal law already prohibits interstate gambling over telephone wires. However, because the Internet does not always travel over telephone wires, these laws which were written before the invention of the Internet have become outdated. H.R. 4777, the "Internet Gambling Prohibition Act of 2006," brings the current prohibition against wireline interstate gambling up to speed with the development of new technology. It also makes clear once and for all that the prohibition is not limited to sports-related bets and wagers.

In addition, H.R. 4777 will add a new provision to the law that would prohibit a gambling business from accepting certain forms of noncash payment, including credit cards and electronic transfers.

This bill also provides an enforcement mechanism to address the situation where the gambling business is located offshore, but accepts money from bank accounts in the United States. The bill also provides an additional tool to fight illegal gambling by giving Federal, State, local and tribal law enforcement new injunctive authority to prevent and restrain violations of the law.

H.R. 4777 will return control to the States by protecting the rights of citizens in each State to decide through their State legislatures if they want to allow gambling within their borders. The regulation of intrastate gambling is within the jurisdiction of the States. So this bill leaves the regulation of wholly intrastate betting or wagering to the States with tight controls to ensure that such betting or wagering does not extend beyond their borders or to minors.

While my legislation prohibits online, interstate gambling, it does not overturn previous act of Congress that address gambling. This is a strong antigambling bill that also protects the rights of States to determine what is and what is not prohibited within their borders.

The opponents of this legislation have a lot to lose. Offshore online gambling Web sites are cash cows, and the greed that propels these companies leads them to solicit bettors in the U.S. despite the fact that the Department of Justice already believes this activity is illegal. The greed that motivates many of these offshore establishments has also motivated nefarious lobbyists such as Jack Abramoff to spread misinformation about previous attempts of the Congress to ban online betting.

Internet gambling is a serious problem that must be stopped. The Internet Gambling Prohibition Act will help eliminate this harmful activity before it spreads further.

I am happy to answer any questions from Members of the Subcommittee and address some of the misrepresentation that is already occurring about this legislation when that opportunity arises.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Goodlatte follows:]

PREPARED STATEMENT OF THE HONORABLE BOB GOODLATTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

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Internet gambling is a serious problem that must be stopped. The Internet Gambling Prohibition Act will help eliminate this harmful activity before it spreads further. I am happy to answer any questions the members of this subcommittee may have regarding this legislation.

Mr. COBLE. And you are to be congratulated. You beat the illumination of the red light.

So the pressure is on you, Mr. Ohr. Mr. Ohr, good to have you with us.

STATEMENT OF BRUCE G. OHR, CHIEF OF THE ORGANIZED CRIME AND RACKETEERING SECTION, UNITED STATES DEPARTMENT OF JUSTICE

Mr. OHR. Good afternoon, Mr. Chairman, Ranking Member Scott.

Mr. COBLE. Pull that mike a little closer to you, Mr. Ohr.

Mr. OHR. Good afternoon Mr. Chairman, Ranking Member Scott, honorable Members of the Subcommittee. Thank you for inviting me to testify today.

I would like to commend Congressman Goodlatte, as well as Congressman Leach and Senator Kyl for their efforts and long-standing commitment to provide law enforcement with additional tools to combat Internet gambling. Today, I am happy to offer the views of

the Department of Justice on H.R. 4777, the "Internet Gambling Prohibition Act of 2006."

I would like to begin by noting that the Government continues to investigate and prosecute illegal Internet gambling. Two recent examples: In January of this year, the U.S. Attorney's office in St. Louis announced a $7.2 million settlement with *Sporting News* to resolve claims that the *Sporting News* promoted illegal gambling from 2000 through 2003 by accepting fees for advertising illegal gambling.

In April of last year, the U.S. Attorney's Office in the District of Massachusetts indicted 13 individuals on racketeering charges which included allegations that the enterprise used an offshore gambling office and that customers placed bets over the Internet. The operator of the offshore gambling office has pled guilty.

I would like to say that the Department supports H.R. 4777 for several reasons. This legislation clarifies and strengthens our position that section 1084 of title 18 applies to both telephone and the Internet.

This bill increases the penalties for a violation of section 1084. It prohibits the acceptance of credit cards for Internet gambling. It provides a civil enforcement mechanism to enforce that prohibition, and it provides a method to cut off the transfer of funds to and from illegal Internet gambling businesses.

The Department does have some concerns about certain provisions of H.R. 4777 that may weaken current law, that may allow some Internet gambling from the home. We view the existing statutes as prohibiting interstate bets or wagers including bets or wagers on horse races. We have previously stated that we do not believe that the Interstate Horse Racing Act amended the existing criminal statutes. We are currently undertaking a criminal investigation related to potential violation of law regarding this activity. We would have concerns about any change in the law that could be construed as permitting interstate wagering on horse races.

We are also concerned about the definition of intrastate for the purpose of exempting certain Internet gambling transactions from the reach of 1084. The definition focuses on the location of the bettor and the betting facility, but ignores the routing of the Internet communication placing the bet. Under current law, the routing of the Internet communication is of great importance in determining whether the transmission is in interstate commerce. We are concerned that the proposed definition might weaken existing law.

While we welcome the bill's provision of an injunctive remedy to restrain any person from paying or assisting in the payment of illegal Internet bets and wagers, we have concerns over the bill's limitation or the type of injunctive relief that may be obtained against an Internet service provider. We believe that Federal Rule of Civil Procedure 65 should be the sole standard used by courts in considering whether to grant injunctive relief and what form that relief should take.

We are concerned that H.R. 4777 permits gambling from the home, as this raises issues about gambling by minors and compulsive gambling. We have concerns about the requirement for the secure and effective customer verification and age verification set

forth in the bill. Online gambling businesses cannot see the customer to do onsite age verification.

Furthermore, the residents' verification requirements set forth in the bill may not be sufficient to ensure that the bettor is, in fact, physically located in the same State as the gambling business when he makes his wager.

The Department believes that Internet gambling should remain illegal. We are concerned about Internet gambling because of the potential for gambling by minors and compulsive gambling, the potential for fraud and money laundering and the potential for involvement by organized crime.

And to cite one example from this area, in January, 2005, the U.S. Attorney's Office in New York's Southern District of New York indicted 17 defendants in an 88-count indictment for running an illegal gambling business that included both telephone and Internet wagers being placed with offsite betting facilities both in the United States and abroad. The principals in this scheme are alleged to be associates of the Gambino organized crime family of La Cosa Nostra.

Thank you, Mr. Chairman.

Mr. COBLE. Well, you too beat the red light.

[The prepared statement of Mr. Ohr follows:]

PREPARED STATEMENT OF BRUCE G. OHR

Department of Justice

STATEMENT

OF

TESTIMONY OF

BRUCE G. OHR
CHIEF
ORGANIZED CRIME AND RACKETEERING SECTION
CRIMINAL DIVISION
UNITED STATES DEPARTMENT OF JUSTICE

BEFORE THE COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON CRIME, TERRORISM, AND HOMELAND SECURITY
UNITED STATES HOUSE OF REPRESENTATIVES

CONCERNING

H.R. 4777, THE "INTERNET GAMBLING PROHIBITION ACT"

PRESENTED ON

APRIL 5, 2006

Statement of Bruce G. Ohr, Chief
Organized Crime and Racketeering Section
Criminal Division
United States Department of Justice
Before the U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Crime, Terrorism, and Homeland Security

April 5, 2006

Good morning, Mr. Chairman, Ranking Member Scott, and Honorable Members of the Subcommittee. Thank you for inviting me to testify today. My name is Bruce G. Ohr and I am the Chief of the Organized Crime and Racketeering Section in the Criminal Division of the Department of Justice. I would like to commend Congressman Goodlatte, as well as Congressman Leach and Senator Kyl, for their tireless efforts and longstanding commitment to provide law enforcement with additional tools to combat Internet gambling. Today, I am pleased to offer the views of the Department of Justice on H.R. 4777, the Internet Gambling Prohibition Act.

Since the Department of Justice last appeared before you on this topic, we have continued investigating and prosecuting illegal Internet gambling. For example, in January 2006, the United States Attorney's Office in St. Louis announced a $7.2 million settlement with the Sporting News to resolve claims that the Sporting News promoted illegal gambling from early 2000 through December 2003 by accepting fees in exchange for advertising illegal gambling. As part of this settlement, the Sporting News will conduct a public service campaign to advise the public of the illegality of commercial Internet and telephonic gambling. On April 11, 2005, the United States Attorney's Office of the District of Massachusetts indicted 13 individuals on racketeering charges, which included allegations that the enterprise used an offshore gambling office in San Jose, Costa Rica and that customers of the enterprise's sports betting business were able to place bets over the Internet and through the use of a toll-free telephone number. The operator of the offshore gambling office was Todd Westerman, who pled guilty on January 10, 2006. Two other defendants have also entered guilty pleas. The trial date for the remaining defendants has not yet been set by the court.

The Department of Justice generally supports the efforts of the drafters of H.R. 4777 because this legislation amends an existing criminal statute and it applies equally to wagering over the Internet and over the telephone. While the Department believes that 18 U.S.C. § 1084 already encompasses both types of wagering, the proposed amendments in H.R. 4777 strengthen our position and assure the continued viability of Section 1084 into the future. Further, the Department also supports the proposals to increase the penalty for a violation of Section 1084, to prohibit the acceptance of certain forms of payment, such as credit cards, for Internet gambling, and to provide for civil enforcement action against such activity. Finally, H.R. 4777 also provides law enforcement with a method to cut off the transfer of funds to and from illegal Internet gambling businesses.

The Department of Justice, however, has concerns regarding some of the provisions of H.R. 4777, including that sections of this proposal may weaken current law and standards and that it would also permit gambling over the Internet from the home and favor certain industries over others.

The Department of Justice views the existing criminal statutes as prohibiting the interstate transmission of bets or wagers, including wagers on horse races. The Department is currently undertaking a civil investigation relating to a potential violation of law regarding this activity. We have previously stated that we do not believe that the Interstate Horse Racing Act, 15 U.S.C. §§ 3001-3007, amended the existing criminal statutes. H.R. 4777, however, would change current law and amend Section 1084 to permit the interstate transmission of bets and wagers on horse races. H.R. 4777 also permits "intrastate" wagering over the Internet without examining the actual routing of the transmission to determine if the wagering is "intrastate" versus "interstate." Under current law, the actual routing of the transmission is of great importance in deciding if the transmission is in interstate commerce. The Department is concerned that these two proposals would weaken existing law.

The Department also opposes provisions in the bill that weaken or alter existing federal law or standards pertaining to civil injunctive relief. The Justice Department believes that Rule 65 of the Federal Rules of Civil Procedure should be the sole standard used by courts in considering whether to grant injunctive relief and what form this relief should take. Rule 65 is the well-established standard that Federal courts use in all cases in which a party is seeking injunctive relief. That provision leaves it to the discretion of the district court judge to determine on a case-by-case basis what form the relief should take. Proposed subsection

1084(i)(3), however, limits the relief that can be granted against an Internet service provider. The Department believes that the judge who has reviewed the specific evidence in the case should have the authority, as he or she currently does under Rule 65, to fashion the appropriate remedy or relief.

The Department is also concerned that H.R. 4777 permits gambling from the home, which raises issues about gambling by minors and compulsive gambling. We also have concerns about the requirement for the "secure and effective customer verification and age verification to assure compliance with age and residence requirements." Unlike casinos, online gambling businesses cannot see their customers in order to do onsite age verification. The exception for intrastate wagering in subsection 1084(d)(1) requires that the bettor be physically located in the state at the time that the wager is made, not that the individual be a resident of that state. Verifying residence would not be sufficient to meet this requirement. For example, if only state residency is subject to verification, an internet gambling customer could be a resident of the state but be physically located in another state when the wager is made. Further, under this verification requirement the State must have the verification system, not the gambling business. This implies that the verification would not be occurring at the time of the actual transmission of bets and wagers. Even if this requirement were changed to verification of physical location, however, the Department believes that further study is needed as to whether existing technology can address compliance where a bettor places bets using his or her cell phone or laptop computer using a WiFi or similar wireless internet access.

As the Department has stated on prior occasions, we also have concerns about compulsive gambling and other deleterious effects if Internet gambling is permitted. Because it is so easy to access and use, Internet gambling could exacerbate the problems and temptations facing compulsive gamblers. For example, the United States Attorney's Office in New Mexico recently charged a bank executive with fraud charges for stealing $5 million from Union Bank. The executive pled guilty to a criminal information charging him with felony theft, embezzlement or misapplication of funds. The executive admitted that he used most of the money to fund Internet gambling accounts.

As we have noted on several occasions, as a general matter the Department believes that Internet gambling should remain illegal. The Department of Justice is concerned about Internet gambling because of the potential for gambling by minors and compulsive gambling, the potential for fraud and money laundering, and the

potential for involvement of organized crime. For example, a recent indictment charged members of the Uvari group, which included associates of the Gambino Organized Crime Family. The Uvari Group established wagering accounts for their customers with off-site gambling business and the customers placed bets on horse races and other sporting events over the internet and the telephone.

We also are concerned that this bill would permit interstate wagering by the horse racing industry. Under H.R. 4777, other industries could only conduct intrastate wagering. As expressed earlier, it is the Department's view that the Interstate Horseracing Act did not change Section 1084. H.R. 4777, however, expressly permits interstate wagering on horse racing. The Department questions why, under the provisions of H.R. 4777, one industry will be able to accept interstate wagers while other industries that are also regulated by the states cannot.

Finally, the Department of Justice also has some drafting concerns with the legislation, including several of the definitions slated to be added to Section 1081. For example, since the definition of the term "bet or wager" requires that the activity be "predominately subject to chance," we are concerned whether this definition is sufficient to cover card games, such as poker. In addition, the definition of the term "information assisting in the placing of bets or wagers" should include the receipt of information by the gambling business from bettors or third parties, and not just information sent by the gambling business. For example, as drafted, the receipt of line information would not be covered.

Conclusion

On behalf of the Department of Justice, I want to thank you again for inviting me to testify today. We thank you for your support over the years and reaffirm our commitment to work with Congress to address the significant issue of Internet gambling. I am happy to answer any questions that you might have.

Mr. COBLE. But the pressure shifts to Mr. Kindt.

You won't be unduly punished if the red light beats you Mr. Kindt.

STATEMENT OF JOHN W. KINDT, PROFESSOR, UNIVERSITY OF ILLINOIS

Mr. KINDT. Thank you, Mr. Chairman. I don't know of any academic who can do this in under 5 minutes, but I will give it a try; and I would ask for your kind permission for my written remarks be included in their entirety, if you would, sir.

Mr. COBLE. Without objection, it will be done.

Mr. KINDT. Thank you, Mr. Chairman, Members of the Committee, participants and guests from the U.S. House of Representatives and the U.S. Senate. Thank you for your kind invitation to testify before the Committee.

Internet gambling destabilizes U.S. national security and the strategic economic base. This is a State Department issue. And I would like to raise your eyes a little bit beyond the Beltway and look at this from an international perspective. This was brought before the full House Committee on the Judiciary before 1995 as an issue.

Some of the problems with Internet gambling are, first, Internet gambling destabilizes U.S. and international economies. Secondly, it destabilizes and threatens the financial systems of the United States and the international economic system.

Third, it destabilizes U.S. national security in the fight against terrorism. Fourth, it destabilizes military readiness. Fifth, it creates and facilitates new criminal activities.

Sixth, Internet gambling fuels the fastest growing addiction among young people, gambling addiction. Seventh, Internet gambling creates enormous socioeconomic costs of $3 for every $1 in benefits.

And finally, Internet gambling creates and facilitates Government corruption in the United States and throughout the world. Internet gambling causes immediate harm and irreparable harm to the entire U.S. public.

If you would reference the first overhead, you will see that we have a headline here, back in 1996, "40 Economists Sided Against Internet Gambling." Can you get 40 economists to agree on anything? Well, they agree on this. This is a slam dunk. Gambling is lose-lose for the public. It is $3 in costs for every $1 in benefits.

For examples of sworn testimony by professors, academics documenting the immediate and irreparable harm caused by Internet gambling and the advertising of such activities, I have appended statements from three expert witnesses, including myself, sworn testimony from a California case; and I would direct you to that, to those affidavits.[1]

Like drug addiction, the harms to the public are commonly referred to as the ABC's of legalized gambling, socioeconomic impacts caused by gambling activities via cyberspace and particularly via

[1] *See also* Denver University Law Review document at *http://www.ncalg.org/library/studies%20and%20white%20papers/economics/kindtjoydenverlaw.pdf.*

the Internet include new addicted gamblers, new bankruptcies and new crime.

If I could have the second overhead, please.

The second overhead here is from the Michigan State, Detroit College of Law, Law Review. You can see there at the bottom—this is an older statement—talks about the teen population being addicted. And at the top, in the upper right-hand corner, it talks about the crack cocaine of gambling. Now this is a terminology that sociologists—this is not my terminology; and you can see that Internet gambling is well known as the crack cocaine of creating new addicted gamblers.

In the case of these concentrated and multiple electronic gambling devices, the accessibility and the new acceptability, that is, the legalization to the public, dictate that new pathological, that is, addicted, gamblers will double from approximately 1 percent of the public, increasing to 2 percent. Similarly, the new problem gamblers will double from approximately 2 percent to 4 percent of the public.

With the categories specifically focused on teens and young adults, these rates are virtually doubled again to between 4 percent to 8 percent combined pathological, that is, addicted, and problem gamblers. Children, teens and young adults conditioned by the Nintendo phenomenon are already demonstrating double the pathological and problem gambling rates of the older adult population who matured without video games and without accessible legalized gambling venues.

Accordingly, the 1999 Gambling Impact Study Commission recommended that there be no legalization of Internet gambling, actually called for a prohibition and that the U.S. laws criminalizing gambling over the wires be strengthened and expanded to other jurisdictions. I am sure you are familiar with this report.

Gambling industry spokespersons have frequently referred to Internet gambling as the killer application of Internet technology because Internet gambling is crack cocaine to addicting new gamblers and because the feeder market is every living room, work station and school desk.

What are the strategic solutions? It is to eliminate Internet gambling problems and other gambling problems by transforming those gambling facilities into educational and practical technology facilities, thereby stabilizing international financial institutions. Instead of legalizing the casino slot machine establishment at a failing racetrack in 1997, the Nebraska legislature bulldozed the racetrack, cut out all the gambling and made it into an extension of the University of Nebraska and a high tech office park. And they just expanded that facility.

On October 27, 2005, the Illinois House of Representatives voted 67 to 42 for the Senator Paul Simon memorial bill, one of the initial sponsors of the National Gambling Impact Study Commission. This bill was to recriminalize the Illinois casinos. It passed the House; it is currently awaiting action in the Illinois Senate.

Similarly, suggestions have been made to recriminalize gambling facilities in other States and transform the gambling facilities into educational and high tech assets instead of giving the gambling industry tax breaks.

On December 6, 2005, Pennsylvania Representative Paul Clymer, with 32 cosponsors, introduced a bill to recriminalize the Pennsylvania casinos.

Finally, in conclusion, the immediate strategic solution to eliminate or curtail many of the problems caused by gambling activity is a total ban on Internet gambling activities. Socioeconomic history demonstrates that the eventual solution to the U.S. and international gambling problems is to recriminalize gambling, wipe the slate clean and transform gambling facilities into educational and practical technology facilities.

Thank you, Mr. Chairman. Thank you, Committee.

Mr. COBLE. And I plead guilty for having been very naive. I should have known a professor could not have wrapped it up in the 5-minute time frame, but you didn't do too bad.

Mr. KINDT. I did the best I could.

[The prepared statement of Mr. Kindt follows:]

PREPARED STATEMENT OF JOHN W. KINDT

John Warren Kindt
Professor
University of Illinois

Testimony
Before the Subcommittee on Crime, Terrorism, and
Homeland Security
United States House of Representatives

Legislative Hearing on H.R. 4777: The "Internet
Gambling Prohibition Act"

April 5, 2006

TESTIMONY OF JOHN WARREN KINDT[1]

Mr. Chairman, Members of the Committee, participants and guests from the U.S. House of Representatives and the U.S. Senate, thank you for your kind invitation to testify before the Committee.

This Statement will address the following issue areas:

A. Internet Gambling Destabilizes U.S. National Security and the Strategic Economic Base;
B. A Summary List of Problems with Internet Gambling;
C. The Socio-Economic Impacts of Gambling Activities via the Internet, Cell Phones, and Cyberspace: Immediate and Irreparable Harm;
D. Are Electronic Gambling Games and Slots "Fair" to Patrons?; and
F. Strategic Solution to Eliminate Internet Gambling Problems and Other Gambling Problems: Ban Internet Gambling and Transform Gambling Facilities into Educational and Practical Technology Facilities: Stabilizing International Financial Institutions.

In this testimony I have cited to my own work only as introductions to the hundreds of source materials cited in the footnotes. These sources can be referenced by researchers. This Committee has my permission (and the permissions which I have already received from the publishers of my articles and the attachments herein) to reprint and distribute any or all of the articles authored by myself on gambling issues. In PDF format, these articles are available at *www.family.org/gamblingresearch*

A. Internet Gambling Destabilizes U.S. National Security and the Strategic Economic Base

During the 1990s, the international economic and diplomatic ramifications of the spread of U.S. gambling technologies throughout the United States and the world were outlined in an article written at the suggestion and under the auspices of former Secretary of State Dean Rusk. The article was: John W. Kindt, *U.S. Security and the Strategic Economic Base: The Business/Economic Impacts of Legalized Gambling Activities*, 33 St. Louis U.L.J. 567-584 (1995), *reprinted in National Gambling Impact and Policy Comm'n Act: Hearing on H.R. 497 before the House Comm. on the Judiciary*, 104th Cong., 1st Sess. 519-27, 528-45 (1995).

As commonly utilized by U.S. State Department analysts, the McDougal/Lasswell methodology for policy-oriented decision-making highlights these strategic problems with the spread of U.S. gambling technologies.

Monetary interests promoting Internet gambling have long referred to Internet gambling as the "killer application" of the Internet, the world wide web, and cyberspace, including cell phones (hereinafter referenced collectively as "Internet gambling"). *See, e.g.*, William H.

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[1] Professor, Univ. Ill. at Urbana-Champaign. B.A. 1972, William & Mary; J.D. 1976, MBA 1977, U. Ga.; LL.M. 11978, SJD 1981, U. Va.; Associate, Program in Arms Control, Disarmament, and International Security, University of Illinois. Professor Kindt has taught at the University of Illinois since 1978, and he has published over 70 academic articles in law reviews, public policy journals, and economics journals. Over 20 of these articles have dealt with gambling issues, and they are available in PDF format at *www.family.org/gamblingresearch*
To avoid conflicts of interest, Professor Kindt and several academic colleagues do not accept consultant fees or honoraria for work in gambling research areas. This Statement should be interpreted as representing only the individual views of the author. Richard D. Barritt and Tai G. Schuler provided valuable editorial assistance in preparing this Statement.

Bulkeley, *Feeling Lucky? Electronics is Bringing Gambling into Homes, Restaurants and Planes,* WALL ST. J., Aug. 16, 1995, at A1.

Internet gambling places electronic gambling at every work station, at every school desk, and in every living room. The phrase "click your mouse, lose your house" is a common phrase at academic conferences and state legislative hearings analyzing Internet gambling.

B. A Summary List of Problems with Internet Gambling

1. Internet gambling destabilizes U.S. and international economies. John W. Kindt & Stephen W. Joy, *Internet Gambling and the Destabilization of National and International Economies: Time for a Comprehensive Ban on Gambling Over the World Wide Web*, 80 DENV. U.L. REV. 111-153 (2002).
2. Internet gambling destabilizes and threatens the financial systems of the United States and the International Economic System. *See, e.g.*, John W. Kindt & John K. Palchak, *Legalized Gambling's Destabilization of U.S. Financial Institutions and the Banking Industry: Issues in Bankruptcy, Credit, and Social Norm Production*, 9 EMORY U. BANKRUPTCY DEV. J. 21-69 (2002) (lead article). *See also*, John W. Kindt, *The Business-Economic Impacts of Licensed Casino Gambling in West Virginia*, 13 W. VA. U. INST. PUB. AFF. 22-26 (1996) (invited article), *updated and reprinted from, The National Impact of Casino Gambling Proliferation: Hearing Before the House Comm. on Small Business,* 103d Cong., 2d Sess. 77-81 (1994) (statement of Prof. John W. Kindt).
3. Internet gambling destabilizes U.S. national security in the fight against terrorism. John W. Kindt & Anne E.C. Brynn, *Destructive Economic Policies in the Age of Terrorism: Government-Sanctioned Gambling as Encouraging Transboundary Economic Raiding and Destabilizing National and International Economies*, 16 TEMPLE INT'L & COMP. L.J. 243 (2002-03) (lead article).
4. Internet gambling destabilizes military readiness. *See, e.g.*, John W. Kindt, *Gambling with Terrorism and U.S. Military Readiness: Time to Ban Video Gambling Devices on U.S. Military Bases and Facilities?*, 24 N. ILL. L. REV. 1-39 (2003) (lead article).
5. Internet gambling creates and facilitates new criminal activity. *See generally*, John W. Kindt, *Increased Crime and Legalizing Gambling Operations: The Impacts on the Socio-Economics of Business and Government*, 30 CRIM. L. BULL. 538-555 (1994); John W. Kindt, *The Failure to Regulate the Gambling Industry Effectively: Incentives for Perpetual Non-Compliance*, 27 S. ILL. U.L.J. 221-262 (2002) (lead article) [hereinafter *The Failure to Regulate Gambling*].
6. Internet gambling fuels the fastest growing addiction among young people – gambling addiction. *See* John W. Kindt & Thomas Asmar, *College and Amateur Sports Gambling: Gambling Away Our Youth?*, 8 VILLANOVA SPORTS & ENTERTAINMENT L.J. 221-252 (2002) (lead article).
7. Internet gambling creates enormous socio-economic costs of $3 for every $1 in benefits. John W. Kindt, *The Costs of Addicted Gamblers: Should the States Initiate Mega-Lawsuits Similar to the Tobacco Cases?*, 22 MANAGERIAL & DECISION ECON. 17-63 (invited article).

8. Internet gambling creates and facilitates government corruption in the United States and throughout the world. *See generally*, John W. Kindt, *Follow the Money: Gambling, Ethics, and Subpoenas*, 556 ANNALS OF THE AM. ACADEMY OF POLITICAL & SOC. SCI., 85-97 (1998) (invited article) [hereinafter *Follow the Money*].

Callously capitalizing on the 9-11 tragedy, U.S. gambling lobbyists slipped into the 2002 Economic Stimulus Act what the Nevada press termed a $40 billion federal tax break for slot machines and other electronic gambling devices. Tony Batt, *Tax Break for Slots OK'd*, LAS VEGAS REV. J., Oct. 16, 2001, at 1. As of last fall, those tax write-offs were still in force and gambling interests were lobbying for extensions and increases. John W. Kindt, *Internationally, the 21st Century Is No Time for the United States to Be Gambling With the Economy: Taxpayers Subsidizing the Gambling Industry and the Del'acto Elimination of All Casino Tax Revenues via the 2002 Economic Stimulus Act*, 29 OHIO N. UNIV. L. REV. 33-394 (2003) (lead article).

C. The Socio-Economic Impacts of Gambling Activities via the Internet, Cell Phones, and Cyberspace: Immediate and Irreparable Harm.

Internet gambling causes "immediate harm" and "irreparable harm" to the entire U.S. public. For examples of sworn testimony by professors/academics documenting the "immediate and irreparable harm" caused by Internet gambling and the advertising of such activities, see Expert Opinions of Earl Grinols, John Warren Kindt, and Nancy Petry *Cisneros v. Yahoo* (Case No. 04433518, Calif. Superior Ct. San Fran., filed Aug. 3, 2004) [hereinafter *Cisneros*].

However, U.S. businesses continue to provide venues for advertising illegal internet gambling in the United States. *See* 18 U.S.C. § 1084 (the "Wire Act"); Matt Richtel, *Wall St. Bets On Gambling On the Web*, N.Y. TIMES, Dec. 25, 2005, at A1 (The U.S. Justice Department reaffirmed that "online gambling [is] illegal.").

In one California example, a private attorney general action on behalf of the public has been brought as a class action "against the major Internet search engine websites which advertise illegal Internet gambling in California." *Cisneros*, *infra*, Complaint, at 1.

The primary irreparable harm resulting from advertising gambling activities and the resulting gambling consists of pathological gambling, which is comparable to drug addiction. Pathological gambling is recognized as an addictive behavior, specifically an "impulse control disorder." AM. PSYCHIATRIC ASS'N, DIAGNOSTIC AND STATISTICAL MANUAL OF MENTAL DISORDERS, sec. 312.21, at 615-18 (4th ed. 1994) [hereinafter DSM IV]. The American Psychiatric Association (APA) lists 10 diagnostic criteria for pathological gambling. By definition, a "pathological gambler" evidences "[p]ersistent and recurrent maladaptive gambling behavior as indicated by five (or more)" of the 10 criteria. DSM IV, *infra*, at 618. By definition, a "problem gambler" evidences up to four of the criteria.

Like drug addiction, the harms to the public (commonly referred to as "the ABCs" of legalized gambling's socio-economic impacts) caused by gambling activities via cyberspace and particularly via the Internet include:

(a) new addicted gamblers,

(b) new bankruptcies, and

(c) new crime

For the most authoritative analysis of new crime costs linked to the accessibility and acceptability of gambling, *see* Earl L. Grinols, *et. al.*, Casinos and Crime (1999, as updated 2005), forthcoming academic publication as Earl L. Grinols & David Mustard, *The Curious Case of Casinos and Crime*, 88 REV. ECON. & STAT. 28-45 (2006). A table of the authoritative academic studies highlights that the socio-economic public costs of legalized gambling activities are at least $3 for every $1 in benefits. Earl L. Grinols & David B. Mustard, *Business Profitability versus Social Profitability: Evaluating Industries with Externalities, The Case of Casinos*, 22 MANAGERIAL & DEC. ECON. 143, 153 (2001) [hereinafter *The Case of Casinos*]. This 3:1 ratio has been the ratio for many years. *See, e.g., The National Impact of Casino Gambling Proliferation: Hearing before the House Comm. on Small Business*, 103d Cong. 77-81 & nn. 9, 12 (1994).

For the definitive book in these issue areas, *see* EARL L. GRINOLS, GAMBLING IN AMERICA: COSTS AND BENEFITS (Cambridge Univ. Press 2004). For summaries and tables of the major studies of the socio-economic harms, see John W. Kindt, *The Costs of Addicted Gamblers: Should the States Initiate Mega-Lawsuits Similar to the Tobacco Cases?*, 22 MANAGERIAL & DEC. ECON. 17, 44-63, App. Tables A1-A14 (2001) [hereinafter *Mega-Lawsuits*]. *See also*, NAT'L GAMBLING IMPACT STUDY COMMISSION FINAL REPORT chap. 4 (June 1999) [hereinafter NGISC FINAL REPORT]. For a summary of the socio-economic costs of gambling activities as presented to Congress, *see* Testimony and Prepared Statement of Professor John Warren Kindt, *Before the U.S. House of Representatives Comm. on Resources*, 109th Cong., 1st Sess., Apr. 27, 2005 (App. Tables).

In the case of concentrated and multiple electronic gambling devices (EGDs), such as in casinos and racinos (*i.e.*, EGDs at racetracks), the "accessibility" and new "acceptability" (*i.e.*, legalization) to the public dictates that the new pathological (*i.e.*, addicted) gamblers will double from approximately 1.0 percent of the public, increasing to 2 percent. Similarly, the new problem gamblers will double from approximately 2 percent of the public, increasing to 4 percent. When the category is specifically focused on teens and young adults, these rates are virtually doubled again to between 4 percent to 8 percent combined pathological and problem gamblers. *See e.g.*, Durand F. Jacobs, *Illegal and Undocumented: A Review of Teenage Gambling and the Plight of Children of Problem Gamblers in America*, in COMPULSIVE GAMBLING: THEORY, RESEARCH, AND PRACTICE 249 (1989).

These "doubling increases" have reportedly occurred within the gambling facilities' "feeder markets." NGISC FINAL REPORT, *infra*, at 4-4 (50-mile feeder markets); John W. Kindt, *Diminishing or Negating the Multiplier Effect: The Transfer of Consumer Dollars to Legalized Gambling: Should a Negative Socio-Economic "Crime Multiplier" be Included in Gambling Cost-Benefit Analyses?*, 2003 MICH. STATE DCL L. REV. 281, 312-13 App. (2003) (35-mile feeder markets) [hereinafter *Crime Multiplier*]; John Welte, St. Univ. N.Y. at Buffalo, 2004 Study (10-mile feeder markets).

Gambling activities via cyberspace and particularly via the Internet eliminate the radial feeder markets around the casino EGDs and maximize the accessibility and acceptability factors for gambling (and concomitant social negatives) by placing EGDs in every living room, at every work station, and at every school desk. Children, teens, and young adults conditioned by the

Nintendo phenomenon are already demonstrating double the pathological and problem gambling rates of the older adult populations who matured without video games and without the accessible legalized gambling venues. Jacobs, *infra*.

Accordingly, the 1999 U.S. National Gambling Impact Study Commission recommended that there be no legalization of Internet gambling and that the U.S. laws criminalizing gambling over the wires be strengthened (*see* 18 U.S.C. § 1084, the "Wire Act"). The Commission also de facto recommended that the laws criminalizing Internet gambling be redrafted to eliminate any ambiguities and to establish a virtual ban on gambling in cyberspace. NGISC FINAL REPORT, *infra*, recs. 5.1-5.4. The U.S. Gambling Commission also highlighted that EGDs were commonly referenced by the psychological community as the crack cocaine of creating new addicted gamblers. *See, e.g.*, NGISC FINAL REPORT, *infra*, at 5-5; V. Novak, *They Call it Video Crack*, TIME, June 1, 1998, at 58. The Commission reported testimony that Internet gambling magnifies gambling addiction.

Irreparable harm as a result of advertising Internet gambling devolves from the phenomenon that there are large increases in the numbers of pathological and problem gamblers once EGD gambling becomes accessible and acceptable. The legalization of new gambling venues since 1990 and the addictive nature of gambling have led to substantial increases in the numbers of Gamblers Anonymous groups, which are modeled after Alcoholics Anonymous groups.

Gambling industry spokespersons have frequently referred to Internet gambling as the "killer application" (a.k.a. "killer app") of Internet technology because Internet gambling is crack cocaine to addicting new gamblers and because the feeder market is every living room, work station, and school desk. For a summary table showing the various studies reporting the disproportionate revenues which various types of legalized gambling take from pathological and problem gamblers, *see Mega-Lawsuits, infra*, at 25, Table 1 (compiled by Professor Henry Lesieur).

Increasing numbers of experts and clinicians studying pathological gambling have reported that when a new person is "once hooked" they are "hooked for life." *See, e.g., Mindsort, Colorado Lottery 1996*. The salient points are that: (1) these are new pathological gamblers, and (2) these gamblers may be addicted for life (although in remission in many cases). A fortiori, gambling via cyberspace and particularly via the Internet intensifies these problems – a substantial number of which will be irreparable, especially when interfaced with children, teens, and young adults. *See, e.g.*, David P. Phillips, *et al.*, *Elevated Suicide Levels Associated with Legalized Gambling*, 27 SUICIDE & LIFE-THREATENING BEHAV. 373, 376-77, & Table 3 (1997).

D. Are Electronic Games and Slots "Fair" to Patrons?

Issues have arisen involving how "slot machines" are programmed and whether the astronomical odds are "fair" to patrons. *"The Insiders" for Gambling Lawsuits: Are the Games "Fair" and Will Casinos and Gambling Facilities be Easy Targets for Blueprints for RICO and Other Causes of Action?*, 55 MERCER L. REV. 529-593 (2004) (lead article). *See also, Subpoenaing Information from the Gambling Industry: Will the Discovery Process in Civil*

Lawsuits Reveal Hidden Violations Including the Racketeer Influenced and Corrupt Organizations Act?, 82 OREGON L. REV. 221-294 (2003) (lead article). Coupled with pandemic regulatory failures, these issues of "fairness" have been exacerbated. *See The Failure to Regulate Gambling, infra; Follow the Money, infra.*

E. The Feeder Market Impacts of Internet Gambling

The FINAL REPORT of the Congressional 1999 National Gambling Impact Study Commission called for a moratorium on the expansion of any type of gambling anywhere in the United States. Although tactfully worded, the National Gambling Commission also called for the continued prohibition of Internet gambling and the re-criminalization of various types of gambling, particularly slot machines convenient to the public.

Some of the negative impacts of casinos, electronic slot machines, and Internet gambling are detailed in the appendix to the article, *Diminishing Or Negating The Multiplier Effect: The Transfer of Consumer Dollars to Legalized Gambling: Should a Negative Socio-Economic "Crime Multiplier" be Included in Gambling Cost/Benefit Analyses?*, 2003 MICH ST. DCL L. REV. 281-313 (lead article). The circle "feeder market" chart and sources documentation follow this written testimony.

In his classic book entitled ECONOMICS, Nobel-Prize laureate Paul Samuelson summarized the economics involved in gambling activities as follows: "There is ... a substantial economic case to be made against gambling. First, it involves simply *sterile transfers of money or goods* between individuals, creating no new money or goods. Although it creates no output, gambling does nevertheless absorb time and resources. When pursued beyond the limits of recreation, where the main purpose is after all to "kill" time, gambling subtracts from the national income. The second economic disadvantage of gambling is the fact that it tends to promote *inequality and instability of incomes*." PAUL SAMUELSON, ECONOMICS 245 (10th ed.). Furthermore, Professor Samuelson observed that "[j]ust as Malthus saw the law of diminishing returns as underlying his theory of population, so is the 'law of diminishing marginal utility' used by many economists to condemn professional gambling." *Id.* at 425.

F. Strategic Solution to Eliminate Internet Gambling Problems and Other Gambling Problems: Transform Gambling Facilities into Educational and Practical Technology Facilities: Stabilizing International Financial Institutions

Instead of legalizing a casino/slot machine establishment at a failing racetrack in 1997, the Nebraska legislature bulldozed the racetrack and made it into an extension of the University of Nebraska and a high-tech office park. John W. Kindt, *Would Re-Criminalizing U.S. Gambling Pump-Prime the Economy and Could U.S. Gambling Facilities Be Transformed into Educational and High-Tech Facilities? Will the Legal Discovery of Gambling Companies' Secrets Confirm Research Issues?* 8 STANFORD J.L., BUS. & FIN. 169-212 (2003) (lead article).

Thereafter, as pro-gambling interests returned to Nebraska they were repeatedly rebuffed by the academic community, which was exemplified in one instance by 40 economists publicly rejecting new gambling proposals that would "cannibalize" the consumer economy. Robert Dorr, *40 Economists Side Against More Gambling, Signers: Costs Likely Higher than Benefits*, OMAHA WORLD-HERALD, Sept. 22, 1996, at B1.

On October 27, 2005, the Illinois House of Representatives voted 67 to 42 (with 7 voting "present") for the Senator Paul Simon memorial bill (as it is popularly referenced) to re-criminalize the Illinois casinos via H.B. 1920, sponsored by Representative John Bradley. The companion Senate bill is currently awaiting action in the Illinois Senate Rules Committee.

Similarly, suggestions have been made to re-criminalize gambling facilities in other states and transform the gambling facilities into educational and high-tech assets – instead of giving the gambling industry tax breaks. On December 6, 2005, Pennsylvania Representative Paul Clymer (with 32 cosponsors) introduced H.B. 2298 to re-criminalize the Pennsylvania casinos.

Casinos and gambling parlors would generally be compatible with transformations into educational and high-tech resources. For example, the hotels and dining facilities could be natural dormitory facilities. Historically, facilities built for short-term events, such as various World's Fair Expositions, the 1996 Olympic Village (converted to facilities for the Georgia University system), and other public events have been transformed into educational and research facilities.

The immediate strategic solution to eliminate or curtail many of the problems caused by gambling activities is a total ban on Internet gambling activities. Socio-economic history demonstrates that the eventual strategic solution to U.S. and international gambling problems is to re-criminalize gambling and transform gambling facilities into educational and practical technology facilities.

John Warren Kindt
Professor
University of Illinois

Attachments to Statement

Before the Subcommittee on Crime, Terrorism, and Homeland Security
United States House of Representatives
Legislative Hearing on H.R. 4777: The "Internet Gambling Prohibition Act"
April 5, 2006

Reprinted with permission from:
Robert Dorr, *40 Economists Side Against More Gambling*, OMAHA WORLD-HERALD, Sept. 22, 1996, at B1.

p. Omaha World-Herald 9/22/96
p1 of Midlands Section

40 Economists Side Against More Gambling

Signers: Costs Likely Higher Than Benefits

BY ROBERT DORR
WORLD-HERALD BUREAU

Lincoln — Forty Nebraska economists say they oppose the expansion of gambling in Nebraska because the economic costs "are likely to far outweigh" the benefits.

Gambling has a better reputation than it deserves because the economic benefits — mainly jobs or tax revenue — are easy to see, said Loretta Fairchild, economics professor at Nebraska Wesleyan University in Lincoln.

"The economic costs are hidden," said Dr. Fairchild, the main drafter of a statement released Saturday.

The statement opposes gambling only on the basis of its economic costs related to economic benefits.

The signers, mostly economics teachers at Nebraska colleges and universities, might or might not have moral reasons for opposing the expansion of gambling in Nebraska, Dr. Fairchild said.

Two expanded-gambling petition issues have fallen short of the 90,000 valid signatures needed to get those measures on the Nov. 5 ballot in Nebraska. A federal judge has given the leaders of both efforts until Oct. 8 to come up with evidence that too many signatures were invalidated by local election officials.

One issue, supported by Nebraska racetracks and horse owners, would permit opening casinos at or near the state's tracks. The second issue, backed by some keno parlor owners, would allow local voters to authorize slot machines and other electronic gambling at keno parlors.

The statement signed by the 40 economists reads: "We, the undersigned Nebraska economists, are opposed to the expansion of gambling in Nebraska be-

Please turn to Page 8, Col. 1

40 Economists Pan Expanded Gambling

Continued from Page 1

cause the additional direct and indirect costs are likely to far outweigh the additional direct and indirect benefits for the state as a whole."

Dr. Fairchild said studies on gambling have indicated that casinos that draw most of their customers from the local area and the surrounding region "siphon consumer dollars away from other local businesses."

"Regional casinos simply recirculate dollars that already exist, bringing little or no new money to the local economy," said Dr. Fairchild, who has a doctorate in economics from Cornell University.

Dr. Fairchild said many people believe that all the money from gamblers stays in the state. "That's a myth," she said. "It depends on the ownership structure. Many of the casinos are owned by a few large Las Vegas or East Coast-based corporations."

In calculating economic benefits, Dr. Fairchild said, economists include new jobs, profits to any in-state owners, additional tax revenues and savings by consumers in traveling to a nearby out-state compared with going to one farther away.

Costs include the loss of revenue and job reductions in other retail businesses, sales-tax revenue losses, profits going to out-of-state owners, revenue lost by offering forms of gambling, costs of regulating gambling and costs to businesses because of increased absenteeism and lower productivity.

Other economic costs result from an increase in people with gambling addictions, she said. These costs include increased crime leading to more police, jails and courts; costs to businesses of embezzlements, forgeries and thefts; and costs of treating addicted gamblers.

In assessing other gambling studies and drafting the statement, Dr. Fairchild worked with Charles Lamphear, director of the Bureau of Business Research at the University of Nebraska, Lincoln, and John Anderson, professor of economics at UNL.

The economists signed as individuals. The statement did not list their employers. The signers in addition to the three coordinators:

UNL economics professors or associate professors: Craig MacPhee, David Rosenbaum, Ann Mari May, Roger Rietler, Terry Peir and Benjamin Kim.

UNL economics professor emeritus: Wallace C. Peterson.

UNL professors or associate professors of agricultural economics: Michael S. Dumler, Glenn A. Helmers, George H. Pfeiffer, Richard K. Perrin, Raymond J. Supalla, James G. Kendrick, Bruce Johnson, Dale Anderson and R. Gerth Taylor.

Creighton University economics professors or associate professors: Joseph Phillips, Gerard Stockhausen, Thomas Nitsch, James Kitchens, N.K. Vasudeva Murthy and Edward Fitzsimmons.

Bellevue University: Judd W. Patton, associate professor of economics, and James R. Moore, instructor in economics.

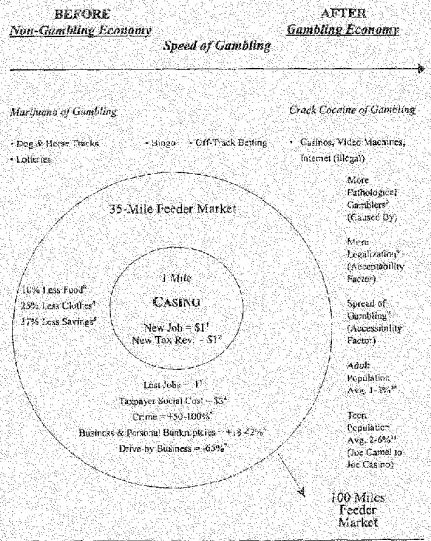
Nebraska Department of Economic Development: James Knotwell, economist, and Kim Newell, recycling economic development advocate.

Doane College, Crete: Lee Morris, assistant professor of finance and economics, and Mary Sue Carter, associate economics professor.

Nebraska Wesleyan University: Joyce Gleason, professor, and Clayton D. Fox, retired economics teacher.

Others: Ron Kovacs, associate professor of management and marketing, University of Nebraska at Kearney; Mehdi Afiat, Chadron State College business department; William Snyder, professor of business, Peru State College; Meenakshi Dalal, economist at Wayne State College; Donna Dudley, business division head, College of St. Mary, Omaha; and Clifton A. Sexton Jr., Lincoln, and Joe Watkins, Grand Island, whose affiliations could not be determined.

Appendix: Business Economics of Licensed Organized Gambling



1. *See National Gambling Impact & Policy Commission Act: Hearing on H.R. 497 Before the House Comm. on the Judiciary*, 104th Cong. 367-405 (1995); Earl L. Grinols, *Bluff or Winning Hand? Riverboat Gambling and Regional Employment and Unemployment*, ILL. BUS. REV., Spring 1994, at 5, 8-11; *see also* Earl L. Grinols, *Gambling as Economic Policy: Enumerating Why Losses Exceed Gains*, ILL. BUS. REV., Spring 1995, at 6, 6-11.

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2. *See* FLA. EXECUTIVE OFFICE OF THE GOVERNOR, CASINOS IN FLORIDA: AN ANALYSIS OF THE ECONOMIC AND SOCIAL IMPACTS (1994); ROBERT GOODMAN, LEGALIZED GAMBLING AS A STRATEGY FOR ECONOMIC DEVELOPMENT 49 (1994). Earl L. Grinols & David B. Mustard, *Business Profitability versus Social Profitability: Evaluating Industries with Externalities, The Case of Casinos*, 22 MANAGERIAL & DECISION ECON. 143 (2001); *see also* John Warren Kindt, *The Economic Impacts of Legalized Gambling Activities*, 43 DRAKE L. REV. 51, 88-95, tbls. 1-3 (1994) [hereinafter Kindt, *Economic Impacts*]; John Warren Kindt, *The Business Economic Impacts of Licensed Casino Gambling in West Virginia: Short-Term Gain but Long Term Pain*, 13 W. VA. PUB. AFF. REP. 22, 23-24 (1998).

3. *See supra* note 1.

4. *See supra* note 2.

5. *See, e.g.*, Earl L. Grinols et al., *Casinos and Crime* (1999).

6. SMR RESEARCH CORP., THE PERSONAL BANKRUPTCY CRISIS, 1997 (1997); SMR RESEARCH CORP., THE NEW BANKRUPTCY EPIDEMIC: FORECASTS, CAUSES, & RISK CONTROL (2001).

7. William N. Thompson & Ricardo C. Gazel, *The Monetary Impacts of Riverboat Casino Gambling in Illinois* (1996).

8. WILLIAM THOMPSON ET AL., WIS. POL'Y RESEARCH INST., WISCONSIN POLICY RESEARCH INSTITUTE REPORT: THE ECONOMIC IMPACT OF NATIVE AMERICAN GAMING IN WISCONSIN, APRIL 1995.

9. HOWARD J. SHAFFER ET AL., HARVARD MEDICAL SCHOOL, ESTIMATING THE PREVALENCE OF DISORDERED GAMBLING BEHAVIOR IN THE UNITED STATES AND CANADA: A META-ANALYSIS, app. E (1997); Press Release, [Harvard Medical School, Harvard Medical School Researchers Map Prevalence of Gambling Disorders in North America (Dec. 4, 1997) (from .84 percent in 1993 "the prevalence rate for 1994-1997 grew to 1.29 percent of the adult population."); *see also* Kindt, *Economic Impacts*, *supra* note 2, at 88-95, tbls 1-3.

10. *See supra* note 9.

11. For the adolescent population, Dr. Durand Jacobs of the Loma Linda University Medical School was reporting 4% to 6%. *See* Durand F. Jacobs, *Illegal and Undocumented: A Review of Teenage Gambling and the Plight of Children of Problem Gamblers in America*, *in* COMPULSIVE GAMBLING: THEORY, RESEARCH, AND PRACTICE 240 (Howard J. Shaffer et al. eds., 1989).

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Table 2. Annual Social Costs per Pathological Gambler

	MD Pohlman et al. (1991) ($)	FL Exec. Office of Gov. (1994) ($)	WI Thompson et al. (1995) ($)	CT Thompson et al. (1998) ($)	SD SD Leg. Research Council 1998–1999 ($)	LA Ryan et al. (1999) ($)	US Gerstein et al. (1999) ($)	SC Thompson and Quinn (1999) ($)	Row averages for studies 1994–1999 ($)
Crime									
Apprehension and increased police costs			48	71	1000	53		116	257
Adjudication (criminal and civil justice costs)	1788		1234	994	57	949		476	676
Incarceration and supervision costs	7878	13 221	768	839	302	690		451	1085
Business and employment costs	11 263								
Lost productivity on job								1092	1092
Lost time and unemployment			2747	3436		5936	350	2156	2919
Bankruptcy			515					118	316
Suicide									
Illness							700		700
Social service costs									
Therapy/treatment costs			627	114	73	386	30	83	189
Unemployment and other soc. svc. (incl. welfare and food stamps)			606	971	549	60	145	318	342
Government direct regulatory costs									
Family costs									
Divorce, separation								111	111
Altered dollars	14 224		3802	9569	240	3 75		2435	2834
									12 586

Reprinted with permission from: Earl L. Grinols & David B. Mustard, *Business Profitability versus Social Profitability, Evaluating Industries with Externalities—The Case of Casinos*, 22 MANAGERIAL & DEC. ECON. 143 (2001) (John Wiley & Sons Ltd., Publ.).

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TABLE 18 Net Economic Impact of Indian Casino Gambling in the Rest of Wisconsin

	$ Millions
Total Positive Economic Impact	339.56
Total Negative Economic Impact	—563.50
Net Economic Impact Before Social and Infrastructure Costs	*—222.94*
Low-Estimate Social Costs	94.67
Median-Estimate Social Costs	189.35
High-Estimate Social Costs	269.45
NET ECONOMIC IMPACT WITH LOW SOCIAL COSTS	*—318.61*
NET ECONOMIC IMPACT WITH MEDIAN SOCIAL COSTS	*—413.29*
NET ECONOMIC IMPACT WITH HIGH SOCIAL COSTS	*—493.39*

SOCIAL BENEFITS AND COSTS

Thus far in our analysis, we have limited our consideration to direct and indirect economic impacts, both positive and negative. These impacts are susceptible to precise measurements, given that the factual data are accurate. Of course, because of limited access to such factual data, we have had to use estimates based on the best reasonable assumptions we have available to us. Nonetheless, we can use the precision of specific-dollar figures for these impacts. When we attempt to assess the economic impact of social benefits and social costs that necessarily attend the introduction of the gambling enterprise into any economy, we delve into a world of imprecision. However, the fact that much doubt surrounds the financial dollars that should be attached to these costs and benefits should in no way be used to deny their existence and importance. We must address social benefits and costs and suggest how they may fit into the overall economic impact analysis that we are conducting.

Social benefits include the creation of a new work ethic among previously unemployed persons, a spirit of self-sufficiency among previously dependent peoples, a variety of new programs supported by revitalized tribal governments. These programs include housing, health, welfare, education, and economic development. On the negative side, the analysis must take note of criminal activity that may be generated by the presence of casinos and also the costs of gambling addictions that result from the existence of the casinos. Our analysis of most of these areas ends with a textual description of activities and problems. Because there have been many studies of problem gambling, we have attempted to assign dollar figures to this problem area (high, medium, and low range), and we believe that these figures should be juxtaposed with the economic-impact figures we have calculated because they reflect a real cost to society.

1. The benefits of investment and self-sufficiency

The greatest value that gaming provides may be found in the degree of independence it allows tribal governments to have. Economic-development programs instituted through government policies have inevitably required tribes to have all their financial decisions certified and ratified by Bureau of Indian Affairs personnel. These approvals denied opportunities for risk-taking and also for gaining expertise that comes with exercising financial responsibility. Gaming funds are more directly controlled by the tribes. A selective listing of many of the projects that have been funded with gaming revenues illustrates a marked growth in that expertise and the responsibility that will become a foundation for tribal self-sufficiency well into the future.

Reprinted with permission from WILLIAM THOMPSON, RICARDO GAZEL, & DAN RUCKMAN, THE ECONOMIC IMPACT OF NATIVE AMERICAN GAMING IN WISCONSIN (Wis. Pol'y Res. Inst. 1995).

Table 1. Percentage of Expenditures by Problem Gamblers for Selected Forms of Gambling by State/Provinces

	Alberta	British Columbia	Nova Scotia	Washington	Louisiana	Iowa	New York	Average
Bingo (%)	42.6	37.1	N/A	44.6	N/A	N/A	49.9	39
Lotto (%)	19.3 lotto; 19.3 instant	17.9 lotto; 14.9 scratch	65.5 lotto; 22.5 scratch	34.2 daily game	17.6 all lotto games	24.7 instant	21.2 lotto; 36 quick draw	34 lotto; 20.6 instant-scratch
Casino (%)	37.3 local; 34.4 card/dice	26.7 slots; 33.1 table	45.7	35.0 card/dice	N/A	38.5 table	41.4	41.8 table games
Slots (%)	38.0	N/A	8.9	N/A	N/A	6.1	N/A	14.7
Video machine (%)	46.9	N/A	52.8	22.9	37.8	N/A	74.6	46.8
All games (%)	32.3	22.8	26.4	24.7	41.2	26.8	39.1	30.4
Horses (%)	54.2 on track off track	29.8 on-track	N/A	25.9	52.7 on-track; 56.9 off-track	48.4	50.0	
Sports (%)	19.0 teaser/sweepstakes	21.7 sports; 19.7 friends, 12.2 pools	N/A	18.9 pools, 52.7 bookies	62.8	43.9	50.0	
Pull tabs (%)	45.1	20.9	N/A	35.2	N/A	N/A	N/A	
Raffles (%)	10.2	N/A	N/A	N/A	N/A	N/A	N/A	
All (%)	32.3	22.6	26.6	24.7	41.2	26.8	39.1	

Sources: Lesieur (1998, table); "Measuring the Costs of Pathological Gambling," Address by Prof. Henry R. Lesieur, Illinois State University, at the National Conference on Gambling Behavior, National Council on Problem Gambling, Chicago, Illinois, 3-5 September 1998 (table)

N/A: not applicable

Added notes of Professor Lesieur:

Pathological gamblers spend an inordinate amount of money on gambling compared to others who gamble (Lesieur, 1998). For example, problem video lottery players in Nova Scotia account for 4% of those who play, yet contribute 52% of net revenue for video lottery playing (Focal Research, 1998). The Australian Productivity Commission (1999) estimated that problem gamblers account for 2.7% of money spent on lottery play, 10.9% of casino table game play, 19% of scratch ticket sales, 23% of wagering on horses and dogs, and 42% of money spent on gaming machine play. Overall, problem gamblers expend 33% of all money spent on gambling in Australia.

Focal Research (1998). *1997/1998 Nova Scotia lottery players' survey*. Prepared for Problem Gambling Services, Nova Scotia Department of Health, Halifax, Nova Scotia.

Author.

Reprinted with permission from: John W. KINDT, *THE COSTS OF ADDICTED GAMBLERS: SHOULD THE STATES INITIATE MEGA-LAWSUITS SIMILAR TO THE TOBACCO CASES?* 22 MANAGERIAL & DEC. ECON. 17 (2002) (John Wiley & Sons, Ltd., Pub.).

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Table A4*. Bankruptcy Costs — Costs of 1.5 Million *New Pathological* Gamblers[1] 1994–1997**

Socio-economic costs category	Average cost	Average cost (adjusted[2] to current $)**	Population creating new problem	Total new costs** (1998)
21% filed bankruptcies[3]	$171,640[4] (1995)			
> 30% (SMR research)[5]				
23% (Wu., Thompson)[6]				
28% (Quebec)[7]				
Costs per bankruptcy[8] (SMR) (WBFA: $53,308)[9]	$29,650 (1997)	$29,650		
Legal costs[8]	$505 → $1000 (1997)	$505 → $1000		
Court costs[8]	$418 → $837 (1997)	$418 → $837		
Admin. costs[8] (Thompson: "too low")	$100 ? (1995)			
> 10% (projected to 15%) of total bankruptcy costs[10] of $40 billion per year[11] and 1.35 million filings[12] per year				
Pathological gamblers = 75% of total gambling/bankruptcy problem[13]				
Problem gamblers = 25% of total gambling/bankruptcy problem[13]				
Annual Range: ?				
Total new bankruptcy costs due to pathological gamblers, 1994–1997: ?				

Note: Usually ignored by bankruptcy attorneys, it was historically required that anyone filing for bankruptcy indicate money and assets lost because of gambling during the year, including "dates, names, and places, and the amounts of money . . . lost." 1 U.S.C. Appendix: Bankruptcy Rules, Form 7, in I. Nelson Rose, Gambling and the Law 46 (1986).

* Footnotes at end of this article.

** Numbers may easily be adjusted to current dollars by visiting the "Consumer Price Index (All Urban Consumers)" of the U.S. Bureau of Labor Statistics at http://stats.bls.gov/ and utilizing the following formula example:

$$\$\ \text{Former Year} \times \frac{\text{CPI Current Year}}{\text{CPI Former Year}} = \$\ \text{Current Year}$$

Example:

$$\$4000000\ (1983) \times \frac{166.5\ (1999)}{99.6\ (1983)} = \$6690703\ (1999)$$

Table A5*. Bankruptcy Costs — Costs of 3.5 Million *New Problem* Gamblers[1] 1994–1997**

Socio-economic costs category	Average cost	Average cost (adjusted[2] to current $)**	Population creating new problem	Total new costs** (1998)
21% filed bankruptcies[3] (10% Elliott Conservative No.)[4]	$40,650 (1995)			
Costs per bankruptcy[8] (SMR) (WBFA: $53,308)[9]	$29,650 (1997)	$29,650		
Legal costs[8]	$505 → $1000 (1997)	$505 → $1000		
Court costs[8]	$418 → $837 (1997)	$418 → $837		
Admin. costs[8] (Thompson: "too low")	$100 ? (1995)			
> 10% (projected to 15%) of total bankruptcy costs[10] of $40 billion per year[11] and 1.35 million filings[12] per year				
Pathological gamblers = 75% of total gambling/bankruptcy problem[13]				
Problem gamblers = 25% of total gambling/bankruptcy problem[13]				
Annual Range: ?				
Total new bankruptcy costs due to pathological gamblers, 1994–1997: ?				

Note: Usually ignored by bankruptcy attorneys, it was historically required that anyone filing for bankruptcy indicate money and assets lost because of gambling during the year, including "dates, names, and places, and the amounts of money . . . lost." 1 U.S.C. Appendix: Bankruptcy Rules, Form 7, in I. Nelson Rose, Gambling and the Law 46 (1986).

* Footnotes at end of this Article.

** Numbers may easily be adjusted to current dollars by visiting the "Consumer Price Index (All Urban Consumers)" of the U.S. Bureau of Labor Statistics at http://stats.bls.gov/ and utilizing the following formula example:

$$\$\ \text{Former Year} \times \frac{\text{CPI Current Year}}{\text{CPI Former Year}} = \$\ \text{Current Year}$$

Example:

$$\$4000000\ (1983) \times \frac{166.5\ (1999)}{99.6\ (1983)} = \$6690703\ (1999)$$

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Attorneys for Plaintiffs

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN FRANCISCO

MARIO CISNEROS, et al., On Behalf of Themselves, All Others Similarly Situated, and/or the General Public Plaintiffs, vs. YAHOO!, INC., et al., Defendants.	Case No. CGC 04433518 CLASS ACTION DECLARATION OF DR. EARL GRINOLS IN SUPPORT OF PLAINTIFFS' RENEWED MOTION FOR A PRELIMINARY INJUNCTION AND CONTEMPT DATE: TBD TIME: TBD DEPT: 304; The Honorable Richard A. Kramer DATE ACTION FILED: 08/03/04

1. I declare under penalty of perjury under the laws of the State of California that the following facts are true to the best of my knowledge and the following opinions are mine based upon my years of research and review of the evidence provided to me in this case.

2. My education includes, University of Michigan, Honors Program, 1969-70, Bachelor of Arts in Mathematics, University of Minnesota, Summa cum laude, June 1973, Bachelor of Science in Economics, University of Minnesota, Summa cum laude, June 1973, Doctor of Philosophy, Economics, Massachusetts Institute of Technology, June, 1977. I have held teaching positions at Cornell University, University of Illinois, University of Chicago, in addition to positions with the US Treasury and the President's Council of Economic Advisers. I am currently Distinguished Professor of Economics at Baylor University. My study of the economics of gambling dates to 1990. My publications include Gambling In America: Costs and Benefits (Cambridge University Press), published last year and other articles. I have testified on gambling matters twice before Congress and consulted numerous times with statehouses from Maine to Hawaii.

3. This document addresses the nature and extent of irreparable harm from Internet gambling. The issues discussed are

(a) the types of harm,

(b) the connection between internet advertising and irreparable harm, and

(c) the extent of the harm and the methodologies used to measure it

I. Types of Harm

4. Class III gambling consists of games that are often associated with casinos such as blackjack, baccarat, slot machines, roulette, and poker but are not Class I ("social games solely for prizes of minimal value") or Class II (bingo and bingo-like games).[1] Internet gambling is Class III gambling, the harmful consequences of which have long been known and documented. Dostoevsky's *The Gambler*, details the main character's dissipation and ruin due to his gambling. In the United

[1] Indian Gaming Regulatory Act, 25 U.S.C. §2710 [Sec.11]

States, Warren's 1828 *The Gamesters* describes the "abyss of ruin" caused by gambling.[2] Classifying the types of harm for formal academic study and measurement is a more modern pursuit, dating from approximately 25 years ago.[3] The goal of recent classification is to provide exhaustive and mutually exclusive categories of harm. Categories harmful consequences that have been identified include: suicide, bankruptcy, crime, business and employment-related harm, illness, social service costs, and family-related harm. Added to these are the social costs of government direct regulation and the effects of abused dollars.[4]

5. Suicide results when an individual's loss of large sums of money and inability to control the urge to gamble rises to the level of an intolerable burden that is perceived to be relieved only in death. Bankruptcy is related to the degree of financial distress caused by gambling losses.[5] Just as resources destroyed in a terrorist explosion are permanently lost to society for other uses, bankruptcy removes resources from society in the bankruptcy legal process, as well imposing losses on creditors who are not paid. Members of society, including those who do not gamble, experience crime-related harm if they are the victim of criminal activity. There is a connection between crime and pathological gambling. Pathological gambling is a recognized impulse control disorder of the Diagnostic and Statistical Manual (DSM-IV) of the American Psychiatric Association. Committing illegal acts to finance gambling is one of the recognized symptoms. Many studies have publicized the crime

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[2] Warren, Caroline M. (1828). *The Gamesters; or Ruins of Innocence. An Original Novel, Founded in Truth.* Boston: J. Shaw.

[3] The modern study of harm dates to Robert M. Politzer, James S. Morrow, and Sandra B. Leavey (1981). "Report on the Societal Cost of Pathological Gambling and the Cost-Benefit/Effectiveness of Treatment." The Johns Hopkins Compulsive Gambling Counseling Center, presented at the Fifth National Conference on Gambling and Risk-taking.

[4] *See Grinols, Earl L. Gambling in America: Costs and Benefits,* New York: Cambridge University Press, 2004, pp. 131-146.

[5] *See SMR Research Corporation* (1998). "The Personal Bankruptcy Crisis, 1997: Demographics, Causes, Implications & Solutions." Hackettstown, N.J.: Author; Michelle Clark Neely (1998). "Personal Bankruptcy" The New American Pastime?" *The Regional Economist,* October, 12-13; Mark W. Nichols and Thomas Garrett (2005). "Do Casinos Export Bankruptcy?" The Federal Reserve Bank of St. Louis, Working Paper Series #2005-019A: Mark Nichols Grant Stitt, and David Giacopassi (2000). "Casino Gambling and Bankruptcy in New United States Casino Jurisdictions," *Journal of Socio-Economics,* 29, 247-261.

consequences of gambling. For example, the 1990 Maryland Department of Health and Mental Hygiene's survey of gamblers in treatment found that 62 percent committed illegal acts as a result of their gambling and 23 percent had been charged with criminal offenses.[6] A similar survey of nearly 400 members of Gambler's Anonymous showed that 57 percent admitted stealing to finance their gambling.[7] Moreover, the amounts are not small. On average they stole $135,000, and total theft was over $30 million.[8] The National Gambling Impact Study Commission's final report issued in June 1999 reported that among those who did not gamble (had not gambled in the past year) only 7 percent had ever been incarcerated. In contrast, more than three times this number (21.4 percent) of individuals who had been pathological gamblers at any point during their lifetime had been incarcerated.[9] Business and employment-related harm include costs such as lost productivity on the job and direct business expenses. A firm that must fire an embezzling employee, hire and retrain a replacement suffers irreparable harm relative to the alternative where the firing did not take place.[10] Depression, stress-related illness, and cardiovascular disorders are among the illnesses that have been tied to gambling. Social service costs relate primarily to government assistance including therapy and treatment costs, unemployment, welfare and food benefits. Child and spousal abuse are among the family harms. Gambling historically has been a vehicle for fraud, scams, and abuse. If adopted as a legal activity, internet gambling will require government oversight and regulation. Direct regulatory costs, like government costs for the aftermath of August 2005 hurricane Katrina, represent real resource burdens

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6 Maryland Department of Health and Mental Hygiene, Alcohol and Drug Abuse Administration (1990). *Final Report: Task Force on Gambling Addiction in Maryland*, Baltimore: Author.

7 Henry Lesieur of the Institute of Problem Gambling before the National Gambling Impact Study Commission, Atlantic City, New Jersey January 22, 1998.

8 *Ibid.*

9 National Gambling Impact Study Commission (1999). National Gambling Impact Study Commission Final Report (June 18). Washington: USGPO.

10 The following news account describes a business-related cost of gambling. "A 64-year-old mother of seven pleaded guilty Tuesday to embezzling $298,000 from her employer – driving it out of business – to feed her slot machine habit. Laura A. Iserloth, who lives in Sheboygan County . . . (Wisconsin). . . embezzled the money from the Kettle Moraine Employees Credit Union over a 10-year period." *Milwaukee Journal Sentinel*, 9 August 2000.

on society. Finally, abused dollars — gambling money acquired from family, employers, or friends under false pretenses — represent harm to those whose funds are taken. An example is the young Wisconsin gambler who took out 20 credit cards in his father's name and ran up $170,000 in gambling debts on them.

6. That gambling leads to the harms described is relatively uncontroversial. Identifying the extent of harm and measuring it is more challenging.

II. Connecting Internet Gambling Advertising to Irreparable Harm

7. Greater ease of access, length of play, rate of play, and arousal of play are associated with increased development of pathological gambling and creation of social harm.[11] Breen and Zimmerman (2002) document that machine gambling leads more quickly to pathology than other forms of gambling (1.1 years versus 3.6).[12] Williams and Wood (2004) employ prospective diaries,[13] the best methodology yet employed, to document that 60 percent of machine gambling revenues derive from problem gamblers.[14] Internet gambling is machine gambling that provides great ease of access, length of play, and high rate and arousal of play. Advertising can be persuasive or informative. Both functions and internet links serve to increase the amount of the advertised Internet gambling activity. Thus increased access through persuasion or information increases the quantity of social harm.

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[11] Frank L. Quinn (2001). "First Do No Harm" What Could be Done by Casinos to Limit Pathological Gambling," *Managerial and Decision Economics*, 22, 1-3, 133-142.

[12] Robert B. Breen and Mark Zimmerman (2002). "Rapid Onset of Pathological Gambling in Machine Gamblers," *Journal of Gambling Studies*, 18, 1, 31-43.

[13] "Prospective diaries involve participants recording relevant behaviors or expenditures in a logbook or diary, on a daily basis, for a certain period of time." Robert Williams and Robert Wood (2004. "The Demographic Sources of Ontario Gaming Revenue." Prepared for the Ontario Problem Gambling Research Centre," June, 1-65 (p. 14).

[14] *See Williams and Wood* (2004), Table 17, p. 42.

III. Extent of Harm and its Measurement

8. Problem and pathological gamblers[15] are associated with much of the social harm of gambling. Study of problem and pathological gamblers is used in developing the first of two measures of damage. Statistical analysis is used in the second. Consider crime. Crime is affected by multiple factors including population density, the number of males and females in different age ranges, percent of each age group that is white, percent of each age group that is black, per capita personal income, unemployment rates, per capita retirement compensation, per capita income maintenance payments, and "shall issue" laws (for example, laws giving citizens the right to carry concealed firearms upon request—argued by some to reduce certain crimes).[16] Hence, only by direct observation of the actions of gamblers or a careful sifting of a large body of data can the effect of gambling be identified.

9. Tallying the crimes of problem and pathological gamblers and the associated costs to society such as police, apprehension, adjudication, and incarceration costs, generates the average crime costs to society of an additional pathological or problem gambler. Using this methodology, Thompson, Gazel and Rickman, found that an average problem gambler costs society $10,113 per year of which crime was $4,225, or 42 percent of these costs.[17] More recent research puts the overall number at $10,330 per year.[18]

10. Combining crime costs with studies of the prevalence of pathological and problem gamblers provides crime cost figures for society as a whole. Using the numbers just reported implies annual crime costs per adult capita of $57. This number can be compared to the crime costs found by the second method for relating casinos to crime.

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[15] A problem gambler is an individual who suffers from the same behavioral problems as a pathological gamblers but to a lesser degree.

[16] *See John Lott* (1998). *More Guns, Less Crime.* Chicago: The University of Chicago Press. John Lott and David Mustard (1997). "The Right to Carry Concealed Handguns and the Importance of Deterrence." *Journal of Legal Studies*, 26, 1, 1-68.

[17] Thompson, William N., Richard Gazel, Dan Rickman. (1996). "The Social Costs of Gambling in Wisconsin," *Wisconsin Policy Research Institute Report*, 9, 6, 1-44.

[18] *Grinols* (2004), Table 7.1, pp. 172-173.

11. Crime consequences are also determined through analysis of crime statistics. The advantage is that this method is direct, and — because it looks at more than just crimes committed by problem and pathological gamblers—more inclusive. A recent study is the examination of police records by Smith, Wynne, and Hartnagel (2003) who find that 4 percent of the crime files they reviewed were gambling-related in Edmonton, Alberta, Canada.[19] They write, "what we uncovered is probably only a modest portion of what really occurs"[20] because of various reporting issues. Grinols and Mustard's (2005), using the most comprehensive data set to date covering FBI Index I crime statistics for the entire United States, find that 8 percent of crime was the result of gambling in counties where Class III establishments were present.[21]

12. The following table summarizes the results of 9 original studies covering different states and times.[22] A comparable table can be constructed for problem gamblers. According to research, the implied harm to American society is greater than $32 billion annually with a preferred mid range estimate of $43 billion, or $165 and $219, respectively, per adult.[23]

IV. Summary

13. Based on my research and knowledge, Class III gambling and the internet advertisements and links at issue that promote it cause irreparable harm. The magnitude of the harm is significant and serious, placing it with the harm of other activities that engender harmful externalities such as illegal drug use or drunk driving. Crimes ranging from embezzlement to murder are among the

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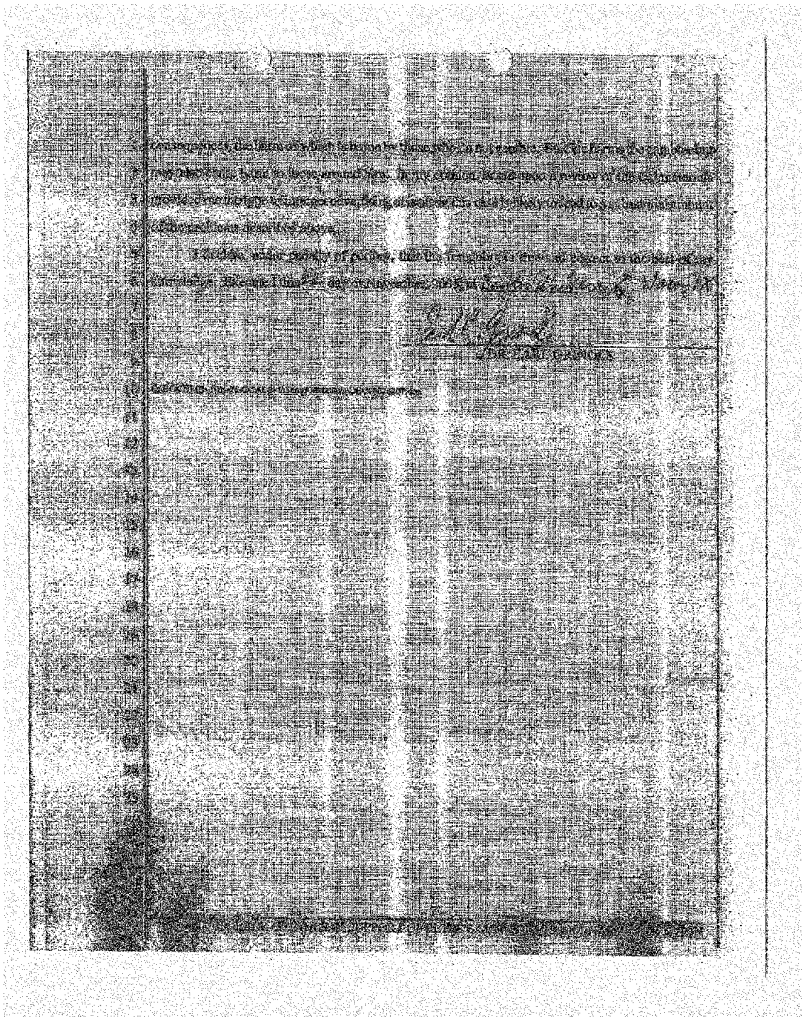
[19] They were 208 gambling related occurrences out of 5196 viewed files. See Table 4, p. 45 of Gary Smith, Harold Wynne, and Tim Hartnagle (2003). "Examining Police Records to Assess Gambling Impacts: A Study of Gambling-Related Crime in the City of Edmonton: A Study Prepared for The Alberta Gaming Research Institute," March, pp. 1-111. Gambling related crimes tended to be a higher proportion of some incidents. For example, 130 of 482 counterfeiting incidents (27 percent) were gambling related.

[20] *Ibid.*, p. 79.

[21] Grinols, Earl L. and David B. Mustard (2005). "Casinos, Crime, and Community Costs," *The Review of Economics and Statistics* (forthcoming).

[22] *Grinols* (2004), p. 172-173.

[23] *Ibid.* pp. 175-181.



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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN FRANCISCO

MARIO CISNEROS, et al., On Behalf of Themselves, All Others Similarly Situated, and/or the General Public Plaintiffs, vs. YAHOO!, INC., et al., Defendants.	Case No. CGC 04433518 CLASS ACTION EXPERT OPINION OF JOHN WARREN KINDT IN SUPPORT OF PLAINTIFFS' RENEWED MOTION FOR PRELIMINARY INJUNCTION DATE ACTION FILED: 08/03/04

I, JOHN W. KINDT, declare as follows:

1. I have personal knowledge of the matters stated herein, based upon my years of research and review of the evidence provided to me in this case and, if called upon, I could and would competently testify thereto.

2. I have been a professor of Business Administration and Legal Policy at the University of Illinois and have been there since 1978.

3. I hold the following degrees, S.J.D. International Law and Policy, University of Virginia LL.M. International Law, University of Virginia, MBA, University of Georgia, and J.D. University of Georgia.

4. I have been actively researching issues involving gambling and the economic and social impacts of gambling for several years. As a result, I have published over 20 academic articles in law reviews as well as in law and economics journals. I have reviewed numerous examples of defendants' advertising in this matter.

5. As a result of my research and training and the gambling advertising evidence I reviewed I have formed the opinion that defendants' advertising of gambling activities as described in the Complaint via the Internet constitute immediate and irreparable harm to the residents of California.

6. The primary irreparable harm resulting from advertising gambling activities and the resulting gambling consists of pathological gambling, which is comparable to drug addiction. Pathological gambling is recognized as an addictive behavior, specifically an "impulse control disorder." Am. Psychiatric Ass'n, Diagnostic and Statistical Manual of Mental Disorders, sec. 312.21, at 615-18 (4th ed. 1994) [hereinafter DSM IV]. The American Psychiatric Association (APA) lists 10 diagnostic criteria for pathological gambling. By definition, a "pathological gambler" evidences "[p]ersistent and recurrent maladaptive gambling behavior as indicated by five (or more)" of the 10 criteria. DSM IV, *infra*, at 618. By definition, a "problem gambler" evidences up to four of the criteria.

7. Like drug addiction, the harms to the public (commonly referred to as "the ABCs" of legalized gambling's socio-economic impacts) caused by gambling activities via cyberspace and particularly via the Internet include:

(a) new addicted gamblers,

(b) new bankruptcies, and

(c) new crime.

For the most authoritative analysis of new crime costs linked to the accessibility and acceptability of gambling, *see* Earl L. Grinols, *et al.*, Casinos and Crime (1999, as updated 2005), forthcoming academic publication as Earl L. Grinols & David Mustard, The Curious Case of Casinos and Crime, __ Rev. Econ. & Stat. __ (2006). A table of the authoritative academic studies highlights that the socio-economic public costs of legalized gambling activities are at least $3 for every $1 in benefits. Earl L. Grinols & David B. Mustard, Business Profitability versus Social Profitability: Evaluating Industries with Externalities, The Case of Casinos, 22 Managerial & Dec. Econ. 143, 153 (2001) [hereinafter The Case of Casinos]. This 3:1 ratio has been the ratio for many years. *See, e.g.*, The National Impact of Casino Gambling Proliferation: Hearing before the House Comm. on Small Business, 103d Cong. 77-81 & nn. 9, 12 (1994).

8. For the definitive book in these issue areas, *see Earl L. Grinols, Gambling in America: Costs and Benefits* (Cambridge Univ. Press 2004). For summaries and tables of the major studies of the socio-economic harms, see John W. Kindt, The Costs of Addicted Gamblers: Should the States Initiate Mega-Lawsuits Similar to the Tobacco Cases?, 22 Managerial & Dec. Econ. 17, 44-63, App. Tables A1-A14 (2001) [hereinafter Mega-Lawsuits]. *See also, Nat'l Gambling Impact Study Commission, Final Report* chap. 4 (June 1999) [hereinafter *NGISC Final Report*]. For a summary of the socio-economic costs of gambling activities as presented to Congress, *see Testimony and Prepared Statement of Professor John Warren Kindt*, Before the U.S. House of Representatives Comm. on Resources, 109th Cong., 1st Sess., Apr. 27, 2005 (App. Tables).

9. In the case of concentrated and multiple electronic gambling devices (EGDs), such as in casinos and racinos (*i.e.*, EGDs at racetracks), the "accessibility" and new "acceptability" (*i.e.*, legalization) to the public dictates that the new pathological (i.e., addicted) gamblers will double from approximately 1.0 percent of the public, increasing to 2 percent. Similarly, the new problem gamblers will double from approximately 2 percent of the public, increasing to 4 percent. When the category is specifically focused on teens and young adults, these rates are virtually doubled again to between 4 percent to 8 percent combined pathological and problem gamblers. *See, e.g.*, Durand F. Jacobs, Illegal

and Undocumented: A Review of Teenage Gambling and the Plight of Children of Problem Gamblers in America, in *Compulsive Gambling: Theory, Research, and Practice* 249 (1989).

10. These "doubling increases" have reportedly occurred within the gambling facilities' "feeder markets." *NGISC Final Report, infra*, at 4-4 (50-mile feeder markets); John W. Kindt, Diminishing or Negating the Multiplier Effect: The Transfer of Consumer Dollars to Legalized Gambling: Should a Negative Socio-Economic "Crime Multiplier" be Included in Gambling Cost/Benefit Analyses?, 2003 Mich. State DCL L. Rev. 281, 312-13 App. (2003) (35-mile feeder markets) [hereinafter Crime Multiplier]; John Welte, St. Univ. N.Y. at Buffalo, 2004 Study (10-mile feeder markets).

11. Gambling activities via cyberspace and particularly via the Internet eliminate the radial feeder markets around casino EGDs and maximize the accessibility and acceptability factors for gambling (and concomitant social negatives) by placing EGDs in every living room, at every work station, and at every school desk. Children, teens, and young adults conditioned by the Nintendo phenomenon are already demonstrating double the pathological and problem gambling rates of the older adult populations who matured without video games and without accessible legalized gambling venues. Jacobs, *infra*.

12. Accordingly, the 1999 U.S. National Gambling Impact Study Commission recommended that there be no legalization of Internet gambling and that the U.S. laws criminalizing gambling over the wires be strengthened (*see* 18 U.S.C. §1084, the "Wire Act"). The Commission also de facto recommended that the laws criminalizing Internet gambling be redrafted to eliminate any ambiguities and to establish a virtual ban on gambling in cyberspace. *NGISC Final Report, infra*, recs. 5.1-5.4. The U.S. Gambling Commission also highlighted that EGDs were commonly referenced by the psychological community as the crack cocaine of creating new addicted gamblers. *See, e.g., NGISC Final Report, infra*, at 5-5; V. Novak, They Call It Video Crack, Time, June 1, 1998, at 58. The Commission reported testimony that Internet gambling magnifies gambling addiction.

13. Irreparable harm as a result of advertising Internet gambling devolves from the phenomenon that there are large increases in the numbers of pathological and problem gamblers once EGD gambling becomes accessible and acceptable. The legalization of new gambling venues since

1990 and the addictive nature of gambling have led to substantial increases in the numbers of Gamblers Anonymous groups, which are modeled after Alcoholics Anonymous groups.

14. Gambling industry spokespersons have frequently referred to Internet gambling as the "killer application" (a.k.a. "killer app") of Internet technology because Internet gambling is great; cocaine to addicting new gamblers and because the feeder market is every living room, work station, and school desk. For a summary table showing the various studies reporting the disproportionate revenues which various types of legalized gambling take from pathological and problem gamblers, see Meyer-Lowenstein, *Infra*, at 25, Table 1 (compiled by Professor Henry Lesieur).

15. Increasing numbers of experts and clinicians studying pathological gambling have reported that when a new person is "once hooked" they are "hooked for life." *See, e.g., Mindtool, Colorado Lottery 1996.* The salient points are that: (1) there are new pathological gamblers, and (2) these gamblers may be addicted for life (although in remission in many cases). A fortiori, gambling via cyberspace and particularly via the Internet intensifies these problems — a substantial number of which will be irreparable, especially when interfered with children, teens, and young adults. *See, e.g.*, David P. Phillips, *et al.*, *Elevated Suicide Levels Associated with Legalized Gambling*, 27 Suicide & Life-Threatening Behav. 373, 376-77, & Table 2 (1997).

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed this 21st day of November, 2005, at ~~Champaign, Illinois~~ Hollis Summit, Missouri.

John Warren Kindt
JOHN WARREN KINDT

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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN FRANCISCO

MARIO CISNEROS, et al., On Behalf of Themselves, All Others Similarly Situated, and/or the General Public Plaintiffs, vs. YAHOO!, INC., et al., Defendants.	Case No. CGC 04433518 CLASS ACTION DECLARATION OF DR. NANCY PETRY IN SUPPORT OF PLAINTIFFS' RENEWED MOTION FOR A PRELIMINARY INJUNCTION AND CONTEMPT DATE: TBD TIME: TBD DEPT: 304; The Honorable Richard A. Kramer

DATE ACTION FILED: 08/03/04

I, Nancy Petry, pursuant to California law, certifies that the following statements are true and correct and understands that these statements are made under penalty of perjury:

1. This declaration is made in lieu of direct testimony at trial. I am an expert witness in the case, and all of the statements set forth below are based upon personal knowledge and/or belief.

2. I graduated from Randolph-Macon Woman's College in 1990, with a Bachelor of Arts degree in Psychology, and Harvard University in 1994, with a Doctor of Philosophy degree in Psychology.

3. I presently hold the rank of Professor of Psychiatry (in Psychology) at the University of Connecticut School of Medicine.

4. Over the past 15 years, I have gained extensive experience in the design, conduct, analysis, and interpretation of clinical research trials in the treatment of addictive disorders, including pathological gambling. This experience has allowed me to become familiar with the development, manifestation, and treatment of pathological gambling. My research has resulted in over 100 publications in scientific journals. I also have written an invited book on pathological gambling. These publications are detailed in my curriculum vita.

A. **Overview**

5. The United States has experienced three waves of gambling popularity throughout its history. The first wave of heavy gambling began with the early settlers and continued throughout the 18th century, with many of the original 13 states and early universities, including Harvard, founded on lottery proceeds. Gambling activities waned in the early 19th century (Rose IN. *Fordam Urban Law Review*, 1980; 8: 245-300) but then resumed in popularity with the migration west after the Civil War (Edwards JE, In Lowitt R (Ed.), *Politics in the Postwar American West*. 1995; Norman, OK: University of Oklahoma Press). During this period, tales of corruption and violence associated with gambling were paramount in the West, and lotteries back East were being shown to be corrupt and dishonest.

6. Over the years, states gradually abolished gambling, with even Nevada passing anti-gambling legislation in 1910 (Rose IN. *Fordam Urban Law Review*, 1980; 8: 245-300). After decades of gambling abolition in most states, the third resurgence of gambling is now upon us. New, tightly

regulated state-managed lotteries were initiated in New Hampshire in 1968, with the bulk of other states soon following suit. In the late 1980s, states began allowing casino-style gambling on Native American Indian reservations or waterways, and over half the states now have casino gambling available. In fact, some form of legalized gambling is presently available in every state but Utah and Hawaii (National Research Council. *Pathological Gambling: A Critical Review.* 1999; Washington, D.C.: National Academy Press).

7. Along with the legalized and heavily regulated gambling that exists in most states including California, society is now inundated by new forms of illegal gambling opportunities — Internet gambling. All popular forms of gambling that are available at casinos can now be engaged upon via the internet. Internet gambling, however, is neither regulated nor sanctioned by any individual state or the federal government. Nevertheless, it is available to any California resident with access to a computer and the internet. The internet has increased availability of all forms of gambling to 24 hours a day, seven days a week, from the comfort of one's own home. As detailed below, Internet gambling carries with it a high potential for risk and devastation on both a personal and societal level.

B. Pathological Gambling and Its Consequences

8. Gambling can become a serious problem for many people. Almost 11 million Americans, or about 1 in 20 adults, experience some form of a gambling problem during the course of their lifetimes (Shaffer HJ, Hall MN, Van Der Bilt J. *Am J Public Health* 1999; 89; 1369-1376). Pathological gambling, also colloquially referred to as "compulsive gambling," is the most severe form. Pathological gambling is a psychiatric disorder that was first introduced into the Diagnostic and Statistical Manual for Mental Disorders, the primary diagnostic system for classifying psychiatric disorders, in 1980.

9. The current classification system (American Psychiatric Association. *Diagnostic & Statistical Manual of Mental Disorders* (4th Ed.) 1994; Washington, D.C.: American Psychiatric Association Press) states that an individual must experience at least 5 of 10 symptoms for a diagnosis. Symptoms include being preoccupied with gambling (e.g., handicapping or planning gambling ventures); betting with increasing amounts of money; having repeated unsuccessful efforts to reduce or cease gambling; experiencing psychological withdrawal symptoms when not wagering; betting to

escaping problems or adverse moods; chasing losses by risking more in an attempt to win back past losses; lying to others to conceal the extent of gambling; committing illegal acts to finance gambling; jeopardizing or losing a relationship or job because of gambling; and relying on others to assist financially with situations caused by gambling.

10. The range of adverse effects on the individual gambler can be surmised from the diagnostic criteria outlined above. They include loss of employment, breakups of families and friendships often because of distrust surrounding financial issues (Lorenz VC, Shuttlesworth DE. *J Community Psychiatry* 1983; 11: 67-75; Lorenz VC, Yaffee RA *J Gambling Behav.* 1989; 5: 113-126), legal difficulties (Blaszczynski AP, McConaghy N. *J Gambling Studies* 1994; 10: 99-127), and emotional distress (*Ibanez A, Blanco C, Donahue E. et al. Am J Psychiatry* 2001; 158: 1733-1735; Petry NM. *Am J Addictions* 2000; 9: 163-171). Evidence is also mounting that pathological gambling is associated with poor physical health (Pasternack AV, Fleming FM, *Arch Family Med* 1999; 8: 515-520; Moravco BJ, von Eigem K, Petry, NM. *Gen Hospital Psychiatry*, in press).

11. The adverse effects of gambling extend directly to at least 8 to 10 other individuals for every pathological gambler affected (Lobsinger C, Beckett L. *Odds on the Break Even: A Practical Approach to Gambling Awareness* 1996; Canberr, Australia: Relationships Australia, Inc.). Most often, these include immediate and extended family members, coworkers, friends, and neighbors, and even strangers. Other individuals are usually impacted by the financial consequence of pathological gambling, including lending money, covering up for the gambler at work, or being the victim of a gambling-related crime. Spouses can be devastated by financial losses, which may include large credit card debt, informal loans from friends and relatives, and illegal debt to bookies. Failure to pay mortgages or rent may result in loss of homes or evictions, and about twenty percent of treatment seeking pathological gamblers report bankruptcies (Petry NM. *Addiction* 2003; 98: 645-655). Psychological and physical abuse is also common in families of gamblers (Muelleman RL, DenOtter T, Wadman MC, Tran TP, Anderson J. *J Emergency Med.* 2002; 23: 307-312).

12. Children of pathological gamblers may be among the most negatively impacted. Pathological gamblers may engage in aggressive and violent outbursts toward their children, and some even steal from their children in an attempt to gain more money for gambling. Compared to children of

non-pathological gamblers, children of pathological gamblers are more likely to be unhappy, depressed and suicidal, to experience parental aggression and abuse, and to develop a gambling problem themselves (Isaramurg S, Nitirat P, Chunyton P, Wongarsa C. *J Medical Assoc Thailand* 2001; 84: 1481-1489; Lesieur HR, Klein R. *Addictive Behaviors* 1987; 12: 129-135; Lesieur HR, Rothschild J. *J Gambling Behav.* 1989; 5: 269-281).

13. Pathological gambling does not occur in isolation, and it is often associated with a spectrum of other psychiatric conditions, making this a vulnerable population. For example, in a nationally representative survey of over 43,000 respondents (Petry NM, Stinson FS, Grant BF. *J Clin Psychiatry* 2005; 66: 564-574), 49.6% of individuals identified as pathological gamblers had a mood disorder, 41.3% an anxiety disorder, and 73.2% an alcohol use disorder. Thus, pathological gambling is a condition that disproportionately impacts those with other psychiatric problems.

C. Prevalence Rates and Their Relationship to Gambling Accessibility

14. Four independent, nationally representative surveys of the prevalence of pathological gambling have been conducted in the United States to date. The first survey was commissioned in 1976, in response to the expansion of legalized gambling opportunities, primarily lotteries, occurring throughout the U.S. at that time. This survey was instituted prior to adoption of pathological gambling as a psychiatric condition, and therefore, it evaluated problem gambling, and attitudes toward gambling, rather than actual diagnoses (Kallick M, Suits D, Dielman T, Hybels J. *Survey of American Gambling Attitudes and Behaviors.* USGPO Stock No. 052-003-00254. 1976; Washington, D.C.: U.S. Government Printing Office. The next survey was not conducted until 20 years later (*Gerstein DR, Volberg RA, Toce MT, et al. Gambling Impact and Behavior Study: Report to the National Gambling Impact Study Commission.* 1999; Chicago, IL: National Opinion Research Center), this time in response to legalization of casino-style gambling on Native American Indian reservations and waterways throughout the U.S. At around the same time, Welte and colleagues (*Welte J, Barnes G, Wieczorek W, et al.* J Studies Alcohol 2001; 62: 706-712) led an independent evaluation of prevalence rates of pathological gambling and its association with alcohol use disorders. Finally, the National Epidemiology Survey of Alcohol and Related Conditions (NESARC) was conducted in 2001-2002, and

it included a module on assessment of pathological gambling (Petry NM, Stinson FS, Grant BF. J Clin Psychiatry 2005; 66: 564-574).

15. The first three of these surveys each included fewer than 2700 respondents, which is generally considered small for estimating prevalence rates of disorders that occur in relatively low proportions of the population. They also all had response rates that are on the low end, of only 55-65%. The NESARC study (Petry NM, Stinson FS, Grant BF. *J Clin Psychiatry* 2005; 66: 564-574), in contrast, included over 43,000 respondents and had a very high response rate of 81%.

16. These studies found rates of pathological gambling ranged from 0.4 to 2.0%. The largest study noted the lowest prevalence rate (Petry NM, Stinson FS, Grant BF. *J Clin Psychiatry* 2005; 66: 564-574), but it was still within the range of the other surveys (*Gerstein DR, Volberg RA, Toce MT, et al. Gambling Impact and Behavior Study: Report to the National Gambling Impact Study Commission.* 1999; Chicago, IL: National Opinion Research Center; Kallick M, Suits D, Dielman T, Hybels J. *A Survey of American Gambling Attitudes and Behavior.* 1979; Ann Arbor: University of Michigan Press; *Welte J, Barnes G, Wieczorek W, et al. J Studies Alcohol* 2001; 62: 706-712) when considering statistically derived confidence intervals. While pathological gambling affects a relatively small proportion of the U.S. population, it nevertheless has significant consequences on the individual, his or her family members, and society at large as detailed earlier.

17. Data suggest that increasing access to legalized gambling opportunities has led to a concomitant rise in the proportion of the population experiencing gambling problems. Shaffer and colleagues (Shaffer HJ, Hall MN, Van Der Bilt J. Am J Public Health. 1999: 89; 1369-1376) used meta-analytical techniques to compare rates derived from prevalence studies conducted prior to 1993, to those conducted between 1993 and 1997, after the introduction of casino style gambling in a number of states. Rates of combined problem (the sub-diagnostic threshold condition) and pathological gambling rose from 4.4% in the earlier studies to 6.7% in the later studies.

18. However, few longitudinal studies traced changes in rates over time within a specific population. Three states (Connecticut, Iowa, and Minnesota) conducted statewide surveys before and after initiation of casinos. Two of the three found statistically significant increases in problem or pathological gambling with the advent of casinos (Emerson MO, Laundergan JC. *J Gambling Studies.*

1996; 12: 291-304; Volberg RA. *Gambling and Problem Gambling in Iowa:* A Replication Study. 1995; Roaring Spring, PA: Gemini Research; Volberg RA, Steadman HJ *Problem Gambling in Iowa.* 1989; Delmar, NY: Policy Research Associates, Inc; WEFA, ICR Survey Research Group, Lesieur H, Thompson W. *A Study Concerning the Effects of Legalized Gambling on the Citizens of the State of Connecticut.* 1997; Newington, CT: State of Connecticut Department of Revenue Services, Division of Special Revenue). In a more localized study, *Room et al.* (*Addiction* 1999; 94: 1449-1466) surveyed individuals residing in the Niagara Falls area with the opening of a local casino, and they also found statistically significant increases in both problem and pathological gambling. In Quebec, *Ladouceur et al.* (Ladouceur R, Jacques C, Ferland F, Giroux I. *Canadian J Psychiatry,* 1999; 44: 802-804) likewise found statistically significant increases (and almost a doubling of rates) of pathological gambling as gambling became more embedded in that culture.

19. Moreover, the National Gambling Impact Study Commission (1999; Accessed at: govinfo.library.unt.edu/ngisc/reports/fullrpt.html) found that the highest rates of pathological gambling occurred in greatest proximity to casinos. Similar effects are noted in Canada. *Cox et al.* (Cox BJ, Yu N, Afifi TO, Ladouceur R. *Canadian J Psychiatry* 2005; 50: 213-217) reported that the highest prevalence rates of pathological gambling were in provinces with the highest densities of electronic gambling machines. Furthermore, in six of ten communities surveyed in the U.S., the advent of casinos was associated with an increase in domestic violence cases (*Gerstein DR, Volberg RA, Toce MT, et al. Gambling Impact and Behavior Study: Report to the National Gambling Impact Study Commission.* 1999; Chicago, IL: National Opinion Research Center).

20. Perhaps among the most troubling statistics are those related to suicides. Phillips (Phillips DP, Welty WR, Smith MM. *Suicide & Life Threatening Behavior* 1997; 27: 373-378) noted that Las Vegas has the highest rate of suicide in the nation, both among its residents and visitors. In Atlantic City, a large increase in suicide rates occurred concomitant with the opening of casinos. *Campbell et al.* (Campbell F, Simmons C, Lester D. *J Death & Dying* 1999; 38: 235-239) examined the impact of increasing opportunities to gamble in Louisiana. They compared suicide rates between 1989-1990 and 1994-1995, and found high rates of unemployment and per capita spending on the lottery were significantly associated with increased rates of suicide over this time period. *McCleary et al.*

(McCleary R, Chew KSY, Merrill V, Napoliatano C. *Suicide & Life Threatening Behavior* 2002; 32: 209-221) evaluated suicide rates in 148 U.S. metropolitan areas before and after the advent of casinos, and found a positive correlation between the presence of casinos and suicide rates as well.

21. Pathological gambling, and its adverse consequences, is more likely to impact certain subgroups (Petry NM *Pathological Gambling: Etiology, Comorbidity, & Treatment*. 2005; Washington, D.C.: American Psychological Association Press. *See* Chapter 4 for details). In virtually every prevalence survey, younger age and male gender are risk factors for pathological gambling. Racial and ethnic minorities also develop gambling problems at higher rates than members of the majority race. Finally, socioeconomic status is linked with the development of pathological gambling, and increased access to gambling opportunities may be especially troublesome for lower income individuals. With the introduction of the national lottery in 1994 in the United Kingdom, for example, Grun and McKeigue (Grun L, McKeigue P. *Addiction* 2000; 95: 959-966) found that the proportion of households that gambled more than 10% of their annual income increased significantly from 0.4% to 1.7%. Among low-income households, this increase was even more dramatic, from 0.6% to 3.2%.

22. Lotteries, however, only attract a subtype of gamblers, and few pathological gamblers endorse lottery gambling as their most troublesome gambling activity (Petry NM. *Addiction*. 2003; 98: 645-655). Casinos have gambling opportunities that attract most everybody. They include gambling that is both strategic and non-strategic in nature, there are low and high stakes betting opportunities, and immediate access to winnings is possible as well as larger but more delayed winnings. The heterogeneity of options is designed to attract and encourage gambling behaviors (Petry NM, Roll JM. *Seminars in Clinical Neuropsychiatry* 2001; 6: 17-183), and importantly, Internet gambling incorporates all these features.

D. Internet Gambling

23. Now, a new era is upon society, which may begin to break down the geographical barriers associated with casino gambling. Three-quarters of the U.S. population presently lives within a 300-mile radius of a casino (*Gerstein DR, Volberg RA, Toce MT, et al. Gambling Impact and Behavior Study: Report to the National Gambling Impact Study Commission*. 1999; Chicago, IL: National Opinion Research Center), which is still quite a distance to travel to gambling. About a similar

proportion of the population has access to the internet at work or home, with estimates indicating that 65.1% of homes are now connected to the internet, up from 46.9% in 2000, and growing daily (*Cole JI, Suman M, Schramm P et al. The Digital Future Report: Surveying the Digital Future.* 2004. Los Angeles, CA: University of Southern California). Thus, the majority of Americans can access the internet at work, from home, *or* both. Through this medium, people can access gambling at any time of day or night, and Internet gambling constitutes virtually all types of gambling that are available in casinos.

24. Little data are yet available regarding the prevalence of Internet gambling participation or problems associated specifically with this form of wagering. Ladd and Petry (Ladd GT, Petry NM. *Psychology of Addictive Behaviors* 2002; 16: 76–79) published the first empirical study evaluating rates of gambling participation in a sample at high risk for gambling problems — a racially/ethnically diverse group of persons attending medical and dental clinics that serve the poor. Of the 389 patients who participated in the study, only a small proportion, 8.1%, reported ever having placed a bet on the internet. Internet gamblers were younger and more likely to be members of racial/ethnic minorities than individuals who had never bet on the internet.

25. Most importantly, individuals with Internet gambling experience had extraordinarily high rates of pathological gambling. In fact, 64.5% of Internet gamblers were classified as pathological gamblers. This rate was almost 6 fold higher than the rate for individuals participating in this survey who had never gambled on the internet.

26. These results were replicated and extended in two other independent studies. In another, much larger sample of 1,426 individuals attending medical and dental clinics (Petry NM, *Internet Gambling Is Associated with High Rates of Pathological Gambling and Poor Physical and Emotional Health,* manuscript under review), 4.0% of respondents reported trying Internet gambling between 1 and 10 times in their lives, and an additional 2.8% of respondents indicated more regular and up to daily Internet gambling. Internet gamblers were more likely to be male and younger than non-Internet gamblers.

27. Internet gamblers, especially the more frequent Internet gamblers, were also more likely to have experienced gambling problems. Prevalence rates of pathological gambling were 7.9%, 29.8%

and 65.9% among individuals who had never bet on the Internet, those with infrequent Internet gambling experience, and those with more regular Internet gambling participation, respectively. These data suggest that either Internet gambling leads to problem gambling behaviors, or individuals who gamble problematically are more prone to gamble on the internet.

28. This study also included a standardized instrument assessing global emotional and physical health. Internet gambling participation, even occasional Internet gambling, was significantly predictive of poor emotional health. Regular Internet gambling was highly predictive of poor physical health. The cross-sectional nature of the study design prevents an understanding of causality of these relationships, but the data are clear that Internet gambling is closely linked with adverse consequences.

29. In sample of 630 college students (Petry NM, unpublished data), a larger proportion had tried Internet gambling. Almost 1 in 5 (18.1%) students had wagered on the internet. Frequency of Internet gambling participation was again significantly related to pathological gambling behaviors, with only 2.1% of the newer-Internet gamblers being classified as pathological gamblers, compared with 12.0% of those who gambled on the internet but less than 10 times and 33.3% of the more regular Internet gamblers.

30. Thus, these studies demonstrate that, although relatively rare in adult populations, Internet gambling is fairly common in younger cohorts, and associated with emotional distress, even among occasional Internet gamblers. More substantial involvement with Internet gambling is closely linked with pathological gambling behaviors and has an additive and independent effect on poor emotional and physical health.

31. Psychologically healthy individuals may largely ignore advertisements about Internet gambling. However, promotional materials about Internet gambling may be particularly effective in encouraging initial involvement in Internet gambling among less healthy or vulnerable populations. As noted above, even occasional Internet gambling is associated with increased risk for pathological gambling and poor emotional health. Such advertisements may also have adverse effects on maintaining or resuming involvement in Internet gambling among pathological gamblers who are trying to quit gambling, as detailed below.

E. Advertisements and Internet Gambling

32. Advertising, by its very ubiquity in society, is profitable. No company or business would advertise if such practices did not increase revenues and sell products. In the case of Internet gambling, the item being sold is gambling opportunities, and clearly advertising over the internet holds to the same tenets associated with other forms of advertising. It draws people to "purchase" the product, or it would not have grown into the industry that it has.

33. Society places restrictions on advertisements for items that are considered dangerous. Examples include limitations on the advertising of alcohol and cigarettes, which are prohibited to sell to minors under the ages of 21 and 18, respectively. Similarly, the pharmaceutical industry is heavily constrained in terms of its advertisements of medications, which can only be prescribed to individuals with documented medical conditions. Advertisements for guns and other weapons are simply prohibited on television, radio and billboards.

34. The rationale for these restrictions is simple. Advertising is a big business, and this big business has a major impact on individuals', especially young and vulnerable persons', purchasing decisions. Hence, liquor and cigarette ads are restricted from some television stations or programming hours and times that target youth. The American Public Health Association Government Council (*Am.J Public Health* 1992; 83: 468-472), the Federal Trade Commission (*Self-Regulation in the Alcohol Industry: A Review of Industry Efforts to Avoid Promoting Alcohol to Underage Consumers. Executive Summary*. 1999; Washington, D.C.: Federal Trade Commission) and the American Medical Association (*Youth, Young Adults, and Alcohol: Key Facts and Prevention Strategies*. 2000. Available at http:/www.ama/assn.org/ama/pub/article/3566-3641.html.) all concur that alcohol advertisements contribute to the widespread social acceptability and foster initial and continued drinking behaviors.

35. Gambling, similarly to alcohol and cigarette usage, is illegal for individuals under the age of 18, and 21 in some states. There are two reasons for these age restrictions. One is that problems with gambling are significantly higher in youth and young adults relative to older populations (*see Petry NM. Pathological Gambling: Etiology, Comorbidity & Treatment*. 2005; Washington, D.C.: American Psychological Association Press, for review). Adolescents and young adults experience gambling problems at 2-5 times the rates of older adults. Further, the younger one begins gambling, the more

likely one is to develop a problem with gambling and to have more severe problems extending throughout a range of areas of psychosocial functioning (Burge AN, Pietrzak RH, Molina CA, Petry NM. *Psychiatric Services* 2004; 55: 1437-1439).

36. A second reason for restrictions on advertising targeted toward youth is because they are considered a vulnerable and impressionable group, who may be more prone to buy or engage in activities that are positively marketed. In a longitudinal study, *Ellickson et al.* (Ellickson PL, Collins RL, Hambarsoomians K, McCaffrey DF. *Addiction* 2005; 100: 235-246) recently demonstrated that exposure to alcohol ads in 7th graders predicted both onset and frequency of alcohol use at grade 9. While parallel studies are not yet available for gambling advertisements, exposure to gambling ads among youth may increase propensity to gamble, which in turn may be linked with development of gambling problems and the sequel of adverse consequences associated with pathological gambling.

37. Other vulnerable populations may also be adversely impacted by advertisements. Older adults and individuals with some psychiatric disorders have been drawn into sweepstakes and other gimmicks (Mendez MF, Bronstein YL, Christine DL. *J Am Geriatrics Society* 2000; 48: 855-856). Given the high co-morbidities between pathological gambling and other psychiatric disorders (Petry NM, Stinson FS, Grant BF: *J Clin Psychiatry* 2005; 66: 564-574), individuals with psychiatric conditions may be more prone to gamble on the internet in response to the ads.

38. Impulsivity is a common problem among pathological gamblers, and some other psychiatric populations as well. Pathological gamblers, especially those with comorbid psychiatric conditions, have high rates of impulsivity as measured by personality questionnaires, decision-making tasks, and laboratory studies (Alessi SM, Petry NM. *Behavioral Processes* 2003; 64: 345-354; Petry NM. *J Abnormal Psychology* 2001; 110: 482-487; Petry NM. *Drug Alc Dependence* 2001; 63: 29-38; Petry NM, Casarella T. *Drug Alc Dependence* 1999; 56: 25-32). Individuals with impulse control problems react quickly, often without weighing the consequences of their actions or considering the long-term effects.

39. An inherent and unique danger to Internet gambling, and the advertisement of this form of gambling, is its immediacy (Petry NM, Roll JM. *Seminars in Clinical Neuropsychiatry* 2001; 6: 17-183). With other forms of gambling, one needs to drive to the casino, go into the convenience store, or

at least purposefully place the phone call to the bookie and wait for the phone to ring. In contrast, once an Internet gambling ad appears on one's computer, it is only a matter of seconds before one can be into the site gambling. Individuals with high levels of impulsivity, such as pathological gamblers, may be more reactive to these advertisements.

40. Importantly, pathological gamblers who are attempting to cease gambling report that advertisements are a significant trigger for them to gamble. In an evaluation of therapy charts from patients treated in our clinic (Morasco BJ, Weinstock JM, Ledgerwood DM, Petry NM, *Psychological Factors that Promote and Inhibit Pathological Gambling*, manuscript under review), gambling ads were placed in the top three categories of reasons why they gamble, and among their major triggers for experiencing urges to gamble. The cognitive-behavioral therapy utilized in our treatment program is designed to assist patients with managing high-risk gambling situations. Attempting to avoid gambling advertisements was reported as one of the major strategies utilized by these patients during treatment.

41. Avoiding Internet gambling ads may simply not be possible if one needs to use the internet for work or personal reasons. For individuals in our treatment programs who report Internet gambling, we recommend removal of the computer, or at least disconnection from the internet, at both the home and work environments. However, this is clearly not always possible for gamblers whose work requires internet use. With the growing ubiquity and necessity computers in everyday life, avoidance of Internet gambling ads will become even more difficult.

42. Self-banning or exclusions programs are practiced in many casinos (Nowatzki NR, Williams RJ. *International J Gambling Studies* 2002; 2: 3-25). This practice refers to a program in which pathological gamblers voluntarily place their names to a list, making it illegal for them to enter, or win money, at a casino. Similarly, individuals can be asked to have their names removed from marketing departments at casinos. However, excluding oneself from Internet gambling advertisements is presently not at option, so long as one uses the internet.

43. In summary, Internet gambling appears to be a dangerous activity in that it is associated with substantially high rates of pathological gambling behaviors. It is also related to poor emotional and physical health. Advertisements can have pronounced effects on consumer behaviors, especially among some vulnerable populations such as youth. While gambling has been part of virtually every

known civilization, past cultures and societies have placed some important and logical restrictions on gambling, including the practice of some Native American tribes to never allow betting on credit. Gambling in the past has always included at least some aspects of socialization, which can serve to check and modulate behaviors. In contrast, the active promotion of Internet gambling activities does not pay heed to age, financial means, or vulnerabilities of potential customers. No social medium is involved to prevent, recognize, or curb problems when they do develop. Instead, these advertisements promote an illegal activity that can have dire consequences for the individual, his or her family, and society.

44. After reviewing the Internet gambling advertisements on the compact discs provided by the plaintiffs, it is my opinion that the continued use of such advertisements may cause irreparable harm to individuals who are risk for and/or who have already developed pathological gambling. The negative consequences that may result include increased gambling participation, development of significant financial debt and possibly bankruptcies, emotional distress, and even suicide.

I declare, under penalty of perjury, that the foregoing is true and correct to the best of my knowledge. Executed this ____ day of November, 2005, at _____.

DR. NANCY PETRY

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Gambling in the past has always included at least some aspects of socialization, which can serve to check and modulate behaviors. In contrast, the active promotion of Internet gambling activities does not pay heed to age, financial means, or vulnerabilities of potential customers. No social medium is involved to prevent, recognize, or curb problems when they do develop. Instead, these advertisements promote an illegal activity that can have dire consequences for the individual, his or her family, and society.

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I declare, under penalty of perjury, that the foregoing is true and correct to the best of my knowledge. Executed this 22nd day of November, 2005, at Lansing, KY.

DR. NANCY PETRY

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STATEMENT OF SAMUEL A. VALLANDINGHAM, VICE PRESIDENT AND CHIEF INFORMATION OFFICER, THE FIRST STATE BANK

Mr. VALLANDINGHAM. You certainly took the pressure off me. So, Mr. Chairman, Ranking Member Scott and Members of the Committee, my name is Sam Vallandingham. I am Vice President of the 101-year-old First State Bank in Barboursville, West Virginia. I am also a member of the Payments and Technology Committee for the Independent Community Bankers of America.

Barboursville is a historical town of 3,183 people in the far western part of the State near the Kentucky border. We have 50 employees, two branches and 127 million in assets.

I appreciate the opportunity to testify on the proposed use of checking electronic payments systems to limit Internet gambling. I commend this Committee and Members for fighting against terrorism and money laundering. We urge you to recognize that small banks like mine have a substantial regulatory burden under the USA PATRIOT Act and the Bank Secrecy Act to identify our customers while documenting and reporting suspicious transactions.

ICBA believes that it is critical that our resources be focused where risk to national safety and financial soundness are greatest. Our concern is that the added burden of monitoring transactions for Internet gambling will drain resources currently engaged in antiterrorism and anti-money-laundering compliance and divert our attention from the daily operation of our bank.

Ultimately, we question whether this legislation will actually reduce Internet gambling. Can Congress justify the time and expense required by community banks to comply with another layer of regulation?

Additionally, regulatory burden is detrimental not only to the bank, but to the community that depends on us for economic stimulus, small business funding, job creation and continued community revitalization.

There are two bills pending before the House of Representatives that attempt to end Internet gambling through restriction of payments—H.R. 4777, sponsored by Representative Goodlatte of Virginia, and H.R. 4411, recently passed by Financial Services Committee. Although the bills have many similarities, there are some important differences.

H.R. 4411 prohibits any person engaged in the gambling business from accepting credit, electronic funds transfer, checks or other types of payment. The bill directs the Treasury Department, the Federal Reserve and the Justice Department to work together to develop regulations requiring banks to identify and block restricted financial transactions.

H.R. 4777 would update the law against interstate gaming to include Internet gambling and criminalize acceptance of credit, electronic fund transfers or other payments by anyone in the gambling business.

The regulation and compliance burden created by these proposals is substantial. Their key enforcement mechanism would require banks to identify and block transactions between customers and Internet gaming companies. This will not work because it failed to

recognize the differences between the credit card systems and the check clearing and automated clearinghouse or HCS networks.

Credit cards operate within an electronic system that assigns codes to identify the merchants and the type of transaction. Checks and ACH payments are routed from the originator of the payment, the merchant, to the receiver, the customer, using only bank routing and account numbers. The payee is not identified. And unlike credit cards, the check clearing and HCS networks cannot identify and block payments to Internet gambling companies, and they cannot reconfigure to function as a transaction monitoring service.

This legislation, therefore, should exempt check and HCS transactions; otherwise, it would require a massive overhaul of the check and HCS systems, create enormous regulatory burden and give police-like powers to financial institutions to identify and block illegal transactions.

The bill should give the Federal Reserve rule-writing and regulatory oversight. The Federal Reserve is well acquainted with payment system and knows the limitations of the check clearing and HCS networks. If the check and ACH transactions are not exempted, the resulting compliance cost to the banks and payment system would be enormous.

The CBO's analysis of H.R. 4411 determined that the costs to the private sector would be less than 128 million if it applies to credit card transactions only. CBO added, quote, "If the regulations also include the requirement for banks to identify and block checks and other bank instruments, the direct cost to comply with the mandates could increase significantly," end quote. These costs would include the redesign and rebuilding of the payment system structure, increasing labor and training costs to banks, redesign the checks and HCS formats and education of the customer, as well as payment delays and significantly slowed payment systems.

If the Congress wants to make certain transactions illegal, it should look for solutions that do not harm the Nation's payment systems and do not saddle our banks with the burden of enforcement. Responsibility for identifying and blocking prohibited credit and debit transactions should lie with the credit card networks, not the financial institutions. Only the credit and debit card networks have the ability to determine the origin of the transaction, and thus, only the credit and debit card networks have adequate information to identify an illegal transaction.

Neither banks nor our Nation's payment systems can function as transaction monitoring and blocking service as envisioned by this legislation. To the extent that this legislation attempts to protect families and minor children, I assure the Committee, there are processes and procedures in place that permit a customer to rescind fraudulent HCS or check transactions.

On behalf of my community bank and nearly 5,000 members of the Independent Community Bankers of America, I ask you to remember this as you consider the legislation and increased regulatory burden it would create for our industry.

Thank you.

Mr. COBLE. Thank you, Mr. Vallandingham.

[The prepared statement of Mr. Vallandingham follows:]

PREPARED STATEMENT OF SAMUEL A. VALLANDINGHAM

Testimony
of
Mr. Samuel A. Vallandingham
Vice President
The First State Bank
Barboursville, WV

On behalf of

Independent Community Bankers of America
Washington, DC

"Legislative Hearing on H.R. 4777, the Internet Gambling Prohibition Act"

United States House of Representatives

Committee on the Judiciary
Subcommittee on Crime, Terrorism, and Homeland Security

April 5, 2006

Mr. Chairman, Ranking member Scott and members of the committee, my name is Sam Vallandingham. I am Vice President of the 101 year-old First State Bank in West Virginia. I am also a member of the Payments and Technology Committee for the Independent Community Bankers of America.[1] My bank is located in Barboursville, a historical town of 3,183 people in the far western part of the state near the Kentucky border. We have 50 employees, two branches and $127 million in assets.

Banking has been in my family for four generations. My great grandfather, a Kentucky tobacco farmer, sold his farm to raise capital to start the First State Bank. It is said that my grandfather came to West Virginia in a horse and buggy and these too were eventually sold, with the proceeds used to set up the bank. The original charter, dated September 1, 1905 and the certificate of authority still hang on the wall in the bank's main office.

On behalf of ICBA, I would like to extend my appreciation for the opportunity to testify on the proposed use of the checking and electronic payments systems to limit criminal behavior, in this case, Internet gambling. We appreciate the committee's willingness to have an open dialogue on the effect of this proposed legislation on community banks.

Background and Summary of ICBA Position

This committee and members of the House should be commended for actively engaging in the fight against terrorism and anti-money laundering. We urge you to recognize that through the passage of the USA Patriot Act and Bank Secrecy Act, small banks like mine have undertaken a substantial burden to confirm the identity of our customers while documenting and reporting suspicious transactions. ICBA believes that it is critical that our resources be focused where risks to our national safety and financial soundness are greatest.

Our concern is that the added burden of monitoring all payment transactions for the taint of Internet gambling will drain finite resources currently engaged in complying with anti-terrorism, anti-money laundering regulations and the daily operation of our bank to meet the financial needs of our customers and community. While we share concerns about Internet gambling, it is highly doubtful that the pending legislation, if passed, would affect the popularity of Internet gambling. **Ultimately, we question whether the Internet gambling bills currently before the House will efficiently and effectively regulate the targeted behavior at a level which will justify the**

[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever changing marketplace. For more information, visit ICBA's website at www.icba.org.

time and expense required by community banks to comply with another layer of regulation.

There are two bills pending before the House of Representatives that purport to end Internet gambling through the restriction of payments: H.R. 4777, sponsored by Representative Goodlatte of Virginia and H.R. 4411, recently passed by the Financial Services Committee. Although the bills have many similarities, there are some important differences.

H.R. 4411 prohibits any person engaged in the business of betting or wagering from knowingly accepting credit, electronic fund transfers, checks or any other types of financial transactions in connection with unlawful Internet gambling. The bill also directs the Treasury Department and the Board of Governors of the Federal Reserve System in consultation with the Justice Department to issue regulations requiring payment systems to identify and prevent restricted financial transactions.

Unlike H.R. 4411's focus on prohibiting the underlying financial transactions, H.R. 4777 would amend the prohibition against interstate gambling and criminalize the knowing acceptance of credit, credit proceeds, electronic fund transfers or other such monetary payments by anyone in the gambling business.

The burden of regulation and compliance created by these proposals is substantial, as a key enforcement mechanism would require banks to identify and block transactions between bank customers and Internet gaming companies. **These proposals do not recognize that the check clearing system and the Automated Clearing House (ACH) network do not have the same capabilities as the credit card association networks to identify different types of transactions.** These systems were never intended to identify illegal activity, monitor individual transactions and regulate enforcement functions. The payments system was not designed to be a transaction monitoring service. It was designed to be an effective and efficient method for transferring dollars from one party to another.

This legislation, if passed, would not only necessitate a massive overhaul of our nation's check clearing and ACH systems, but also create enormous regulatory burden requiring the deputization of financial institutions to identify and block illegal transactions. For these reasons, we oppose the use of the check and ACH payments system to monitor Internet gambling transactions. If in the opinion of this committee, a bill must be passed to address the Internet gambling problem, then we respectfully request rule writing and regulatory oversight be given to the Federal Reserve Board of Governors (Federal Reserve) which is well acquainted with the functionality of the payments system and the limitations of the nation's check clearing and ACH networks. Additionally, given the limitations of the check clearing and ACH networks, we request an exemption for check and ACH payments.

Community Banks are Disproportionately Burdened with Regulation and the Cost of Compliance

Recently, ICBA testified about community banks' need for relief from severe regulatory burdens and the resulting substantial costs of compliance.[2] In January 2004, two economists at the Federal Reserve Bank of Dallas concluded that the competitive position and long term viability of small banks is questionable due to the crushing regulatory burden shouldered by our industry.[3] The costs are disproportionately heavy for community banks because unlike the large multinational banks, we cannot benefit from economies of scale and a large workforce to ultimately pass the high cost of compliance to a national customer base.

When discussing the cost of compliance and the disproportionate effect of regulation on community banks, there is one basic difference between our largest and smallest financial institutions. Large banks have many hundreds or thousands of employees and the financial resources to easily and quickly hire and train more employees to work exclusively on ensuring that the bank complies with the growing number of regulations. In contrast, a community bank with $100 million in assets typically has 30 full-time employees; a $200 million bank may have up to 60 employees. Unlike the big banks, if my bank is faced with new regulations, we must train one of our 50 current employees to be responsible for compliance. This not only creates costs, but takes our employees away from their core duty of serving our customers and our community.

This disproportionate regulatory impact caused by legislation like the proposed Internet gambling bill makes it difficult for us to fulfill our central mission of financing and supporting our local communities. Community bankers provide tremendous leadership in their communities. Additional regulatory burden is detrimental not only to the bank, but to the community that depends on us for economic stimulus, small business funding, job creation and continued community revitalization.

How Different Elements of the Payment System Function

Our nation's payment system includes check clearing, ACH, a myriad of credit and debit card products, wire transfers and new innovations. Each type of payment operates over a different network. For example, the credit card network, an all-electronic system, is vastly different from the ACH and check clearing networks. Businesses desiring to accept and process credit card

[2] Testimony of Ms. Terry Jorde, President/CEO, CountryBank USA, Cando, ND and Chairman-Elect of the Independent Community Bankers of America, March 1, 2006 *and* testimony of Mr. David Hayes, President/CEO, Security Bank, Dyersburg, TN and Chairman of the Independent Community Bankers of America, June 21, 2005 to the United States Senate Committee on Banking, Housing and Urban Affairs.
[3] Gunther and Moore, "Small Banks' Competitors loom Large," *Southwest Economy*, Federal Reserve Bank of Dallas, Jan/Feb. 2004.

payments receive a merchant category code to identify the type of merchant or business. Every transaction routed from a specific business has the corresponding merchant category code. Therefore, credit card networks are able generally to identify transactions originated by an Internet gambling company and block payment as required in the proposed legislation. However, merchants can be assigned the correct merchant category code only if they fully disclose all lines of business. For example, a general merchandiser could operate an Internet gambling enterprise, but fail to disclose this business line to the organization sponsoring the merchant's credit card system.

Generally, debit card networks have capabilities similar to credit card networks.

Conversely, the **check clearing system** is a paper-based network that is beginning to migrate to an electronic system. According to the Federal Reserve System's 2004 Federal Reserve Payments System Study, more than 36 billion paper checks were processed nationally in 2003.[4] Although paper-based, banks do have an automated process for clearing and settling paper checks. The check clearing system relies on machines to read the Magnetic Ink Character Recognition Line, commonly known as the MICR line. The MICR line includes the paying bank's routing and transit numbers, the customer's bank account number, the check serial number, and the amount of the check. Checks are cleared, settled, and deducted from customer accounts using this MICR line information. The payee information is NOT processed. Although the industry is making progress in converting paper checks to electronic images, the process still relies on processing the MICR line information of the check image. Unlike the credit card system, **the check clearing system does not have a merchant or transaction coding process.** This is a long-standing commercially acceptable banking practice. The check clearing process does not provide a means to identify and prohibit checks payable to Internet gambling companies and it cannot be reconfigured to function as a transaction monitoring service.

Electronic payment systems were developed to provide an alternative to the paper check. Electronic payment systems include all forms of electronic payments, including ACH payments, debit and credit cards, money transmittals and wire transfers. Similar to the check clearing network, the ACH network does not have the capability to identify and prohibit certain transactions. Transactions are routed from the originator of the payment, in this case the Internet gambling company, to the receiver, the customer, using the customer's bank routing, transit and account numbers. The only way to identify the originator is by the company name. **Therefore, the ACH network, like the check clearing system, does not provide a means to identify and prohibit payments originated by Internet gambling companies and it cannot be reconfigured to function as a transaction monitoring and blocking service.**

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[4]Federal Reserve System, *The 2004 Federal Reserve Payments Study, Analysis of Noncash Payments Trends in the United States: 2000 – 2003*, updated December 15, 2004 (2004).

Using this system to identify and to block Internet gambling transactions is unfeasible. Banks cannot control Internet gambling because check and ACH networks offer limited information to the bank about the underlying transaction. A bank can neither distinguish between legal and illegal transactions nor identify the ultimate recipient of funds, particularly where a third party payment system is utilized. In short, to a bank, a simple purchase of bread and milk at a grocery store paid for using a check looks substantially similar to an Internet gambling transaction paid for with the same checking account. **Recognizing the specialized purpose of the check clearing and electronic payment systems, we strongly urge the Committee to exempt checks and electronic payments, like ACH transactions, from the proposed legislation.**

The Burden of Regulation and the Cost of Compliance

One of the most difficult aspects of implementing the proposed regulation is that **financial institutions would have the judicial-like duty of distinguishing between legal and illegal acts.** The proposed Internet gambling bills do not prohibit all Internet gambling. Rather, they create a distinction between legal and illegal Internet gambling. This distinction turns on the type of gambling (horseracing versus poker), the location of the transaction (interstate, intrastate or tribal lands) and the source of the gambling (offshore Internet website versus US-based casino). Thus, the burden is placed on a bank to identify if a transaction originated at an Internet gambling site, to distinguish what portion of the transaction was legal or illegal and to determine where the transaction occurred. Particularly in the case of checks which move with the customer, it is impossible for a bank to determine the location of a transaction and thus, whether a wager was legal or illegal.

This legislation, if passed, would necessitate a cumbersome and expensive overhaul of the ACH and check networks. This overhaul would impede their efficiency and accuracy and increase inconvenience and costs to customers. Our nation's payments system is the global model of speed and efficiency. It was designed to permit consumers and businesses to complete transactions quickly and accurately. The proposed legislation would undermine the system and threaten the economy. In order to comply with the proposed legislation, these networks would have to be substantially reengineered and significant resources would have to be diverted to investigating parties, payees and transactions. The customer would not only absorb the resulting costs, but also the inconvenience of time consuming transactions. Under this proposed regulatory framework, the simple act of writing a check would require recording extensive additional information, including the location of the transaction, business of the payee and legal character of each part of the transaction. The likely result is that banks would deny many legal transactions and the payments system will be significantly slowed.

Check and ACH Transactions Should Be Exempted

This legislation promises to create substantial regulatory burden and significant costs as it would require banks to act as the gatekeepers for all check and ACH transactions. As a primary clearing house for checks and ACH transactions, the Federal Reserve is familiar with the limitations of using the payments systems to regulate Internet gambling transactions. A possible solution to this dilemma is to exempt check and ACH transactions from the scope of this legislation or to direct the Federal Reserve to exempt any transactions where it is unfeasible to identify and block illegal gambling activity. **If it is not reasonably practical to block such transactions without harming the efficiency of the payments system, then they should be exempted.**

If check and ACH transactions are not exempted, the resulting compliance costs to banks and the payments system would be enormous. On Friday, March 31, the Congressional Budget Office (CBO) released its analysis of H.R. 4411. The analysis determined that the enactment cost of this bill to the private sector would be below $128 million[5] if regulators *only apply rules to credit card transactions* and not to other payment options. "However, **if the regulations also include the requirement for banks to identify and block checks and other bank instruments…the direct cost to comply with the mandates could increase significantly**…."[6] These resulting costs would not be limited to the redesign and rebuilding of the payments system structure, but increased labor and training costs to the banks, redesign of check and ACH forms, education of the customer as to how to complete the redesigned forms as well as the high economic costs of payment delays and a significantly slowed payments system.

Congress may still wish to make these transactions illegal, but should adopt enforcement solutions that do not require extraordinary costs to the nation's payment systems and will not saddle the nation's banks with the burden of enforcement. Moreover, the responsibility for identifying and blocking prohibited credit and debit card transactions should lie with the credit and debit card networks and NOT the financial institutions. Only the credit and debit card networks have the ability to determine the character

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5 The $128 million threshold was established in the Unfunded Mandates Reform Act of 1995. 2 U.S.C. § 1501 (1995). The act requires the CBO to estimate the costs of bills with federal mandates reported out of committees. The CBO must provide a detailed cost estimate for each bill containing an annual aggregate impact of $50 million or more on the public sector (i.e., state and local governments) or $100 million on the private sector. The act allows a point of order in both the House and Senate against any bill or joint resolution reported by an authorizing committee that lacks the necessary CBO statement, or that result in direct costs in excess of $50 million a year to state and local governments. A proposed bill is in order if it provides funding to cover the costs of the mandate. In addition, federal agencies must assess the effects of new regulations on state, local, tribal governments and the private sector while seeking to minimize burdens where possible.

6 Congressional Budget Office, *Congressional Budget Office Cost Estimate, H.R. 4411: Unlawful Internet Gambling Enforcement Act of 2006 as ordered reported by the House Committee on Financial Services on March 15, 2006*, 30 March 2006 at 4.

of the transaction and thus, only the credit and debit card networks have adequate information to identify an illegal transaction.

Protections are in Place to Protect Minors from Abusing Check and ACH Payments to Gambling Websites

One of the primary motivations behind this bill is the desire to prevent minors from accessing online gambling resources. Fortunately, there are many consumer protections in place that allow the customer to be made whole when there is fraudulent use of an ACH or check payment. Federal Reserve Regulation E[7] creates a right of recession for 60 days following the receipt of the account statement showing the fraudulent ACH payment or debit card transaction. The fraudulent use of a check is subject to the Uniform Commercial Code Article 4[8] which gives the customer 12 months to request a return of funds.

Conclusion

As a representative of the ICBA, I urge you to reject proposals to use the banking system to restrict Internet gambling unless there is a reasonable chance that the measures will be effective and will not add to the tremendous regulatory burden of our nation's financial institutions. The proposals that we have seen do not meet this test. Congress should not pass legislation that claims to "do good" but neither effectively and efficiently restricts bad behavior nor encourages positive action.

Community bankers oppose the use of the payments system to control antisocial or unseemly behavior, such as gambling, particularly where the regulatory burden and compliance costs to the private sector would be astronomical. Banks should not be deputized and given the duty of both identifying and blocking illegal activity. I am concerned that the proposal before this committee would merely increase my regulatory burden and compliance costs to the detriment of my community without the payoff of effectively stopping Internet gambling. **Despite the sincere intentions of the authors, neither my bank nor our nation's payment systems can function as a transaction monitoring and blocking service as envisioned by this legislation.** In so much as this legislation attempts to protect families and minor children, I assure the committee that there are processes and procedures in place that permit a customer to rescind a fraudulent ACH or check transactions.

[7] FRB Electronic Funds Transfer (Regulation E), 12 C.F.R. § 205 (2006).
[8] Bank Deposits and Collections, U.C.C. § 4-406 (2001).

If in the opinion of this committee, the legislation will be effective and the social need to restrict Internet gambling outweighs the potential harm to small banks like mine, then I respectfully ask that regulatory supervision be given to the Federal Reserve. We strongly urge the committee to modify the legislation to exempt the check clearing and ACH networks or to direct the Federal Reserve to exempt these transactions.

On behalf of my community bank and the nearly 5,000 members of the Independent Community Bankers of America, I ask you to remember this as you consider this legislation and the increased regulatory burden it will create for our industry. Thank you.

Mr. CANNON. Mr. Chairman.

Mr. COBLE. The gentleman from Utah.

Mr. CANNON. I am not a Member of this Subcommittee, as you know, but because of the peculiar effect that this has on my State, I would ask unanimous consent that I be allowed 5 minutes at some point in time to question the witnesses.

Mr. COBLE. Without objection, I will do this caveat, Mr. Cannon. I will recognize you after I recognize the Members of the Subcommittee.

Mr. CANNON. Thank you, Mr. Chairman.

Mr. COBLE. Without objection. It is good to have you with us, Mr. Cannon.

Before I start questioning, we thank each of you. And each of the witnesses alluded to gambling oftentimes.

I am a country music fan and Merle Haggard, the popular country balladeer, recorded a song some recent years ago entitled "The Kentucky Gambler," and the concluding words of the chorus were these, "But a gambler loses much more than he wins," and I think with rare exception, that is true.

Now, some of these sports shows, Mr. Scott, I have seen lately, gambling, some of these guys, I think, win much more than they lose. But I think generally, the Haggard conclusion is correct, more lost than won.

Mr. Goodlatte, the authority to authorize and regulate wagering has in large part been reserved to the States. What impact would your bill have on a State's ability to authorize and regulate wagering over the Internet, A; and B, if a State chose to permit wagering over the Internet, what steps would need to be taken?

Mr. GOODLATTE. Well, thank you, Mr. Chairman, as it is an excellent question. And this bill is primarily designed to buttress the ability of the States to do what has traditionally always been the case in the United States; gambling has been illegal in this country unless regulated by the States.

The States, however, because of the very nature of the Internet find it difficult to do that; and so, by prohibiting, modernizing the Wire Act to cover the new types of transactions that were not contemplated in 1961 when the Wire Act was written 45 years ago, we are recognizing that new tools need to be provided to all levels of the Government, certainly to the Justice Department, but also to State and local governments to enforce the laws that the States have to regulate gambling in those States.

Now, because we also recognize that the States have had the primary responsibility in this area, we tell the States in this legislation that they can regulate gambling on the Internet in their State if they meet two criteria which, in my opinion, today cannot be met. Perhaps some day in the future technology may allow it, in which case then I think it would be up to each individual State to do that.

Mr. COBLE. Hurry along because we have the 5-minute rule.

Mr. GOODLATTE. They have to make sure that the gambling is restricted to the confines of the State and, two, that minors do not participate. The technology does not exist to allow either of those, so Internet gambling under this legislation will nonexistent unless that technology changes.

Mr. COBLE. I thank you, sir. Mr. Ohr, in your prepared statement, you express concern over the possible weakening of Federal law covering Internet wagering on horse racing. Are there other industries similarly situated to horse racing and are they addressed in this bill?

Mr. OHR. Mr. Chairman, the Department obviously continues to have the position that Internet gambling should continue to be banned; and we would oppose—we would have very serious concerns about any possible weakening of that ban. With respect to the existence of other industries, I am not really qualified to speak.

We would have the same concerns with respect to those other industries as we would as to whether horse racing or any other industry is construed under the bill as getting some kind of permission.

Mr. COBLE. Mr. Goodlatte, are industries so involved?

Mr. GOODLATTE. No. I want to make that very clear. In response to some of the comments already made, there is no carve-out in this legislation for horse racing, for lotteries, or any other type of gambling.

There is, however, as noted by Mr. Ohr, a separate Federal statute that addresses the issue related to gambling on horses. And some maintain that that legislation, that previous legislation, allows it. The Justice Department maintains that it does not.

This legislation takes no position on that issue whatsoever. We do not attempt to repeal the statute. But we also do not interpret that statute in as much a way to legalize gambling.

Mr. COBLE. And that was enacted in the early 1970's?

Mr. GOODLATTE. I believe that is correct.

Mr. COBLE. Mr. Kindt, in your opinion, what are the distinct concerns related to Internet gambling versus gambling in person or other forms of gambling, A; and B, is the better way to cure the social ills associated with Internet gambling to regulate the industry or to make it illegal?

Mr. KINDT. Thank you, Mr. Chairman.

First of all, let me clarify one thing you introduced me as a law professor. I am a professor of business and legal policy. We make more money.

Mr. COBLE. I stand corrected, and congratulate you for that.

Mr. KINDT. Thank you, Mr. Chairman.

If we can get the overheads up there, my No. 4 overhead might help visualize this. It is entitled Annual Social Costs Per Pathological Gambler.

Basically, we are talking about two phenomena here. One is called the acceptability factor and the other is called the accessibility factor. If you have the acceptability factor, that means it is legalized or we see common today we see PR everywhere that says gamble, gamble, gamble; and the younger generation is getting this message everywhere that it is okay to gamble on the Internet.

I see students walking around my campus with T-shirts advertising illegal poker sites, and they don't know it is illegal.

So what we are talking about here is what sociologists and academics reference as the acceptability factor and that is, the message that it is okay to gamble, and of course we have legalized cer-

tain types of gambling. And that further confuses it and sends a message.

And then there is also the accessibility factor, and that is maximized by Internet gambling. Accessibility, you don't have to fly out to Las Vegas anymore. You don't have to go down to the casino anymore. It is right there at every work desk and every school desk, in every living room.

And so you will see an explosion in the numbers of pathological and problem gamblers, and the social costs are enormous. These are the top studies in a table for the Committee to review, and the social costs are at least $3 for every $1 in benefit.

Mr. COBLE. When my red light illuminates, I am going to the recognize Mr. Scott.

But, Mr. Kindt, do you think outright illegal or regulation?

Mr. KINDT. I think outright illegal, and I testified before the National Gambling Impact Study Commission. They said "prohibition"; if you can't prohibit it, you can't regulate.

Mr. COBLE. And, Mr. Banker, hopefully we will have a second round. I will get to you subsequently.

The distinguished gentleman from Virginia, Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

I think—as Professor Kindt has just indicated, one of the problems I have where you seek to kind of make it illegal—it is not illegal to do it, but it is illegal to run the operation—if you want to prohibit the activity, it is my view that it ought to be illegal to gamble on the Internet and that would clearly be enforceable.

Is that right, Professor Kindt?

Mr. KINDT. Well, I think that I would like to leave the details of the practicality of this to the people drafting the legislation, and I do that with respect to your question, Representative Scott.

Mr. SCOTT. Well, Mr. Ohr, if it were illegal to gamble over the Internet, would you have any problem catching people gambling? If you busted a site, you can get their mailing list and you can go after each and every one of them. Word would get around, and they would stop doing it.

Mr. OHR. Congressman, as Congressman Goodlatte has already mentioned, the approach of the Federal Government from the beginning of gambling legislation has been to support the States as the primary regulators or the ones with primary jurisdiction.

Mr. SCOTT. With any kind of illegal activity, you catch both sides. You don't just go after the sellers, you also go after the buyers; is that right?

Mr. OHR. Well, the Government has, the Department has traditionally focused on trying to—focusing on the large rings and trying to go after the most sophisticated and the largest operators; and we would continue that approach under this bill.

Mr. SCOTT. Is it illegal to gamble on the Internet?

Mr. OHR. Not at the Federal level.

Mr. GOODLATTE. Mr. Scott, if I might respond to that. We have had this discussion before, and I certainly understand your point of view. But the fact of the matter is—as Mr. Ohr indicates, we have always at the Federal level focused on supporting the States and targeted the entities offering gambling services. But virtually every State has their own regulations regarding what individual

bettors may or may not do. And so we are simply supporting their efforts in that regard.

We don't think there needs to be a Federal law in conjunction, in addition to the State laws that already target the individual bettors.

Mr. SCOTT. Okay.

Well, Mr. Ohr, are you aware of anyone who has ever been recently busted for gambling on the Internet?

Mr. OHR. I am not. At the Federal level, as I said, we don't have a prohibition; and I am not qualified to talk about what the States have or who they have busted.

Mr. SCOTT. You are qualified to speak of what you ever heard.

Mr. OHR. I am not familiar with any such case.

Mr. SCOTT. In your prosecutions, have you gotten anybody that lived and worked and didn't come within the jurisdiction of the United States?

Mr. OHR. Yes, we have prosecuted people who have conducted offshore gambling sites. Yes, we have.

Mr. SCOTT. And how did you—where was the prosecution?

Mr. OHR. Prosecutions took place in the district courts here. One example——

Mr. SCOTT. How did you get them here?

Mr. OHR. In one case, I think the defendant entered the United States and stood trial.

Your question goes, I think, to the problems of international law enforcement and——

Mr. SCOTT. You are familiar with—I forgot his name—selling pot seeds in Canada.

Mr. OHR. I am aware of that case.

Mr. SCOTT. And they won't extradite him, so we haven't been able to do anything about it.

Do we expect countries to extradite people running these sites to the United States so you can prosecute them?

Mr. OHR. We have a number of ways of attempting to enforce our criminal laws against people outside the United States who violate our laws—through extradition, through——

Mr. SCOTT. These sites are running all over the Internet. Who have you prosecuted that hasn't entered the United States?

Mr. OHR. We need to get them here to the United States before we can prosecute them. There are many ways of achieving that.

We certainly work very hard with our international partners to go after criminals who are violating U.S. law, even if they are located in other jurisdictions. It is not just a problem limited to Internet gambling.

It is related to all kinds of crimes, and certainly the Department does not believe that the difficulties we face in prosecuting people outside the U.S. who commit crimes within the U.S. should stop us from trying. And we will continue to work on this.

Mr. SCOTT. It is illegal now; is that right?

Mr. OHR. Yes.

Mr. SCOTT. To run a gambling operation. And anybody—how long would it take you to find a gambling site on the Internet, a minute?

Mr. OHR. I think anybody can find an Internet gambling site.

Mr. SCOTT. And it is not illegal to do it, to gamble on the Internet.

Mr. OHR. There is no Federal prohibition. That is up to the individual States.

Mr. SCOTT. Do you have any idea how much money is being made by the companies with gambling, with the gambling done in the United States both in the untaxed winnings and what we could get in taxes from the operator if they would submit to the jurisdiction and let us tax their operation?

Mr. OHR. Well, the tax question I can't really answer. The amount of business that is taking place on Internet gambling sites has been cited in this hearing to be billions of dollars, and I believe that is correct.

Mr. SCOTT. Is any of it taxed, so far that you know?

Mr. OHR. Not that I am aware of.

Mr. COBLE. I thank you, Mr. Scott.

The distinguished gentleman from Michigan and Ranking Member, Mr. Conyers.

Mr. CONYERS. Thank you, gentlemen, for your testimony. We seem to begin this discussion with a bit of a conundrum here dealing with horse racing. The Department of Justice asserts, and before Mr. Ohr testified today, that horse racing is not legal. But 4777 would make it legal.

Mr. Goodlatte is shaking his head vigorously, "no." I want it to be in the record.

Mr. Ohr, can you give us a little enlightenment on it? I have read your position, particularly page 2. Where are we on horse racing in terms of gambling and its illegality?

Mr. OHR. Congressman, as I stated, the Department's position is that betting, interstate betting on horse races is illegal under 1084, and that was not modified by the Interstate Horse Racing Act.

My understanding from what Congressman Goodlatte has stated is that it is not his intention to change that. We certainly look forward to working with Congressman Goodlatte and Members of this Committee to effectuate that intent.

Mr. CONYERS. Well, it is mentioned in the bill, though. Members claim that an amendment to the Commerce, Justice, State appropriations bill in 2000 legalized Internet gambling on horse races under the Interstate Horse Racing Act.

Mr. GOODLATTE. Mr. Conyers, if I might be permitted——

Mr. CONYERS. You could be permitted.

What is your position on this? Is that true?

Mr. GOODLATTE. What the legislation does is, it does not attempt to——

Mr. CONYERS. No. No. No. Wait. Let me pose the question.

Does—did the 2000 year appropriations bill legalize Internet gambling on horse races under the Interstate Horse Racing Act?

Mr. GOODLATTE. I don't have an opinion on that particular piece of legislation. This legislation does nothing to change the status of that legislation. So if that legislation authorizes interstate horse racing, we don't change that.

If the Justice Department's position is correct, that that legislation has never allowed betting on horses via the Internet across State lines, we don't change that either.

This legislation does not attempt in any way to overturn that statute, which was passed by the Congress and subsequently amended by the Congress, nor does it attempt to ratify the position taken by the horse racing industry on that.

So there is no carve-out in this legislation for horse racing.

Mr. CONYERS. Well, but let's look at the bill itself, subsection F, "Nothing in this section shall be construed to prohibit an activity allowed under Public Law 9515 U.S.C. 3001."

Mr. GOODLATTE. That's correct, Mr. Conyers.

Mr. CONYERS. So, wait a minute, "nothing shall be construed to prohibit activity," so you are making it clear.

Mr. GOODLATTE. No. No. That says, "Nothing shall be construed to prohibit an activity allowed," but the Justice Department has already testified that they do not believe that that statute allows that activity. The horse racing industry will tell you to the contrary.

We don't take a position what any particular activity may be allowed or not allowed under that act. We are making it very clear. We are not overturning the act. We are also making it very clear that we do not take any position on what that act allows.

Mr. CONYERS. Let me read to you from the Department of Justice statement that they submitted:

"The Department of Justice views the existing criminal statutes as prohibiting the interstate transmission of bets or wagers including wagers on horse races. The Department is currently undertaking a civil investigation relating to a potential violation of law regarding this activity.

"We have previously stated that we do not believe that the Interstate Horse Racing Act amended the existing criminal statutes. H.R. 4777, however, would change current law and amend it to permit the interstate transmission of bets and wagers on horse races. This proposal would weaken existing law."

Is that essentially what you said here, Mr. Ohr?

Mr. OHR. Congressman, that was our—that is a statement that was, I understand, from Congressman Goodlatte; that is not what he intended to do by this provision of the bill.

Mr. CONYERS. Well, wait a minute. This was after you wrote this, you talked to Goodlatte, and then you found out that this is not correct.

Mr. OHR. Right.

Mr. CONYERS. So you want to change it?

Mr. OHR. Our concern would be, we would be concerned if the law could be construed as changing current law; and obviously we look forward to working with Congressman Goodlatte and the Members of the Subcommittee to make sure——

Mr. CONYERS. In other words, you think think should be—what you have given us is a change of—what you are telling us now is a change from what you said here?

Mr. OHR. That is correct.

Mr. CONYERS. And you didn't bother to explain it during your testimony, and—I mean, this is a very unusual situation, Mr. Chairman. We have got the Department of Justice representative telling us that what he has submitted to the Committee is not ac-

curate, because he has talked to Chairman Goodlatte, and they have gotten this straightened out.

[2:59 p.m.]

Mr. OHR. We remain concerned to the extent that the bill's provision could be construed as legalizing that activity because we think—and that is a concern. I can't say that our concern has been fully addressed.

Mr. CONYERS. I am feeling better already. This is a heck of a way to conduct—here is a multibillion dollar subject matter before us and I need you to please carefully resubmit to Chairman Coble and this Committee where all of this comes out. Because we can't have it both ways. Either there is a carve-out here, which is widely regarded to exist, or there isn't.

I thank the Chairman.

Mr. COBLE. I thank the gentleman.

I say to the distinguished gentleman from Utah, the distinguished gentlelady from Texas, Ms. Jackson Lee, has consented to let you precede her. So you are recognized, Mr. Cannon, for 5 minutes.

Mr. CANNON. I thank the Chairman and Ms. Jackson Lee.

As I said earlier, Utah has a particular interest in this issue because it is one of the few States that actually has a total prohibition. Only one other State, like Utah, has a total prohibition on gambling. While I am a clear, adamant opponent to gambling, one of the things I don't want to see is the opportunity for gambling in my State because we preempt State law. So I have got to acknowledge I am as confused as Mr. Conyers is about where we actually are.

Let me ask Mr. Ohr a question, and maybe we can elaborate. I read your testimony, and it lays out the issues pretty well. But just to be clear for the record, it is my understanding the Department's position on Internet gambling bills, whether Leach, Kyl or Goodlatte is those bills, should not have exceptions or carve-outs like the ones in section 1084(d) and (f). Is this correct this is the same policy position the Department has articulated for at least the last 6 years?

Mr. OHR. That is correct.

Mr. CANNON. What has that changed base had upon your discussions with Mr. Goodlatte?

Mr. OHR. We continue to believe that interstate gambling on horse racing is illegal under 1084. My understanding from what Congressman Goodlatte has said is that he does not intend to affect the current state of the law, so obviously we want to continue to work with him on that, but that does not change the Department's position that we believe this activity is and should remain illegal.

Mr. CANNON. If I have a kid in Utah that gets addicted to games, computer games and Nintendo and the like, and he then gets addicted to gambling and he decides he likes horse racing, you are going to argue that whoever is providing that horse racing opportunity is violating the law and the kid who is doing it is violating the law.

Mr. OHR. Certainly that the person providing that service, if they are doing it in an interstate fashion, is violating 1084. The kid

would be violating the law under the laws of the State of Utah, as I understand it.

Mr. CANNON. You would cooperate with the State of Utah in helping kids get a very clear understanding they should not be gambling.

Mr. OHR. Absolutely.

Mr. CANNON. What happens when a clever lawyer argues that this bill ratifies because it doesn't take a clear position on precluding horse racing?

Mr. OHR. That is our concern, and that is why we continue to have a concern with that provision.

Mr. CANNON. It just seems to me you sort of shifted positions. In talking to Mr. Goodlatte, you said it not a carve-out. This is a very difficult position because, of course, what I want is clarity going back to the people in Utah that you can't gamble in Utah. It is clear to me that is going to be a tack or part of the response that anybody trying to argue before courts that horse racing is legal, they are going to focus on this and say everything was precluded except us; therefore, we are obviously not precluded, and the bill says we are not precluded. Doesn't that seriously undermine your position?

Mr. OHR. That is why we have concerns, and we understand Congressman Goodlatte's statement to be that he does not intend to legalize or change the current law which we believe prohibits this kind of activity. To the extent that his bill could be read or construed to permit that, that is a big concern of ours.

Mr. CANNON. It will be argued by proponents of horse racing that that is the meaning of this bill.

Mr. OHR. Our concern is, if the bill passes in its current form, it would; and that would raise the concerns I have stated.

Mr. CONYERS. Would the gentleman yield for just a second?

I just wanted to make sure that our friend from the Department of Justice understands the Reno Justice Department has a view that this kind of legislation that has carve-outs, the Ashcroft Justice Department had the view that this bill has carve-outs, the Gonzalez Justice Department has taken the same view, and now the Ohr Justice Department agrees with all the previous Justice Departments.

Mr. COBLE. I believe the time belongs—I think the time belongs to Mr. Cannon, Mr. Conyers.

Mr. CONYERS. He yielded.

Mr. COBLE. I am sorry.

Mr. CANNON. I note I only have a moment remaining, so let me just say that I think the weight of the Federal thinking on this issue is pretty consistent, and it is a cause for grave concern. I don't want Utah to get bombarded with gambling that becomes legal and back-door a system that is going to lead many kids to the kind of difficulty that Mr. Kindt has already talked about, which I think is an abomination.

Unfortunately, Mr. Goodlatte had to leave, so we are not going to be able to clarify some of these things, but this is the core problem that I have with this issue, and either we resolve that for the sake of Utah or I have to oppose the legislation strenuously.

Thank you, Mr. Chairman. I yield back.

Mr. COBLE. I thank the gentleman.

The gentleman from Michigan.

Mr. CONYERS. I just want unanimous consent to proceed for one additional minute.

Mr. COBLE. Without objection.

Mr. CONYERS. Because it is very important that we understand that this carve-out didn't just get invented this afternoon. This has gone through several Administrations. Mr. Ohr, I think, has come around to what is more consistent with his written statement, submitted that there are likely carve-outs.

Now the good intentions of an author of legislation notwithstanding doesn't really amount to much in a Judiciary Committee hearing. We may in good faith intend a lot of things, but horse racing is a very lucrative business and gambling is part of it, so we need to be very careful about this and ask the gentleman to give us his best thinking on this, and if there is anything he wants to submit to the Chairman after this hearing, we would be delighted to receive it.

Mr. COBLE. Mr. Conyers, we will keep the record open for 7 days. We will have a second round.

Now have you finished, Mr. Conyers?

The gentlelady—and I apologize, I didn't realize that Mr. Cannon had yielded to you, and to you I apologize for that.

The gentlelady from Texas, Ms. Jackson Lee, is recognized for 5 minutes.

Ms. JACKSON LEE. Mr. Chairman, I appreciate the fact that we had a Member and proponent against the legislation, and seems that he has disappeared.

Let me, first of all, raise the question of what—very sort of broad question.

I would be happy to yield.

Mr. CONYERS. I just wanted to ask Mr. Ohr if he knows that we have comments from the horse racing industry that confirm that they obtained a carve-out for their industry, that that is their attitude on the subject. Are you familiar?

Mr. OHR. I am not familiar with their comments.

Mr. CONYERS. You wouldn't be surprised if that were the case?

Mr. OHR. That causes us concern, yes, sir.

Mr. CONYERS. Thank you very much. I thank the gentlelady for yielding to me.

Ms. JACKSON LEE. I am delighted to yield.

Mr. Ohr, I will follow up with you then. Mr. Goodlatte is not present, and forgive me for being detained at another meeting and engaged in another meeting in the outer office here. Give me again the assessment that you have from the Department of Justice on the necessity of this legislation.

Mr. OHR. I would be happy to do that, Ms. Congresswoman.

The Department supports this legislation. We believe that, primarily because it strengthens the position the Department has taken throughout, that section 1084 applies both to telephone and to the Internet gambling, interstate gambling over telephone or interstate gambling over the Internet, and for that reason as well as some additional tools that are provided in the bill, the Department supports the bill.

We do have several concerns about certain provisions of the bill, some of which we have been discussing here. They are outlined in my written testimony.

Ms. JACKSON LEE. My colleague just mentioned the carve-out for horse racing. Are you aware or is the Department aware of the various companies that offer online betting on horse racing already existing, as I understand it?

Mr. OHR. I don't have a specific—I would have to get back to you on specific examples, if that is what you are asking.

Ms. JACKSON LEE. I am looking for that kind of explanation, if you would.

Because I guess where I am going on this questioning, and I will include the other gentlemen in just a moment, is both the necessity but also the discriminatory fact or discriminatory aspects that may incur out of this particular legislation if we don't get it right. And so I am sensing that we are not getting it right, and even with your support I have great questions.

I understand the Reno Justice Department, Ashcroft Justice Department and the Gonzalez Justice Department all have taken the view that the bill has carve-outs that I think you are concerned about, is that my understanding?

Mr. OHR. We have concerns about any carve-outs. We certainly believe that we would have any very serious concerns about any bill that would create an exception to 1084 and allow, for example, interstate gambling on horse races.

Ms. JACKSON LEE. With that in mind, since we have a state of confusion, I would be concerned about legislation that poses more confusion than solutions.

Is it Mr. Kindt from the University of Illinois? Just because I missed Mr. Goodlatte, give me your assessment on a bill that seems to have a discriminatory aspect. What are you trying to focus on on this legislation?

Mr. KINDT. I was asked to appear with regard to the socioeconomic impacts of gambling, and to that end let me just mention one thing that Representative Scott raised earlier and that was about all the flow of income coming in. What I put up here in one of the overheads were the eight leading studies, and no matter how much money you have coming in in tax revenue, it doesn't cover the social costs. All eight of those studies—it is usually a three to one ratio, of $3 in cost for every $1 in benefits.

Ms. JACKSON LEE. Let me make this point on your point, which is have we challenged the industries across the board to actually invest in correcting whatever these social ills might bring about? Have we ever had a scenario where the industries have been taxed, if you will, to create a better atmosphere if, for example, some may have thought that the bill has defects in it?

Mr. KINDT. The industry has created, sometimes voluntarily, sometimes with the encouragement of the States, programs to address addicted gambling, but it is usually extremely low considering what the problems are, and when you add up the benefits and you do a valid cost-benefit analysis, the costs simply overwhelm the benefits. I put up two or three overheads in this hearing to demonstrate that.

It is really a slam dunk when it comes—this is not a debatable issue. There is no debate on this. The costs are really just very large. It is like drug addiction. They call it the crack cocaine of creating addiction, is this gambling addiction. So that is not my terminology. That is the overwhelming terminology of the majority of sociologists and psychologists who deal with the area.

I remember Jesse Jackson, Jr., coming to Chicago on Martin Luther King Day and saying—and this is a very contentious statement, but he said "these are the new economic chains on our people."

Ms. JACKSON LEE. My time is gone. Let me conclude, Mr. Chairman, if you would just indulge me an additional minute.

I cannot pose a question to Mr. Vallandingham, but let me say this, even without this legislation, I think what you are suggesting is that this legislation would go to the expansion of what may be a vastly costly disease, which is gambling, period. My concern would be, are we finding a solution to the cancer or are we narrowing it to one isolated form of gambling or one we can bring the industry in and challenge it to do a better job, period. If we don't have Internet gambling or we have these carve-outs, we have a fractured bill, then we are still not getting to the sickness of gambling for those who are sick in doing it.

So I make that point, and I make the point that the bill seems to—as I said, the proponent is not in the room, and I am sorry that he is not, but hopefully we will have some further explanation. I think we went through this before, Mr. Coble; and, to Mr. Scott, we went through this before.

I conclude by saying this, that the issue of this gambling issue, Mr. Chairman and Mr. Ranking Member, needs to be broader than the immediate hearing that we have. I am going to put two questions on the record. So I am going to end, and they can give it to me in writing.

Then I will pose a question, because I was taken aback by a hearing by the Energy and Commerce Committee on criminal activity with children and Internet sexual activities. Again, I am just making a brief comment; and I would commend to the Chairman and the Ranking Member that, since they were talking about criminal penalties in the Energy and Commerce Committee, that we might have a subsequent hearing dealing with the utilization of the Internet for abuse against children.

Let me read these two questions: Does the Administration support total ban or does it wish to permit the interpretation of horse racing—excuse me, looks like interpretation of horse racing to be a subject to controversy. If the exception were deleted from H.R. 4777, would the domestic horse racing industry stop this practice?

In any event, we will have these in writing; and I thank the Chairman and the Ranking Member for the indulgence.

Mr. COBLE. I thank the gentlelady.

Folks, we are on a stopwatch to try to meet that floor vote, so I think we are going to have a second round.

Mr. Kindt, you indicated you might want to make a statement during Mr. Conyer's questioning. Did you get a chance to do that?

Mr. KINDT. No, sir. I am fine, and I know that I was behind, going out of order. I apologize to Mr. Scott, as a fellow Virginian

in my former life, when I addressed one of my comments to Representative Lee.

Mr. COBLE. I wanted to be sure that you were heard.

Mr. KINDT. Let me just say, in response to Ms. Lee's question, that from my limited knowledge of reading through the bill my interpretation would be I do not believe it either enables or overturns the horse racing. Now, again, the bill changes rapidly, but that is my interpretation at this point.

The only other point I would make with regard to Mr. Cannon—I hope I am not speaking out of order again—is that I think this debate in the legislative hearing would be introduced into any court proceeding. So Mr. Goodlatte and the intent of Congress would in fact be determinative, I would hope, if the court was having trouble deciding how to interpret the particular statute.

Mr. COBLE. I thank you, Mr. Kindt.

Mr. Banker—I pronounce that better. You testified, as it pertains to banks, H.R. 4777 would create a, quote, "an added burden of monitoring all payment transactions for the taint of Internet gambling." What section of 4777 are you stating that would create that burden?

Mr. VALLANDINGHAM. As I understand it, Mr. Chairman, it would criminalize anybody who was involved in the process of transferring those payments, including the banks, knowingly or unknowingly. So, ultimately, we would be responsible for the monitor of those payments and the prohibition of those payments.

Mr. COBLE. Is it true, sir, that the banking industry is already taking steps to assist in the identification of money laundering, one of the serious concerns related to Internet gambling?

Mr. VALLANDINGHAM. Yes, sir. The Anti-Money Laundering Act is something that we are vigorously pursuing, and in doing so we identify those customers which we deal with, and we also monitor transactions of a certain threshold and report those. But we are not responsible for making any decisions about whether they are legal or illegal. We are only responsible for the recording of those transactions in which another entity makes the determination whether those are viable transactions or not.

Mr. COBLE. Thank you, sir.

Professor Kindt, I apologize for having demoted you to the school of law. It was an innocent omission on my part.

I have exhausted my time. I will yield to the gentleman from Virginia, Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. Kindt, you mentioned the question of whether the taxes could offset the social costs. If you have got $24 billion a year gambling on the Internet, a large portion which is from the United States from which you are getting no taxes, some taxes would be more than what you are getting now.

Mr. KINDT. Representative Scott, we hear this or I have heard this argument in academic circles for years; and basically I think you raise the issue that I tried to start out with, which is that this is an international issue. We need to get the State Department in on this and start talking about this in terms of international economics and our friendship, commerce and navigation treaties; and that would alleviate this type of problem.

Mr. SCOTT. If you are going to have an international agreement and come to an agreement, I think we are going to be on the short end of that stick. Because in most of the other countries it is already legal. So if there is going to be a consensus, it is going to be to legalize and regulate.

Mr. KINDT. With respect, Representative Scott, I think what we are really doing here, and I have provided several law review articles just as introductions, with citations, I think we are destabilizing——

Mr. SCOTT. You would simplify the thing by making it illegal to gamble on the Internet, would you not?

Mr. KINDT. It has been illegal to gamble on the Internet for ages past.

Mr. SCOTT. That is how you would address it.

Mr. KINDT. Yes. I think that is how the national commission said they would address it as well.

Mr. SCOTT. Thank you.

Mr. Ohr, of the people that you have prosecuted for gambling, have any of them been for—involving horse racing?

Mr. OHR. I would have to get back to you on that, Congressman. I am afraid I don't have the answer.

Mr. SCOTT. You believe the present law, it is illegal to gamble on the Internet on horse racing?

Mr. OHR. That is correct.

Mr. SCOTT. At one time, having read the bill before you talked to anybody, you concluded that it would not be illegal if the bill passed.

Mr. OHR. We certainly have concerns that the bill's language could being construed to permit that.

Mr. SCOTT. Mr. Vallandingham, do you know the average size of a transaction for gambling?

Mr. VALLANDINGHAM. I am told about $110.

Mr. SCOTT. When you do drug money, you look for $10,000 transactions?

Mr. VALLANDINGHAM. Five thousand, generally.

Mr. SCOTT. So they kind of stick out. Hundred, couple of hundred.

Mr. VALLANDINGHAM. Couple hundred sequential.

Mr. SCOTT. Do you know what the credit card entry on Paypal would be if somebody paid for one of these bills through Paypal?

Mr. VALLANDINGHAM. No, I would have to get back to you as far as what—I assume you are requesting the merchant code through Paypal for the identification of the payee, is that is what you are asking about?

Mr. SCOTT. That wouldn't help you, because you wouldn't know what it was for. If you knew it was a casino, you wouldn't know if it was legal or illegal, you just know the payee.

Mr. VALLANDINGHAM. Which is one of the problems.

Mr. SCOTT. If the payee were an attorney who is serving an escrow agent in France——

Mr. VALLANDINGHAM. The identification of the payee would not be sufficient enough to determine whether it was a valid or nonvalid payment.

Mr. SCOTT. Are you aware of procedures that can identify someone in terms of age and residence?

Mr. VALLANDINGHAM. No, I am not, not based on the Internet. Obviously, if you meet with them in person, you do have that information.

Mr. SCOTT. Mr. Goodlatte is not here. I had a question on how they can do an interstate—legalize and regulate intrastate. Anybody want to make a comment on that?

I yield back.

Mr. COBLE. Thank the gentleman.

I will leave it up to Ms. Jackson Lee, you are next in line, or Mr. Cannon.

Ms. JACKSON LEE. I will yield to Mr. Cannon.

Mr. COBLE. Mr. Cannon, you are recognized for 5 minutes.

Mr. CANNON. Thank you, Mr. Chairman.

Let me state as that I believe gambling is a pernicious vice; and, Mr. Kindt, I agree with you entirely. From everything I have seen, the costs of gambling far outweigh any kind of benefits that a State or society can ever gain from gambling. I can't understand lotteries. I think they are the craziest thing we do. It is a tax on people that can't do math, and they tend to be poor anyway. So it is a horrible thing, from my point of view.

As I was speaking about Utah and the problem that we have with having Utah law diluted, you were nodding. I take it you would agree you would not want to see any carve-outs, horse racing, or whether we characterize it some other way, or lotteries online. You would like to see that not happen, I would think.

Mr. KINDT. Are you addressing your question to me?

Mr. CANNON. Mr. Kindt, yes.

Mr. KINDT. From my limited reading of the bill and the way I read it and I understand it, I don't believe that it enables or overturns—I don't think it changes the status quo.

Mr. CANNON. With regard to horse racing.

Mr. KINDT. With regard to horse racing.

Mr. CANNON. You pointed out what we are doing here, we are writing a law review article or a brief for a court. And the problem is, and I think, Mr. Goodlatte, at the end of my time, you may want to address this, but seems to me what we are doing with this bill is being absolutely unclear about what we are doing with horse racing. That makes the argument for the horse racers when they go into court, and I believe Mr. Ohr has said that is probably going to be the case, so this bill is going to affect the arguments in court, at least. And I don't know how you can say that we intend—this represents a policy against horse racing when, in fact, what we are doing is not dealing with horse racing.

Now that Mr. Goodlatte is back, I would appreciate if you would address that, but not right now because I have another couple of questions.

I have always resisted this bill only because of the narrow interest of the States. Utah is only one of two shining stars in the country that don't have any gambling. That has always been my concern about this particular bill.

Let me ask, Mr. Ohr, dog racing interests have stated that section 1084(f) will give horse racing an unfair advantage over other

forms of racing. Convenience stores have stated section 1084(f) or (d) will allow States to take their lotteries online. Do you agree with those two statements, that is, that it is unfair, not whether it would make horse racing legal, but——

Mr. OHR. We continue to oppose all forms of Internet gambling. I think I have made that general statement.

Mr. CANNON. What about the lotteries and convenience stories and their concerns in particular?

Mr. OHR. I would make the same statement.

Mr. CANNON. Mr. Vallandingham, if I understand your testimony correctly, you are concerned this bill would burden you with trying to determine the purpose of electronic fund transfers, and that is a concern, right?

Mr. VALLANDINGHAM. Yes, it is. Our transactions, check, ACH transactions are uncoded. We would not only have to determine whether it was illegal or legal but where it occurred and several other facets in determining whether it should be paid or not.

Mr. CANNON. You talked a little about credit card transactions and the kind of coding they have, but ACH clearinghouse transactions, those are much harder for you to track.

Mr. VALLANDINGHAM. Yes. We don't collect that information on ACH transactions. They generally contain the routing number, the account number and the amount. Therefore, the payee is not known, and it is not tracked, and, as we identified earlier, identification of the payee is not enough to determine if this is a valid transaction.

Mr. CANNON. Do you see that there would be a tendency for people to move away from these relatively traceable transactions? Do you see there is a tendency to move away to less traceable transactions like e-commerce transactions or foreign banking transactions?

Mr. VALLANDINGHAM. If it was a criminalized activity, I think they would. Currently, I think that checks in ACH are not a predominant method of payment for these type of transactions, but I think most of the transactions occur through the credit and debit card industries.

Mr. CANNON. If you track those, the ability for a person, even a very young person, committed to gambling by setting up a Paypal account or e-commerce transactions and maybe setting up a bank account offshore, that is not a very difficult thing to do for someone who has a compulsion.

Mr. VALLANDINGHAM. That is correct; and I think those involved in the gaming industry would make that information readily available, making it that much easier.

Mr. CANNON. In the few moments I have left, we had an earlier discussion—and I know you had to leave, Mr. Goodlatte—but I am deeply concerned about the idea that this debate becomes the predicate for a legal argument that transcends what we may have in our hearts and minds individually or as a body; and I think that issue is sort of enjoined again in my last question to Mr. Ohr. Would you like to respond to that?

Mr. GOODLATTE. I very much would like to respond to that. As you know——

Mr. COBLE. If Mr. Goodlatte would suspend just a moment. We are up against the wall on this. This vote is imminent, so, Bob, if you could be terse, I would appreciate that.

Mr. GOODLATTE. Let me make one point very clear, and that is no matter what the outcome of the dispute between the horse racing industry and the Justice Department of another statute not a part of this legislation authorizes or doesn't authorize, no matter how that turns out, it would still be illegal for Utah residents to bet on horse racing, so Utah could still prosecute no matter what the outcome was of that dispute between those parties.

More to the broader question about this, we had this same legislation with some modification before this Committee 5 years ago, and if you make the perfect the enemy of the good, you can see exactly what happens. During those 5 years, offshore gambling, sucking billions of dollars out of this country, including from Utah residents, has quadrupled.

Mr. CANNON. Mr. Chairman, may I make one comment in response? I appreciate that.

Mr. COBLE. Very tersely.

Mr. CANNON. We are looking at the issue of preemption. I think we decided last cycle it would preempt Utah law. I would like to work with you on that.

Mr. GOODLATTE. We would very much like to work with you.

Mr. CANNON. How we solve the larger pernicious problem is vital in the context of how we keep those places where we actually reject gambling pure. Thank you.

Mr. COBLE. The gentleman's time has expired.

We have been joined by the distinguished gentleman from Ohio. Mr. Chabot, good to have you with us.

I am going to recognize the distinguished gentlelady from Texas, Ms. Jackson Lee, but I want to say, Mr. Goodlatte, in your absence, Mr. Scott—and I don't want to beat this race horse to death, but horse racing has attracted much attention in your absence.

Ms. Jackson Lee.

Ms. JACKSON LEE. We welcome him back.

A lot of issues have gotten a lot of attention.

Let me just recognize the good faith, Mr. Goodlatte, of this legislation but argue or at least make the provocative argument as to whether or not there are elements that we are not curing. For example, it comes to my attention—has come to my attention that an Internet gambling industry and prohibition thereof may prevent, or the way the legislation is written, gaming operations from verifying, one, the age of potential customers, identify problem gamblers, which I believe Mr. Kindt is interested in, and preventing the use for fraudulent activities. Your bill may, in fact, be standing in the way.

Let me, as I pose those thoughts for you, suggest that H.R. 4777 would require, as I understand, States that authorize Internet gambling within their borders to impose secure and effective customer ID and age verification systems to ensure compliance with age and residence requirements. But is it your understanding that such technology exists, technology that can reliably prevent minors from gambling on the Internet?

If I can finish my line of questioning, I heard Mr. Vallandingham—I didn't have a question before—talk about the complication dealing with money laundering or banking scenarios which leads us from one pool of dirty water into other. If you might comment on that aspect of it.

Then let me just say that it has also come to my attention, again, with the United Kingdom and Australia, they regulate their Internet gaming companies. For example, companies regulated in the United Kingdom reportedly must use special age verification software, record all bets, place caps on how much an individual can wager at a time and be subject to routine audits for fraud or money laundering. Might be interesting, Mr. Goodlatte, that we didn't take that approach. Have you taken a look at these regulatory regimes and assessed their effectiveness in preventing underage use and abuse by problem gamblers and money launderers or of regulated gaming sites?

I think we should look further to both of those nation states as to whether that has been an effective approach to take.

Mr. GOODLATTE. Thank you, Congresswoman. Those are very good questions.

To take the last one first, we have looked at what other countries have attempted to do, but the fact of the matter is, as we have all acknowledged here today, the way the Internet operates, it goes to the lowest common denominator. So the country that is going to regulate the least is the one where these sites are going to flock to. I think you will find that an attempt to regulate in the United States, where we have 50 different States, that each have different forms of regulations today would be an impossibility.

With regard to your first question, also very good, we require States that might like to do this to be able to both verify age so that minors don't gamble and verify that the person betting is inside the State when they do that. Neither of those technologies exist that are effective today; and notwithstanding what is said about what is done in Britain, they cannot effectively verify the age of the people placing bets online.

So if that occurs and if that technology is there to satisfy other States and prosecutors that a State can contain it within their State, we don't stop recognizing States have the right to regulate gambling as they always have, we don't stop them here on the Internet, but they have to keep it contained within their State.

Ms. JACKSON LEE. I guess I didn't hear why we couldn't go the route of Australia and the U.K., which seems to have some semblance of working. I don't think I have heard clearly why we can't go that route.

I am going to let Mr. Vallandingham answer this question about how murky this gets for you, if you would, please, in terms of the assessment you have to make in the banking industry.

Mr. VALLANDINGHAM. To make sure that I answer your question correctly, would you please indicate——

Ms. JACKSON LEE. What difficulties does the bill pose for you as presently drafted? I am reminded of an earlier hearing we had this week on sex activity with children on the Internet, and there was some kind of pay line they had to deal with. But I am asking specifically how does it impact you negatively.

Mr. VALLANDINGHAM. First and foremost, our systems aren't set up to be a payment monitoring system. So in order to do that there would be a required major overhaul of both the check clearing system and the ACH system and ultimately increase the cost to the banking industry and ultimately to the consumer in the long haul.

Additionally, I think that the continued change in the way these sites would collect their payments would force us—it would be a moving target. We would continue to have to alter the systems, even if we were in some way able to make it work, so it would be continued overhead in the long haul.

Additionally, it adds yet another layer of regulation in trying to assess these payments and determine whether they are valid or not valid and should we block them or not; and it would divert attention away from things that are being successful such as anti-money laundering and know your customer programs that ultimately help us keep the fight against terrorism being successful.

Ms. JACKSON LEE. Mr. Chairman—and I thank you very much. Let me, if you would allow me, to conclude very briefly.

Because I respect Mr. Goodlatte greatly. He knows that we have been dealing now with a series of events that included the former lobbyist, Mr. Abramoff, but I want to make sure as we are discussing anew, and I think it is important for you to state, are we free of the taint of the e-lottery debacle and writing in language or not writing in language or supporting this legislation or not supporting this legislation? Because my particular company or client that I am representing was not satisfied. Are we free of that now so whatever our position is on this bill, for or against it, that we don't have this taint? I understand he was arguing about protection of State lotteries. We may still have that as an issue. But help us know that we are free of that taint as the legislation is before us.

Mr. GOODLATTE. If I might have leave to respond to the gentlelady.

Mr. COBLE. I hate to keep you on a short leash. I have been advised that there is a second Judiciary Subcommittee hearing that will commence at 4:00, so we have to wrap up.

Proceed, Mr. Goodlatte.

Ms. JACKSON LEE. Thank you, Mr. Chairman.

Mr. GOODLATTE. Ms. Jackson Lee, first of all, thank you. You have been dedicated to working on this issue. You have been working with me on this issue, and I very much appreciate that.

I will say I think it is very important Members of Congress address the fact this legislation was derailed several years ago because of misrepresentations by the legislation made by Mr. Abramoff and others, and I think it is very important that we address it now and we address it as thoroughly and responsibly as we can. That is the effort we have made with this legislation. I think it is very good and goes a long way to address any problem, but we are going to work with other Members to make sure we are getting it right and make sure this Congress is not pulled down by misrepresentations by lobbyists about the nature of the legislation.

Ms. JACKSON LEE. I thank the gentleman. I yield back.

Mr. COBLE. Thank the gentlelady.

Mr. Scott and I have one remaining question.

Mr. Vallandingham—am I getting better, Mr. Vallandingham?

Mr. VALLANDINGHAM. Getting better.

Mr. COBLE [continuing]. Is it your belief that Mr. Goodlatte's bill creates criminal penalties for banks and/or financial institutions?

Mr. VALLANDINGHAM. It is my understanding that it would create criminal penalties for anybody who facilitated those payments. So I would say yes.

Mr. COBLE. Mr. Goodlatte, I was thinking that the civil penalties were only directed at gambling businesses. Now do you want to address that, Mr. Goodlatte?

Mr. GOODLATTE. Yes, I would very much welcome the opportunity to address that and assure the members of the banking industry that there are no criminal penalties that apply to banks. The fact of the matter is that this is directed at the gambling institutions, and the only authority that is provided to law enforcement with regard to any financial institution is the right to seek civil injunctive relief.

Mr. COBLE. How about civil penalties against banks or lending institutions?

Mr. GOODLATTE. Only under what is already in existence under laws related to failure to comply with injunctions that might be approved by a court after they are approached by a law enforcement agency that says that somebody is in violation of the law and they want them enjoined from——

Mr. COBLE. Mr. Vallandingham, when you return to West Virginia, will this cause you to sleep more soundly at night after hearing that?

Mr. VALLANDINGHAM. No, it won't. Because the bill doesn't define gambling business other than to say the business of betting and wagering. Other statutes use similar terms, having construed to include within its scope anyone that conducts a gambling business if that person performs any act, duty or function which is necessary or helpful in operating the enterprise. This includes waitresses and other servers, even if they weren't paid. It included custodians, telephone clerks and doormen, also bookkeepers and secretaries. So, clearly, a bank can be viewed as necessary or helpful to an Internet gambling enterprise. No bank acting prudently could ignore that risk.

Mr. COBLE. This will be for another day.

I know Mr. Scott has a question, and 4 is imminent. So, Mr. Scott.

Mr. SCOTT. Let me just pose the question, and we can get the information in due course. I wanted more information on how a State could—if a State wanted to—if Nevada wanted to legalize gambling on the Internet, how would that work? If you have information on that.

Also, if you are aware of identification processes where a person over the Internet can be identified as the person who is over 21 and possibly where their residence happens to be.

Mr. GOODLATTE. Mr. Scott, thank you.

As I have indicated earlier, we don't believe that such technology exists today. So while the legislation would recognize the rights of States to continue to regulate gambling, including gambling on the Internet, unless they can meet those two criteria of being able to

identify where the person is placing the bet and whether or not they are a minor, they will not be able to proceed.

If that technology is developed in the State of Nevada or some other State wanted to proceed to do that, they would proceed to do that; and if some other State believed they were not using technology adequate to that purpose, then they would seek the remedies under this legislation to establish that they should be enjoined from doing that.

Mr. COBLE. I thank the gentleman.

Mr. Goodlatte, you were chomping at the bit. I didn't want to cut you off. Did you want to be heard one final minute in response to Mr. Vallandingham?

Mr. GOODLATTE. Only to ensure him that the intent of this legislation is not to put banks in the situation he described, and we are more than happy to work with his association to accomplish that goal.

As the gentleman knows, another piece of legislation similar but operating somewhat differently in its effect passed the financial services industry and is headed to the floor of the Congress. We want to make sure that these two pieces of legislation are made harmonious and in the process are as friendly to the banking industry as we possibly could make it.

Mr. COBLE. This has been a productive hearing, and I thank the witnesses and I thank those in the audience who have very patiently endured the time with us.

We thank you for your testimony, gentlemen, and in order to ensure a full record and adequate consideration of this important issue, the record will be left open for additional submissions for 7 days. Also, any written questions that a Member wants to submit to the witnesses should be submitted within that same 7-day period.

This concludes the legislative hearing on H.R. 4777, the "Internet Gambling Prohibition Act of 2006." We thank you for your cooperation and attendance, and the Subcommittee stands adjourned.

[Whereupon, at 3:43 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE ROBERT C. SCOTT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA, AND RANKING MEMBER, SUBCOMMITTEE ON CRIME, TERRORISM, AND HOMELAND SECURITY

Thank you, Mr. Chairman. I am pleased to join you in convening this hearing regarding federal regulation of gambling over the Internet. I believe that all gambling should be tightly regulated. It has traditionally been, primarily, a state regulatory responsibility. It should continue to be so, in my judgment, although it is appropriate for the federal government to have a role to assist states in the total regulatory scheme.

The federal government undertook such a role in passing the 1961 Wire Communications Act as a way to assist in the fight against gambling by organized crime syndicates. The Department of Justice contends that it can prosecute Internet gambling businesses under that law, but, clearly, that law was not designed with Internet gambling in mind. While I appreciate the desire of my colleague, the gentleman from Virginia, to update the ability of the Department to address illegal gambling in today's context, I do not believe that H.R. 4777 is likely to be effective in doing so.

Regulating anything on the Internet is problematic, even where desirable. Most law enforcement is jurisdiction dependent. The Internet has no jurisdiction and, as a result, I suspect that even if we are successful in closing down business sites in the United States or in countries that we can get to cooperate, because of the nature of the Internet, and the ingenuity of persons using it, the approach in H.R. 4777 will be, ultimately, ineffective. As we will hear from our witness panel, this bill will create an enforcement nightmare for the financial institutions it requires to look for and stop illegal internet gambling transactions. Identifying Internet gambling activities will be very difficult if not impossible. While some companies may be able to identify some gaming transactions by the codes used, such enforcement efforts can be easily thwarted. A business may have one code for payment purposes but may engage in several activities, including Internet gambling. Caesar's Palace could have a hotel and a gaming operation or a foreign company could have a hotel and a casino that could be paid as a single account over the Internet. Or, an e-cash or electronic payment system, or any escrow agent can relocate in another country and thereby evade the enforcement mechanism in this bill, or even domestically. All the bank knows is that the payment came from "PayPal". And with some Internet gaming activities being legal, how would a financial institution distinguish between them and illegal activities?

Further, we should not overestimate the cooperation we will get from other countries. According to Christiansen Capital Advisors, Internet gambling websites brought in $14.71 billion worldwide last year, which is up from $8 billion the year before. This number is expected to almost double to an expected $24 billion by 2010. Presently, over 85 foreign governments allow some form of gambling online, and that number is likely to grow, as well. So what governments are likely to cooperate with us in prosecuting businesses they authorize to operate? And even if we are successful in getting cooperation from some countries, we would simply be increasing the profit opportunities for uncooperative countries, especially those with whom the United States does not have normal diplomatic relations.

This bill does not prohibit internet gambling; it prohibits running the operation. If we wanted to be effective in prosecuting illegal gambling over the Internet, we would prosecute individual gamblers. A few sting operations would get the word out that if you gamble over the Internet, you are at the mercy of law enforcement, because you leave a trail they can follow. So long as individuals can gamble over the Internet with impunity, a market will be provided for them which the regulatory

scheme in this bill will not be able stop. For example, we prohibit sales of illegal drugs but we see that as long as there remains a demand for drugs, we only have limited success in the war on drugs. If we took the approach of this bill in enforcing drug laws, we would be prosecuting the seller but not the buyer, and have even less effect than we have now.

Since we are not talking about prohibiting Internet gambling but simply prohibiting the operation of internet gambling sites in jurisdictions the FBI can get to, I believe that there are more effective regulatory approaches than the approach offered by H.R. 4777. However, the approaches must be developed, taking into account the technology, state policies with respect to gambling, and Internet gambling practices and preferences. This was the effect of the bill authored by full Committee Ranking Member Conyers last Congress, H.R. 1223. It established a Commission that would study the issue and made recommendations for a regulatory environment for Internet gambling that would be controlled by individual states. States do tend to prohibit individuals from gambling, so Internet gambling can be both effective and individualized to each state. Under the bill's regulatory scheme, if Nevada opted to allow Internet gambling within its borders, it could. If Utah prohibited individuals in that state from gambling over the Internet, it could and that would be enforceable by the federal government, by the states that allow gambling as well as by the state of Utah because in the fullness of time, a gambler could be required to provide a mailing address in order to get paid.

And if protecting the public is a goal of regulating Internet gambling, it is much more likely that those who chose to gamble over the Internet will do so through a licensed, regulated entity under the Conyers approach than under H.R. 4777. First, a consumer in a state where Internet gambling is legal will have confidence that, if they win, they will get paid by the licensed, regulated operation. A consumer would have no similar confidence in "fly-by-night-off-shore-casino.com". So, a likely result from licensed regulated Internet gaming entities would be to drive less reputable businesses, who do not abide by the law, out of business.

Another significant result is that states that chose to authorize Internet gambling can tax it. At a time when unauthorized Internet gambling is flourishing (over $14 billion dollars with half of it originating in the U.S.), and when most states are cash strapped, those states that have already chosen to authorize regulated gambling could receive much needed revenues from both the operators and winners, while contributing to the control of the industry and protections to the gambling public.

The overwhelming portion of those who play the numbers buy legal lottery tickets which are regulated and taxed and actually pay lower odds compared to illegal numbers operations. For the same reasons, people who choose to gamble over the Internet will patronize legal domestic websites, even if they have to pay taxes on winnings. I believe we should regulate Internet gambling, but we should do it effectively. And we should not subject any single business sector to sole or principle responsibility for doing the bulk of the enforcement work, whether it is the banking industry, as in this bill, or the Internet service industry, as we tried in prior bills. There are ways to regulate Internet gambling effectively, and a study Commission to develop those ways is the best way to come up with them. Again, I thank you, Mr. Chairman, for holding this hearing and look forward to hearing the testimony of the witnesses.

RESPONSE TO POST-HEARING QUESTIONS FROM BRUCE G. OHR, CHIEF OF THE ORGANIZED CRIME AND RACKETEERING SECTION, UNITED STATES DEPARTMENT OF JUSTICE

U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

July 19, 2006

The Honorable Howard Coble
Chairman
Subcommittee on Crime, Terrorism, and Homeland Security
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed please find responses to questions posed to Mr. Bruce Ohr, Chief of the Organized Crime and Racketeering Section, Criminal Division, Department of Justice, following Mr. Ohr's appearance before the Subcommittee on April 5, 2006 at its hearing on H.R. 4777, the "Internet Gambling Prohibition Act."

Thank you for the opportunity to supplement Mr. Ohr's testimony. We hope that this information is helpful to you. The Office of Management and Budget has advised that there is no objection to the presentation of these responses from the standpoint of the Administration's program. If we may be of additional assistance, please do not hesitate to contact this office.

Sincerely,

William E. Moschella
Assistant Attorney General

Enclosure

cc: The Honorable Bobby Scott
Ranking Minority Member

The Honorable John Conyers, Jr.

Follow Up Questions to Bruce Ohr, Chief,
Organized Crime and Racketeering Section, Criminal Division,
House Judiciary Subcommittee on Crime, Terrorism, and Homeland Security
Hearing on H.R. 4777, the "Internet Gambling Prohibition Act," April 5, 2006

I. Background on Internet Gambling

1. **How many Americans does the Department estimate to have participated in Internet gambling?**

Response: The Department does not maintain information or statistics concerning the number of Americans who have participated in Internet gambling.

2. **How much money does the Department estimate Americans wager annually over the Internet?**

Response: The Department does not maintain information or statistics concerning the amount of money wagered annually by Americans over the Internet.

3. **If companies that accept bets over the Internet from Americans were taxed in the same manner and at the same rates at which U.S. corporations are taxed, how much revenue would be produced for the U.S. Treasury?**

Response: The Department does not maintain information or statistics concerning the amount of money wagered annually by Americans over the Internet. Thus, we cannot estimate the amount of revenue that would be produced for the U.S. Treasury as a result of such activity.

4. **If Americans who wager over the Internet had their winnings taxed in the same manner, at the same rates, and with similar compliance as taxpayers' winnings in domestic land-based casinos are taxed, how much revenue would be produced for the U.S. Treasury?**

Response: The Department does not maintain information or statistics concerning the amount of winnings by Americans. We note, however, that 26 U.S.C. § 61 defines "gross income" as "all income from whatever source derived," and that income from illegal transactions is included in gross income. Also, § 1.61-14(a) specifically provides, "Illegal gains constitute gross income." We do not have an estimate of the number of Americans who currently do not declare such winnings on their income tax returns.

5. **In the recent proceedings before the World Trade Organization between the United States and Antigua and Barbuda, when asked, the U.S. Trade Representative was reportedly unable to produce any evidence of money laundering being conducted through Internet gambling. What evidence does the Justice Department have that Internet gambling sites are being used for money laundering?**

Response: The Department cannot comment on any pending or planned investigations. We note that some of the Internet gambling cases that have already been prosecuted have included money laundering charges. For example, Gold Medal Sports, located in Curacao, pleaded guilty to a RICO information, which alleged both gambling and money laundering violations, for accepting sports bets over the telephone and Internet from undercover agents from the Internal Revenue Service, Criminal Investigation, in Wisconsin. The money laundering charges stemmed from wire transfers or check disbursements made with Gold Medal betting funds.

6. **In the United Kingdom, Internet gambling companies are licensed and regulated. What steps do public companies regulated by the United Kingdom undertake to prevent abuse of their Internet gambling websites by underage individuals, by problem gamblers and by potential money launderers?**

Response: While the Department is aware that the United Kingdom has legalized forms of Internet gambling, we do not have specific information on the requirements for public companies to offer such wagering in the United Kingdom.

II. Effectiveness of H.R. 4777

1. **If H.R. 4777 were to be enacted into law, could Americans continue to wager over the Internet using foreign based third-party payers?**

Response: The Department believes that it is currently illegal under federal law for foreign based gambling businesses to accept bets or wagers via wire communication facilities from individuals in the United States, and that H.R. 4777 would not change this. H.R. 4777 also prohibits the acceptance of certain forms of payment for such wagering. This restriction is applicable to "an electronic fund transfer or funds transmitted by or through a money transmitting business, or the proceeds of an electronic fund transfer or money transmitting service, from or on behalf of the other person."

If the gambling business is accepting wagers over the Internet from individuals in the United States, then the gambling business would be violating current Section 1084 of Title 18, as well as Section 1084 as it would be amended by H.R. 4777. Depending upon the specific facts, a foreign based third-party payer may be deemed to be a money

transmitting business or a money transmitting service as those terms are defined in H.R. 4777. If this is the case, then the gambling business is prohibited from accepting electronic fund transfers or the proceeds of electronic fund transfers to pay for the illegal gambling. Again, depending upon the specific facts, the foreign based third party payer could be deemed to be aiding and abetting the gambling business and would be criminally liable.

Section 1084, even as amended by H.R. 4777, pertains to the gambling business, not the individual bettors. Thus, while it is currently illegal for gambling businesses to accept wagers from Americans over the Internet, and would continue to be illegal under H.R. 4777, if individuals in the United States are currently using foreign based third-party payers to pay for their wagers, then they would most likely be able to continue to do so.

2. Under H.R. 4777, would wagering on horse races be permitted to continue? If so, how would a U.S. financial institution be able to determine whether a credit card transaction for an Internet bet on horse racing was for a bet placed from a location within a state in which such bets are authorized?

Response: Proposed subsection 1084(d) permits the use of a communication facility for the transmission of bets or wagers or information assisting in the placing of bets or wagers if, at the time the transmission occurs, the individual placing the bet, the gambling business, and facility processing the bets are physically located in the same State. Thus, intrastate wagering on horse racing using a communication facility would be permitted under H.R. 4777.

The Department views current Section 1084 as prohibiting interstate wagering on horse races and believes that the Interstate Horseracing Act did not alter that prohibition. Representative Goodlatte testified that H.R. 4777 is not intended to change the existing relationship between Section 1084 and the Interstate Horseracing Act. After the April 5, 2006 hearing, the Department worked in consultation with Representative Goodlatte to develop legislative language for inclusion in H.R. 4777 to effectuate his intent to maintain the current status quo between the Interstate Horseracing Act and federal criminal statutes. As a result of those discussions, Representative Goodlatte agreed to modify H.R. 4777 by deleting subsection 1084(f), and creating new sections 5 and 6 within the bill.

Section 5, Rule of Construction, is now a separate section of the bill that refers to "this Act," rather than "this section," thus making it more neutral than the original provision, which would have explicitly amended 18 U.S.C. § 1084. Section 6, Sense of the Congress, clearly states that H.R. 4777 does not change which activities related to horse racing may or may not be allowed under federal law, and that the bill does not change the relationship between the statutes in effect at the time of H.R. 4777's consideration. The Department believes that this new legislative language more effectively carries out Representative Goodlatte's intent to preserve the status quo than the introduced version of H.R. 4777. The inclusion of specific language in the legislative history of the bill reiterating the language of Section 6 would be helpful in further confirming that H.R. 4777 is not intended to alter the current relationship between the criminal wagering

statutes and the Interstate Horseracing Act.

H.R. 4777 neither requires U.S. financial institutions to determine the physical location of the individual using the credit card, nor requires financial institutions to monitor transactions. Rather, the requirements for the "secure and effective customer verification and age verification system" pertain to the gambling businesses, not to financial institutions.

Pursuant to proposed subsection 1084(i), Federal, State, tribal, or local authorities can seek declaratory and injunctive relief, which could include a request to have a financial institution block payments to a particular account. The seeking of injunctive relief, however, requires a civil action in which a United States District Court will decide the appropriate form of relief.

3. If H.R. 4777 were to be enacted into law, how would a financial institution be able to determine whether a check or ACH payment being cleared was for a barred Internet gaming transaction?

Response: H.R. 4777 does not impose a duty to monitor upon financial institutions. Thus, financial institutions would only be required to bar transactions pursuant to a court order issued after a hearing pursuant to proposed subsection 1084(i). The financial institution would have the opportunity to inform the court during the hearing if it is unable to bar particular transactions.

4. If H.R. 4777 is enacted, what would be the impact on the number of Americans who wager over the Internet, and on what data or evidence is the Department basing this estimate?

Response: The Department does not maintain information or statistics concerning the number of Americans who currently place wagers over the Internet. Thus, we cannot provide an estimate regarding the extent to which H.R. 4777 would impact the number of individuals who wager over the Internet.

5. Would a U.S. financial institution be in violation of H.R. 4777 if it provides an offshore Internet gambling site with access to information the site uses to screen out minors and to limit wagers by individuals to deter problem gambling?

Response: Under H.R. 4777, criminal liability applies to one who is "engaged in a gambling business." Aiding and abetting liability is also applicable pursuant to 18 U.S.C. § 2, which states as follows:

> "(a) Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal.

> (b) Whoever willfully causes an act to be done which if directly performed by him or another would be an offense against the United States, is punishable as a principal."

Whether a financial institution would violate H.R. 4777 by providing information to offshore Internet gambling sites – information which was subsequently used by the Internet gambling site – would depend upon the specific facts involved in each case. As each case is different, we cannot speculate on whether such conduct would be sufficient to constitute aiding and abetting.

6. What would be the maximum liability exposure (in terms of criminal and civil penalties) of domestic banks and other financial transaction providers under H.R. 4777?

Response: Currently, the maximum penalty for a violation of Section 1084 is two years in prison, a $250,000 fine, and a one-year term of supervised release. H.R. 4777 provides for "a fine under this title or imprisonment not more than five years, or both" for each offense. Generally, each violation could be charged as a separate count in the indictment. The maximum sentence, therefore, would depend upon the number of violations of Section 1084 for which the individual or entity was convicted.

H.R. 4777 also provides for injunctive or declaratory relief. Such relief may be granted pursuant to Federal Rule of Civil Procedure 65. The federal district court would decide what type of injunctive relief would be appropriate. This would be determined on a case-by-case basis after a hearing.

7. What would be the maximum liability exposure (in terms of criminal and civil penalties) of Internet service providers, such as AOL and Earthlink, under H.R. 4777?

Response: The maximum criminal liability would be the same as set forth above in the response to question six.

H.R. 4777 also provides for injunctive or declaratory relief. Such relief may be granted pursuant to Federal Rule of Civil Procedure 65. The federal district court would decide what type of injunctive relief would be appropriate. Proposed subsection 1084(i)(3) pertains to the forms of injunctive or declaratory relief granted against an internet service provider.

This subsection provides that such relief would:

> (A) be limited to the removal of, or disabling of access to, an online site violating this section, or a hypertext link to an online site violating this section, that resides on a computer server that such service controls or operates; except this limitation shall not apply if the service is violating this section or is in active concert with a person who is violating this section and receives actual notice of the relief;

(B) be available only after notice to the interactive computer service and an opportunity for the service to appear are provided;
(C) not impose any obligation on an interactive computer service to monitor its service or to affirmatively seek facts indicating activity violating this section;
(D) specify the interactive computer service to which it applies; and
(E) specifically identify the location of the online site or hypertext link to be removed or access to which is to be disabled.

8. **What would be the maximum liability exposure (in terms of criminal and civil penalties) of telephone companies that could be liable under H.R. 4777?**

Response: The maximum liability exposure for telephone companies would be the same as that set forth in the response to question 6. While current Section 1084(d) – which would be renumbered as subsection 1084(h) if H.R. 4777 were enacted – concerns common carriers discontinuing service upon receiving notice from law enforcement, this provision does not impose a penalty upon the telephone company.

III. **Changes in the Legislation**

1. **The Internet Gambling Prohibition Act of 2000 (H.R. 3125, 106th Congress) would have prohibited the provision of betting services over the Internet and sending information assisting in such betting over the Internet. It did *not* address financial transactions relating to such bets. By contrast, enforcement of H.R. 4777 relies almost exclusively on barring financial transactions related to Internet gambling. Does the Department support the change in the emphasis of the legislation from those actually providing the betting services as provided in the 2000 legislation to now focusing only on financial institutions?**

Response: H.R. 4777 prohibits both gambling and financial transactions. H.R. 4777 would amend an existing criminal statute, does not focus solely on the financial institutions, and is not enforced exclusively by barring financial transactions.

2. **Which would be more effective in enforcing the law and curtailing Internet gambling by Americans – the prohibition of betting services and the sending of information assisting in betting over the Internet as provided for in the 2000 legislation, or barring financial transactions as embodied in H.R. 4777?**

Response: The Department believes that both approaches, the prohibition of betting services and the barring of financial transactions, are useful. We believe that current law prohibits the provision of such betting services. The current federal gambling statutes, however, do not contain any injunctive provisions. As stated in our response to question 1 of this subsection, H.R. 4777 is not limited to focusing only on the financial institutions.

IV. What is Barred and What is Authorized under H.R. 4777

1. **It has been stated[1] that this bill "simply clarifies the state of the law" with regard to the legality of Internet gaming. However, H.R. 4777 specifically excludes pay-to-play fantasy sports contests from the definition of "bets or wagers," and exempts intrastate gambling, intra-Tribal gambling, and interstate horserace gambling and intrastate lotteries from the bill's prohibitions. In the opinion of the Department, does H.R. 4777 alter the legality of any form of gambling?**

Response: With respect to intrastate gambling, Section 1084 currently does not apply to wholly intrastate wire communication transactions. Under current law, the actual routing of the transmission determines if an internet transmission between a bettor and a gambling business, when both are located in the same state, is a transmission in interstate commerce. H.R. 4777 would eliminate any review of the actual routing if the bettor and the gambling business are in the same state. The Department believes that this would be a change in the law.

The Department believes that current federal law prohibits interstate wagering over the Internet, and it is our understanding that it is not the intent of H.R. 4777 to change the legality of interstate wagering. Moreover, with respect to interstate horse racing, it is our understanding that it is not the intent of the legislation to alter the existing relationship between Section 1084 and the Interstate Horseracing Act, and that H.R. 4777 should not be construed in such a manner. With respect to tribal gaming, we do not believe that H.R. 4777 alters the legality of inter-tribal gaming because the Indian Gaming Regulatory Act allows tribes to link tribal casino games.

2. **In your testimony, you state that the Department "has concerns regarding some of the provisions of H.R. 4777, including that sections of this proposal may weaken current law and standards and that it would also permit gambling over the Internet from the home and favor certain industries over others." Does the Department support applying the provisions of H.R. 4777 to all forms of Internet gambling?**

Response: The Department supports applying H.R. 4777 to all forms of gambling over the Internet which are set forth in the bill.

V. Horseracing

1. **It has been claimed by some that an amendment to the Commerce-Justice-State Appropriations bill in 2000, legalized Internet gambling on horse races under the Interstate Horseracing Act. Does the Department concur with this position?**

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[1] Statement on the House Floor, February 16, 2006 (Cong. Rec. p. E191).

Response: The Department of Justice does not concur with this position. The Department of Justice does not view the 2000 amendment to the Interstate Horseracing Act as amending existing criminal statutes.

2. **On July 14, 2003, in a letter to Congressman John Conyers, Assistant Attorney General William Moschella opined that the December 2000 amendment to the Interstate Horseracing Act has no impact on the Wire Act or the legality of Internet gaming. Does the Department still hold this position?**

Response: The Department of Justice continues to maintain this position.

3. **Does the Department have an estimate for the amount of money presently wagered annually by Americans on horse races over the Internet offered by companies operating pursuant to the December 2000 amendment to the Interstate Horseracing Act?**

Response: The Department does not maintain information or statistics concerning the number of Americans who currently place wagers over the Internet. Thus, the Department cannot estimate how H.R. 4777 would impact the number of individuals who would wager over the Internet.

4. **What regulatory regime is presently in place in this country with respect to Internet gaming on horse racing to prevent use by minors and abuse by problem gamblers and money launderers, and how effective is this regime?**

Response: The regulatory regime for gambling on horse racing is a matter of state law. The Department does not maintain information on this topic.

5. **What regulatory regime is presently in place in this country to assure that bets on horse racing are not being placed over the Internet by individuals located in states and jurisdictions that do not permit betting on this activity, and to what extent is this regulatory regime effective in preventing such bets?**

Response: The regulatory regime for gambling on horse racing is a matter of state law. The Department does not maintain information on this topic.

6. **In a press release, the National Thoroughbred Racing Association stated "[T]he NTRA worked with Congressman Goodlatte to ensure that HR 4777 also contained language that protects online and account pari-mutuel wagering." Does the Department concur that H.R. 4777 as presently drafted would permit Internet gambling on horse racing?**

Response: Proposed subsection 1084(d) of H.R. 4777 allows intrastate wagering where the bettor and the gambling business are located in the same state, the state has authorized such bets, and the state has authorized and licensed the gambling business. Thus, intrastate wagering on horse races is permissible under H.R. 4777.

With respect to interstate wagering on horse racing, the Department continues to believe that the Interstate Horseracing Act did not amend existing criminal statutes and that the interstate transmission of bets on horse racing is not permitted. We understand that the horse racing industry does not agree with our position. After the April 5, 2006 hearing, the Department worked in consultation with Representative Goodlatte to develop legislative language for inclusion in H.R. 4777 to effectuate his intent to maintain the current status quo between the Interstate Horseracing Act and federal criminal statutes. As a result of those discussions, Representative Goodlatte agreed to modify H.R. 4777 by deleting subsection 1084(f), and creating new sections 5 and 6 within the bill.

Section 5, Rule of Construction, is now a separate section of the bill that refers to "this Act," rather than "this section," thus making it more neutral than the original provision, which would have explicitly amended 18 U.S.C. § 1084. Section 6, Sense of the Congress, clearly states that H.R. 4777 does not change which activities related to horse racing may or may not be allowed under federal law, and that the bill does not change the relationship between the statutes in effect at the time of H.R. 4777's consideration. The Department believes that this new legislative language more effectively carries out Representative Goodlatte's intent to preserve the status quo than the introduced version of H.R. 4777. The inclusion of specific language in the legislative history of the bill reiterating the language of Section 6 would be helpful in further confirming that H.R. 4777 is not intended to alter the current relationship between the criminal wagering statutes and the Interstate Horseracing Act.

7. **In your testimony, you similarly conclude that HR 4777 "expressly permits interstate wagering on horse racing." You reiterate that the bill "would change current law. . . and permit the interstate transmission of bets and wagers on horse races", that "[t]he Department is concerned that [this proposal] would weaken existing law." Does the Department support striking the provisions of HR 4777 that "expressly permit[s] interstate wagering on horse racing"?**

Response: Please see response to Question 6 above.

8. **Does the Department support clarifying that Internet Gambling on horse races is governed by the Wire Act, and thus barred?**

Response: Please see response to Question 6 above.

VI. Exemptions

1. **H.R. 4777 expressly authorizes or fails to proscribe certain forms of Internet gaming, including Internet wagers on horse racing, fantasy sports, intrastate lotteries, intrastate Internet gambling where authorized under state law and intra-tribal internet gaming. In his letter of July 14, 2003, Assistant Attorney General William Moschella wrote that since the bill then under consideration, H.R. 21, would add exemptions to the Wire Act's definition of**

"bet or wager," it could "make otherwise illegal transactions legal." Does the Justice Department still stand behind its analysis in 2003 that adding exemptions to the Wire Act as is provided for in H.R. 4777 may make activities that are currently illegal now legal and "expand legal gambling opportunities"?

Response: The Department continues to be concerned about any expansion of gambling activities, especially those that would permit gambling from the home.

H.R. 21 did not amend Section 1084. Rather, it proposed to create a new statute that would prohibit persons engaged in the business of betting or wagering from accepting certain forms of payment for unlawful Internet gambling. H.R. 21 defined the term "bet or wager" to exclude "any lawful transaction with a business licensed or authorized by a State." The term "unlawful Internet gambling" was defined to mean "to place, receive, or otherwise transmit a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law in the State in which the bet is initiated, received, or otherwise made."

In a July 14, 2003 letter, the Department expressed a concern that these definitions could allow one to argue that "because the provision does not specify which State's laws must be considered, only the laws applicable in the State in which the gambling business is located need to be consulted in order to determine if the transaction is lawful. This interpretation would make lawful transactions that are currently unlawful in the state where the bet is initiated."

This letter further stated that "one could argue that H.R. 21 would make lawful transactions that otherwise violate other Federal laws. For example, 18 U.S.C. § 1084 prohibits one in the business of betting or wagering from using a wire communication facility in interstate or foreign commerce to transmit a bet or wager on a sporting event or contest. The Department of Justice believes that the transmission of a bet or wager on sporting events or contests over the Internet would constitute such a use of a wire communication facility in interstate or foreign commerce. Section 1084 does not contain any exceptions for bets placed with a gambling business licensed or authorized by a State. Yet, while violating Section 1084, if the bet was placed with a business licensed in a State, it might not be deemed a 'bet or wager' under H.R. 21."

H.R. 4777 differs from H.R. 21 in that H.R. 4777 actually amends Section 1084 and does not create a new statute. Thus, the Department's concerns about the inconsistency between H.R. 21 and Section 1084 do not arise with respect to H.R. 4777. Additionally, H.R. 4777 does not contain the exception to the term "bet or wager" for "any lawful transaction with a business licensed or authorized by a State," which was contained in H.R. 21 and discussed in the Department's letter.

Currently, Section 1084 is not applicable to wholly intrastate wire communication transmissions. The provisions of H.R. 4777 that pertain to state lotteries, tribal gaming, and horse racing are consistent with existing law to the extent that these provisions permit wholly intrastate transmissions. Subsection 1084(d) of H.R. 4777 requires that the bettor, the gambling business, and the support facility be located in the same state in order for this provision to apply. The provision does not contain any requirements for the actual routing of the transmission. Currently, the determination of whether the transmission is in interstate or foreign commerce is made by looking at the actual routing of the transmission. Thus, H.R. 4777 may allow intrastate wagering on lotteries, horse racing, or tribal gaming that current Section 1084 would not allow because the transmission takes place in interstate commerce, even though the bettor and the gambling business are located in the same state.

With respect to state lotteries, subsection 1084(c) allows the transmission of information assisting in the placing of bets or wagers to an out-of-State data center for the purpose of assisting in the operation of the State-specific lottery. Current Section 1084(b) permits the interstate transmission of information assisting in the placing of bets or wagers where betting on the same event is legal in both states. H.R. 4777 would permit State A's lottery to transmit information to a data center in State B even if one could not legally purchase a ticket in State A's lottery in State B. Because the bettor would still need to purchase the lottery ticket within the State that is operating the lottery, the Department is not troubled by this change in the law.

2. Does the Justice Department continue to have the concern, as expressed in 2003 by Assistant Attorney General Moschella, that exceptions written into the Wire Act might be applied to other federal statutes?

Response: The 2003 letter concerned H.R. 21, which created a new statute, but used the same terminology regarding the business of betting or wagering, as existing Section 1084. H.R. 21 also defined the term 'bet or wager" for purposes of that proposed statute. The Department was concerned that, since the term "bet or wager" was being defined for H.R. 21, the proposed definition would be made applicable to other federal statutes, such as Section 1084. H.R. 4777 proposes an amendment to existing Section 1084. Thus, the proposed definition for the term "bet or wager" would be made applicable to Section 1084 and there would not be the potential for conflict between two federal statutes.

3. What regulatory regime is required to assure that the Internet gambling activities permitted under H.R. 4777 (for example, horse racing, intrastate and intra-tribal Internet gambling, intrastate lotteries, and fantasy sports) are not used by minors or abused by problem gamblers and money launderers?

Response: The regulation of gambling that is permitted under H.R. 4777 is generally left to the states or tribes. For example, subsection 1084(d) requires the state or tribe to

license the gambling business and requires that the state have a secure and effective customer verification and age verification system.

4. **H.R. 4777 would exempt intrastate and intra-tribal Internet gambling, and intrastate lotteries from its prohibitions. Does the Justice Department consider such gambling activity barred under current law, and if so, does the Department believe these exemptions open the door for more gambling over the Internet than would otherwise be legal?**

Response: With respect to the transmission of bets or wagers for intrastate gaming, Section 1084 currently does not apply to wholly intrastate gambling using a wire communication facility. However, one looks to the actual routing of the transmission to determine if the transmission is one in interstate or foreign commerce. Under H.R. 4777, if the bettor, gambling business, and the support facility are located in the same state, gambling using a communication facility is permitted. Thus, there may be instances where the Internet transmission is routed outside of the state but the bettor and gambling business are located in the same state. Under current Section 1084, such bets are prohibited, but will be permitted under H.R. 4777.

With respect to inter-tribal gaming, the Indian Gaming Regulatory Act permits the linking of inter-tribal casinos across state lines under certain circumstances. Thus, we would not expect the exceptions in H.R. 4777 to open the door for more gambling over the Internet than would otherwise currently be legal.

Current Section 1084 permits the interstate transmission of information assisting in the placing of bets or wagers if the information is transmitted between two states where wagering on that same event is legal. H.R. 4777 would permit a state lottery in State A to transmit information assisting in the placing of bets and wagers to an out-of-state data center, which is located in State B, where the sale of State A's lottery tickets would not be permitted. This activity would not currently fall within Section 1084(b) because wagering on the same event is not legal in both states. This change should not result in an increase in gambling over the Internet because the transmissions would not be for the sale of lottery tickets to bettors.

5. **Does the Department support permitting a state to operate its lottery over the Internet within the borders of that state? Why or why not?**

Response: The Department has stated in prior testimony that any form of gambling over the Internet raises concerns about gambling by minors and gambling addiction.

6. **If intrastate lotteries conducted over the Internet are permitted, does the Department believe participating states will seek to expand the scope of this activity to allow the sale over the Internet of lottery tickets marketed jointly**

by several participating states (such as is done by land-based sellers with respect to "Powerball" tickets)?

Response: The Department understands that, while Powerball is marketed by several states, the actual Powerball tickets must be purchased from a terminal operated by a licensed retailer in a state that sells the Powerball game. Interstate sale of Powerball tickets is not currently permitted. The provision for intrastate gambling in H.R. 4777 requires that the bettor and the gambling business be located within the same state. Thus, it appears that a state lottery would be able to offer tickets in whatever lottery games it sells, but only to individuals who are within that state at the time of the sale. The Department cannot speculate regarding the types of additional activities state lotteries would wish to authorize.

7. **Does the Justice Department support the exemptions for intrastate and intra-tribal gaming?**

Response: To the extent that these provisions would permit gambling from the home, the Department has stated in the past that any form of gambling over the Internet raises concerns about gambling by minors and gambling addiction. These provisions of H.R. 4777 require that the gambling business be authorized and licensed under state law, or that the Tribe has authorized and licensed the gambling business and that the State or Tribe has explicitly authorized such bets or wagers. Thus, illegal gambling, such as bookmaking, would continue to be prohibited.

8. **Would the Justice Department support an amendment to strike language in the bill that could be interpreted to expand Internet gambling opportunities in the U.S. or otherwise weaken prohibitions the Justice Department believes to be in place?**

Response: If such language is present in H.R. 4777, we will continue to work with Representative Goodlatte's staff to address our concerns.

VII. Fantasy Sports

1. **There are websites[2] that offer participants the chance to win prize money in exchange for an entry fee where the player's chance is determined by the performance of participants in sporting events. These "pay to play" fantasy sites are also open to participation by minors. Does the Department support permitting minors to wager over the Internet on such websites in the hope of winning prize money?**

[2] For example, www.cdmsports.com

Response: To the extent that the activity on fantasy sports websites is actually "gambling," the Department does have concerns about minors gambling on the Internet.

2. **What regulatory regime is presently in place to prevent minors from wagering money in the hopes of winning prizes money on such "pay to play" websites, and how effective is this regime?**

Response: The Department does not maintain information about regulatory regimes for fantasy sports, which would be a matter of state law.

3. **Virginia law defines "illegal gambling" as "the making, placing or receipt, of any bet or wager in this Commonwealth of money or other thing of value, made in exchange for a chance to win a prize, stake or other consideration or thing of value, dependent upon the result of any game, contest or any other event the outcome of which is uncertain or a matter of chance, whether such game, contest or event occurs or is to occur inside or outside the limits of this Commonwealth."[3] Virginia also makes it illegal for the "house" to take a cut of the proceeds.[4] In the Department's opinion, would the provision of H.R. 4777 that authorizes participation in "pay to play" fantasy sports where participants pay for the right to compete for cash and other prizes conflict with, and supercede, Virginia state law?**

Response: Subsection 1084(e) of H.R. 4777 provides that "Nothing in this section creates immunity from criminal prosecution under any laws of any State or Tribe." Thus, to the extent that "fantasy sports" fall within the exception to the term "bet or wager" in subsection 1081(6)(vii) and, thus, are not subject to the prohibition of Section 1084, if the activity violated the laws of a particular state, it would still be illegal in that state.

4. **One "pay to play" fantasy sports website which charges participants a fee in the hope of winning cash or other prizes bars participants from certain states from receiving any cash or other prizes. Specifically, the site's disclaimer states: "(i) eligible legal residents of Arizona, Iowa, Louisiana, Maryland, Montana, and Vermont may play Fantasy Football Gold, but are not eligible to win any prizes."[5] Does the exemption in H.R. 4777 for "pay to play"**

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[3] Va. Code § 18.2-325 (2005).

[4] *See id.* § 18.2-325(4) (defining operator); *see also* "Risk of Robbery Raising Stakes Of Poker Nights," *The Washington Post*, 2/21/2006.

[5] *See* CBS Sportsline, "Disclaimer," available at http://football.sportsline.com/splash/football/spln/single/getting-started; *see also*, ESPN, "Rules - Legal Restrictions," available at http://games.espn.go.com/content/flb/2005/rules?page=legal.

fantasy sports conflict with, and supercede state law in Arizona, Iowa, Louisiana, Maryland, Montana and Vermont?

Response: Please see response to Question 3 above.

VIII. Poker

1. **In your testimony, you state that the Department is concerned whether the definition of the term "bet or wager" is "sufficient to cover card games, such as poker." Would the Department support an amendment to clarify that card games such as poker is covered by the bill's definition of "bet or wager"?**

Response: The Department would support an amendment that clarifies that card games are included within the definition of the term "bet or wager."

RESPONSE TO POST-HEARING QUESTIONS FROM THE HONORABLE WILLIAM E. MOSCHELLA, ASSISTANT ATTORNEY GENERAL, OFFICE OF LEGISLATIVE AFFAIRS, UNITED STATES DEPARTMENT OF JUSTICE, FOR THE APRIL 29, 2003 HEARING ON H.R. 21, THE "UNLAWFUL INTERNET GAMBLING FUNDING PROHIBITION ACT"

U. S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

July 14, 2003

The Honorable John Conyers, Jr.
Ranking Minority Member
U.S. House of Representatives
Committee on the Judiciary
Washington, D.C. 20515

Dear Congressman Conyers:

This is in response to your written follow-up questions to the April 29, 2003, hearing on H.R. 21, the "Unlawful Internet Gambling Funding Prohibition Act."

Your written questions concern the definition of the term "bet or wager" that is contained in Section 3(b)(1)(E)(ix) of H.R. 21. This definition excludes "any lawful transaction with a business licensed or authorized by a State" from the definition of the term "bet or wager." The Department recognizes that this provision has become the subject of controversy, and believes that these controversies exist because the provision is ambiguous. We support clarifying the provision to eliminate the ambiguity, and doing so in a manner that does not allow the expansion of gambling opportunities by making lawful transactions that are currently unlawful.

The definition of "unlawful Internet gambling" contained in H.R. 21 states that a bet or wager is unlawful if it is "unlawful under any applicable Federal or State law in the State in which the bet or wager is initiated, received, or otherwise made." Because the exclusion under Section 3(b)(1)(E)(ix) references "lawful" transactions, one interpretation of subsection (ix) is that it only clarifies that the bill will not affect otherwise lawful transactions. In other words, if the transaction is unlawful under Federal law or the laws of one State, then subsection (ix) cannot operate to make the transaction lawful because, by its terms, it only applies to "lawful" transactions.

The provision can be interpreted in other ways, however, which could make otherwise illegal transactions legal. For example, one could argue that because the provision does not specify which State's laws must be considered, only the laws applicable in the State in which the gambling business is located need to be consulted in order to determine if the transaction is lawful. Under this interpretation, because the

provision does not specify which State's laws must be considered, only the laws applicable in the State in which the gambling business is located need to be consulted in order to determine if the transaction is lawful. This interpretation would make lawful transactions that are currently unlawful in the state where the bet is initiated. Furthermore, under this interpretation, one could argue that H.R. 21 would make lawful transactions that otherwise violate other Federal statutes. For example, 18 U.S.C. § 1084 prohibits one in the business of betting or wagering from using a wire communication facility in interstate or foreign commerce to transmit a bet or wager on sporting events or contests. The Department of Justice believes that the transmission of a bet or wager over the Internet would constitute such a use of a wire communication facility in interstate or foreign commerce. Section 1084 does not contain any exceptions for bets placed with a gambling business licensed or authorized by a State. Yet, while violating Section 1084, if the bet was placed with a business licensed in a State, it might not be deemed a "bet or wager" under H.R. 21. Since H.R. 21 and Section 1084 contain similar terminology, and since H.R. 21 purports to amend Section 1081 and Section 1084, defendants may raise the argument that Congress has now defined the term "bet or wager," and that this new definition should be made applicable to existing statutes, such as Section 1084. In other words, since both H.R. 21 and Section 1084 concern gambling, the interpretation of the term "bet or wager" used in H.R. 21 might be applied by a court to interpret Section 1084, which does not define the term "bet or wager."

This provision is ambiguous and can be interpreted in these contrary ways, and the Department cannot predict which way courts will rule and what interpretation of subsection (ix) will be imposed. Different courts may even interpret the provision in the different ways. Accordingly, we believe this proposed exception to the term "bet or wager" adds confusion and uncertainty not only to H.R. 21, but to existing federal law, as well. We therefore believe it should be clarified.

With respect to your specific questions, the Department has the following responses.

1) Does the Department believe that current law prohibits all types of internet gambling, including gambling on horse racing, dog racing, or lotteries?

Response: The Department of Justice believes that current federal law, including 18 U.S.C. §§ 1084, 1952, and 1955, prohibits all types of gambling over the Internet. We do not believe that the December 2000 amendment to the Interstate Horseracing Act, a civil statute in which the federal government has no role, amended 18 U.S.C.§ 1084 (a pre-existing criminal statute) . While we note that the Fifth Circuit's decision, In re

Mastercard, 313 F.3d 257 (5th Cir. 2002), held that Section 1084 did not apply to casino style gambling on the Internet, the court did not consider other federal gambling statutes. In addition to believing that this case was wrongly-decided on the law, the United States was not a party in that case and does not believe that it would constitute binding precedent in other circuits.

2) Does the Department believe that the language, quoted above, would allow internet gambling on horse racing, if the entity was licensed or authorized by a state?

Response: As stated above, one of the concerns that the Department of Justice has about H.R. 21 is that, if enacted, the definitions of terms used in H.R. 21 might be applied to other federal gambling statutes. Indeed, Internet service providers have already told the Department that they believe that the definition of the term "bet or wager" in H.R. 21 should be made applicable to Section 1084.

As set forth above, this provision only states that the transaction must be a "lawful transaction" without a reference to which State's law must be considered. If H.R. 21 is enacted, and courts interpret this provision to require that only the law of the State in which the business accepting wagers on horse racing is located needs to be referenced to determine that the transaction is "lawful," then gambling on a horse race with a business licensed by a State would not be considered a bet or wager under H.R. 21.

Under H.R. 21, if the transaction is not deemed to constitute a"bet or wager," then the general prohibition provisions on payments is not applicable. If the definitions contained in H.R. 21 are applied to other federal gambling statutes such as Section 1084, then such transactions would no longer violate those other statutes either, even though statutes like Section 1084 are clearly intended to prohibit such transactions.

Similarly, 18 U.S.C. § 1955 requires a violation of state law, and 18 U.S.C. § 1952 requires that the gambling business violate either federal or state law. Given that H.R. 21 would be the most recently enacted statute and would be Internet specific, courts might use the definitions in H.R. 21 to determine that wagering on a horse race is not a"bet or wager."

With respect to horse racing, the Interstate Horseracing Act permits"interstate off-track wagers," which are defined as "a legal wager placed or accepted in one State with respect to the outcome of a horse race taking place in another State and includes pari-mutuel wagers, where lawful in each State involved, placed or transmitted by an

individual in one State via telephone or other electronic media and accepted by an off-track betting system in the same or another State, as well as the combination of any pari-mutuel wagering pools." 15 U.S.C. § 3002(3). While the Department of Justice does not believe that this amendment to the Interstate Horseracing Act amended Section 1084 to permit the interstate transmission of bets on horse racing, the definitions in the Interstate Horseracing Act would make the argument to apply H.R. 21's definition of the term "bet or wager" to other federal gambling statutes even stronger.

3) Does the Department believe that the language, quoted above, would allow internet gambling on dog racing, if the entity was licensed or authorized by a state?

Response: While there is no federal statute for dog racing similar to the Interstate Horseracing Act, the Department believes that the same analysis would apply to dog racing, as well as other state legalized gambling, including lotteries.

4) Does the Department believe that the language, quoted above, therefore, expands legal gambling opportunities on the internet?

Response: The Department believes that, under one interpretation and using the analyses set forth above, it could expand legal gambling opportunities.

5) Does the Department believe that the language, quoted above, requires that an entity be licensed or authorized by a state to conduct internet gambling or that it would suffice for an entity be licensed or authorized by a state for some other purpose?

Response: The provision states only that the transaction be "a lawful transaction with a business licensed or authorized by a State." The plain language of this provision does not require that the business be licensed to conduct Internet gambling by a state. Therefore, it would suffice for the entity to be a gambling business that was licensed or authorized by a state for that purpose, assuming such license or authorization is required under that state's law.

At this time, the legislative history of H.R. 21 does not indicate that Congress intended this provision to require that the business be licensed to conduct Internet gambling by a State. The Committee on Financial Service's report on H.R. 21 does not provide any detailed explanation of this provision and does not state that the provision requires that the business be licensed by a state to conduct Internet gambling. *See* H.R. Rep. No. 108-51 (2003).

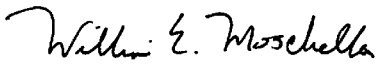
Further, H.R. 21 was introduced by Representative Leach in this Congressional session. In the 107th Congress, Representative Leach introduced H.R. 556, which is basically the same bill as H.R. 21. This particular provision was added to H.R. 556 during the October 21, 2001, markup session held by the Committee on Financial Services without extensive debate. The Committee on Financial Services report on H.R. 556 also does not contain any detailed analysis of this provision. *See* H.R. Rep. 107-339 (2001).

6) Would the Department support an amendment to strike the language, quoted above, or otherwise clarify that the bill does not weaken the prohibitions in current law on internet wagering?

Response: The Department believes that this provision can be interpreted differently and thus has created confusion and possible inconsistencies with existing federal statutes. The Department supports efforts to restrict and contain illegal Internet gambling, and believes this is the intent of H.R. 21. As such, the Department supports clarifying the meaning of this provision so that it cannot be interpreted as expanding Internet gambling opportunities by possibly making legal transactions that are currently illegal. We look forward to working with you and the Committee toward this end.

Again, thank you for the opportunity to comment on this legislation. Please do not hesitate to call on us if you would like us to answer any additional questions or to provide any additional assistance.

Sincerely,



William E. Moschella
Assistant Attorney General

cc: The Honorable F. James Sensenbrenner, Jr.
Chairman

PREPARED STATEMENT OF JOHN A. PHILLIPS, CEO, ARISTOTLE INTERNATIONAL

"Law enforcement and consumer protection agencies as well as industry self-regulatory bodies have long recognized the need for rapid online identity verification for Patriot Act and anti-money laundering compliance, fraud prevention and risk mitigation involving age-restricted products such as tobacco, alcohol, pharmaceuticals, video games and mature content.

The private sector is responding to mounting public pressure in an increasingly socially responsible manner by deploying reliable state-of-the-art technology that effectively addresses this important need.

According to Forbes Magazine, Aristotle's INTEGRITY verification service is the market leader in online identity and age verification technology. INTEGRITY is utilized today by global Fortune 1000 enterprises that are required by law or best-practices professional codes of conduct to identify individuals requesting permission to enter a facility, a website, open an account or conduct certain transactions online.

Institutions relying on INTEGRITY include more than 350 of the nation's largest financial services companies, government agencies and airport security authorities, wineries, distillers, makers of premium cigars, video game publishers and major motion picture studios.

The Federal Trade Commission and other governmental agencies have urged that reliable state-of-the-art methodologies available on the market be deployed to protect children from accessing promotions intended only for adults. In its 2003 report to Congress on the marketing of beverage alcohol products, the FTC pointed to the emergence of online methods, and Aristotle's service in particular, as addressing this public need. (See FTC Report to Congress: *Alcohol Marketing and Advertising* September 2003).

Aristotle's INTEGRITY verification technology is a logical response to the acute need of responsible marketers for reliable, robust and commercially reasonable protective screening.

INTEGRITY today is utilized, for example, to comply with the multi-state Tobacco Master Settlement Agreement provisions that prohibit marketing to minors. The service exceeds the strict standards of such laws for online age-verification as California's Business and Professions Code § 22963, and Virginia Code § 18.2–246.8, governing online tobacco sales. Since adoption, not one INTEGRITY service client has ever been found to have improperly marketed a tobacco product to a minor.

The major motion picture studios also use INTEGRITY to comply with the Motion Picture Association of America (MPAA) guidelines for restricting minors' online access to studio promotions with "R" rated content. Blocking underage teens from purchasing tobacco online is another important value. The Campaign for Tobacco-Free Kids *(http://tobaccofreekids.org/Script/DisplayPressRelease.php3?Display=425)* presents the urgency of this issue on its website.

Vendors in the beverage alcohol business use INTEGRITY as well. In the new era of direct wine shipments, for example, online age verification is an essential component for compliance and responsible marketing across the United States. Without a service such as INTEGRITY, Members of Congress, and the general public would not be able to purchase fine cigars or quality wine, purchase lottery tickets or an R-rated movie by mail, by telephone or online.

In the United Kingdom, INTEGRITY is widely used by licensed casino operators to comply with the strict UK requirements for age verification online.

In addition to the risk mitigation and child protection benefits of age and identity verification, INTEGRITY will benefit those individuals who acknowledge that they are problem gamblers and wish to avoid relapse, or who, for whatever reason, do not wish to be solicited for products or services that are potentially harmful or personally offensive. At the INTEGRITY web site, individuals will be able to put their own names on a confidential list of those who do not wish to be solicited or allowed to open an account with a casino.

Many states have enacted legislation enabling each gaming venue to maintain a list of individuals who have identified themselves as problem gamblers. The problem is that there are many forms of gaming available, each with its own regulatory agency and there is currently no coordination among or between them. Some of the regulations are written in such a way that in Nevada, for instance, you have to register in person at every single casino where you may want to be blocked from temptation.

Leaving aside the irony of sending people to the very places they are trying to avoid, with hundreds of casinos in Clark County alone you'd have to visit several per day every day to achieve comprehensive coverage—and then start over to find the new casinos that had been built in the interim

Aristotle is working on a proposal with the National Council on Problem Gambling, the national non-profit advocate for programs to assist problem gamblers and their families, to enhance INTEGRITY's ability to address this problem. The proposed program would deploy current technology to allow individuals to voluntarily place their names on a self-exclusion master list—one time, at a single web site, rather than having to seek out hundreds of separate sites or physical locations.

The list would be strictly confidential, and the names would not be disclosed to anyone. Individuals could remove their names from the list after a minimum period. Should someone whose name is on the list attempt to open an account with a merchant in the gambling industry, INTEGRITY would not return a match (approval) code to the merchant. The reason for the non-return of the match code would not be specified to the merchant.

In their determination to comply with the law, market responsibly, and meet best practice standards, a rapidly growing number of enterprises across a broad spectrum of commerce and government use Aristotle's INTEGRITY solution.

In its simplest terms, the case for robust ID authentication has never been more apparent, urgent or efficient, thanks in large part to the capabilities of Aristotle International's online service, INTEGRITY."

PREPARED STATEMENT OF KOBUS PAULSEN, CHIEF EXECUTIVE, UC GROUP

Testimony of Kobus Paulsen
Chief Executive
UC Group

April 11, 2006

Submitted for the Record Concerning
Legislative Hearing on H.R. 4777, the "Internet Gambling Prohibition Act"

Held Before the Committee on the Judiciary
Subcommittee on Crime, Terrorism, and Homeland Security
United States House of Representatives
On Wednesday, April 5, 2006, at 2:00 p.m.

Mr. Chairman and Members of the Judiciary Committee, I am Kobus Paulsen, Chief Executive of UC Group, a UK Limited Company which has operated a payments business that specializes in the secure processing and settlement of Internet credit card transactions.

I appreciate the opportunity to submit written testimony to you concerning my experiences with the secure processing of Internet credit card transactions with respect to high-risk transactions, specifically Internet gambling transactions.

I. INTRODUCTION

First, I would like to explain a little about my company, UC Group. UC Group is a UK Limited Company which has operated a payment business that specializes in the secure processing and settlement of Internet credit card transactions since 1997. The UC Group's unique credit card transaction system for e-commerce sectors is specifically designed to provide security, protect against fraud, prevent money laundering, and limit other abuses in areas of e-commerce that are perceived to pose special risks, such as in travel reservations and Internet gambling transactions.[1] UC Group is not an online gambling company but rather a payment service provider that processes a wide variety of credit card transactions (including legal online gambling transactions) for some of the largest financial institutions in the world.

I am submitting this testimony today to address concerns raised about Internet gambling transactions in the context of the legislation offered by Rep. Goodlatte, and to provide information about how many of the same concerns are already being addressed in other nations through the use of technology.

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[1] Other areas of higher risks of payment fraud, money laundering, and related abuses include airline travel bookings, adult entertainment, and consumer purchases of electronic goods. The UC Group's systems and solutions handle a variety of forms of consumer transactions, but as a matter of choice and policy do not include the adult entertainment sector.

II. THE GOODLATTE BILL AND ITS GOALS

The legislation introduced by Congressman Goodlatte (R-VA) seeks to modernize existing U.S. law prohibiting interstate gambling over telephone wires by expanding the prohibition against such activity to cover other methods of electronic communication. It also prohibits gambling businesses from accepting certain types of payments, and provides an enforcement mechanism for situations where an offshore gambling business accepts payment from U.S. bank accounts. The bill specifically permits individual state legislatures to determine whether or not Internet gambling will be permitted within the state, and thus envisions the possibility that Internet gambling will not be completely prohibited.

In reviewing the testimony provided at the Committee's hearing last week, several points made by witnesses stood out with respect to the goals of the Goodlatte bill and the concerns raised about the activity that might be permitted under the bill. Specifically, concerns were raised that allowing any legal Internet gambling (for example, should a state wish to legalize it) would invite a number of social harms – such as underage gambling, compulsive gambling, involvement of organized crime, money laundering, and fraud.

- A warning was issued by Professor Kindt that "Internet gambling places electronic gambling at every work station, at every school desk, and in every living room." He argued that the only effective way to address these problems is a "total ban on Internet gambling activities."

- Mr. Ohr from the Justice Department testified that permitting gambling from home would lead to underage and compulsive gambling, despite the Goodlatte bill's requirements for age verification and residence requirements. Mr. Ohr also raised concerns about the ability to verify the physical location of a bettor, stating that, "the Department believes that further study is needed as to whether existing technology can address compliance where a bettor places bets using his or her cell phone or laptop computer using a WiFi or similar Internet access."

- Mr. Vallandingham from The First State Bank expressed the concern that credit card payments may originate from a company that has many lines of business, including an Internet gambling line, but may only have one merchant code that does not identify the company as a gambling company – making it impossible for a financial institution to determine that the transaction is illegal and should be blocked.

I would like to address each of these points, but first let me state unequivocally that I do not, nor does UC Group, take a position regarding the legality or illegality of gambling or Internet gambling. The legality of Internet gambling differs in different countries. It is legal in some countries, illegal in others, and it is not my place to opine on whether the United States Congress – or the individual states – should prohibit or permit it. However, it is clear from the debate and consideration of various Internet gambling bills that *some* transactions will likely be permitted, and to the extent that this is the case, I respectfully offer to the Committee that there is, today, the technological capability to permit those *legal* transactions to occur – with protections in place to prohibit underage or compulsive gambling, organized crime, money

laundering and fraud. As someone who has spent a career developing such protections – not just for Internet gambling but for *all* online credit card transactions – I hope my testimony today will provide useful information regarding the technological landscape and respond to the concerns raised by some of your other witnesses.

III. UC GROUP'S SERVICE FOR HIGH RISK E-COMMERCE SECTORS

Many of the risks that have been articulated relating to online gambling potentially apply to Internet transactions more broadly. For example, Internet credit card transactions involve risks not present in face-to-face business because the card holder and the merchant are not normally together when the transaction occurs. Without safeguards in place, the lack of face-to-face communication has the potential to increase the risk of fraud and money laundering in any Internet credit card transaction by comparison to its counterpart in the physical world. Some e-commerce sectors, such as gambling and entertainment, raise additional public interest concerns that further enhance the need for making credit card transactions both secure and capable of preventing fraud and other abuses.

UC Group's system provides payment and related financial services to Internet merchants to protect both the merchants and the consumers who purchase goods and services from the merchants. In the credit card transaction chain, it operates between the merchant and the acquiring bank and performs the functions of an online payment service provider. UC Group carries out the full Internet payment process for the merchant, using UC Group's proprietary software. However, unlike traditional online payment processors, UC Group's payment system adds a significant number of security features to ensure that the consumer is protected from merchant fraud; the consumer is protected from theft or fraud by other consumers or by unauthorized or under-aged users, and the merchant is protected from fraud by criminals or unauthorized users. UC Group system offers full protection to cardholders and banks against liability from transactions processed through UC Group system.

UC Group system works as follows:

- First, UC Group sets up a "rolling reserve" escrow account for each merchant in which up to 12.5% of the merchant's revenue is kept for six months. This is done to ensure that any irregularities that could result in chargebacks or refunds can immediately be settled against the escrow account. Requests for chargebacks and refunds to the consumers are accepted as a matter of course and are not disputed. Any claim of an instance of "unauthorized use" of a credit card therefore automatically results in a full repayment to the principal credit card holder, without further investigation, usually within 24 hours of receipt of the repudiated transaction. Depending on the chargeback record of a merchant the "rolling reserve" can be decreased over time to a minimum of 7.5%. It is therefore in the interest of the merchant himself to take all possible steps to avoid unauthorised use of credit cards. This aspect of UC Group's system has been highly successful because UC Group has been able to reduce the average chargeback rate of Internet merchants that are

perceived to be high risk to an average of 0.3% of normal transaction traffic.[2] By way of comparison, UC Group estimates that the normal chargeback rate for high risk Internet transactions not using the UC Group's system is around 2% for Internet gambling transactions, between 3 and 5% for adult entertainment and between 2 and 3% for Internet airline bookings. Thus, about 90% of the possibly improper uses of the credit cards are eliminated at the outset by the processes put into place by the UC Group to combat fraud and unauthorized uses.

- UC Group's system monitors the occurrence of suspicious chargebacks and refunds on a credit card (in particular those linked to possible unauthorised use of the credit card). Should suspicious activity such as chargebacks or refunds occur, UC Group immediately stops accepting further transactions through that credit card.[3]
- UC Group's system does not "aggregate" e-commerce transactions, putting them together into a single pool of funds that is then moved through the payments system. Transactions are kept in separate streams for each merchant and, as needed, for each URL.[4]
- Group's system monitors and compares IP address,[5] country of card holder and country of issuing bank as further protection against fraud.
- UC Group's system constantly monitors the frequency and value of transactions per credit card. The UC Group system ensures that a sudden increase in frequency of use or value of transactions on a credit card is immediately investigated.
- UC Group's system uses secure software which allows it to trace back every single transaction down to the second. In other words, the UC Group system creates an audit trail for every transaction.
- UC Group's system makes continuous use of the services of Baker Tilly (7th largest firm of accountants worldwide), which downloads all transactions on a daily basis and manages the "rolling reserve." All reserve accounts are balanced and reconciled on a daily basis.
- Baker Tilly performs random spot checks to re-verify the identity of card holders registered as users on a merchant's website. These spot checks are conducted by telephone or e-mail on the basis of information supplied by databases such as Verid (www.verid.com). All of the UC Group's systems data (including all transaction records) are stored safely on state-of-the-art high security servers both by UC Group and by Baker Tilly.[6]

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2 Internet merchants can be the victim of attacks by professional credit card fraud rings, which may cause occasional peaks in the number of chargebacks. For the purposes of this paper this was not regarded as part of "normal transaction traffic."

3 Chargebacks or refunds can be objectively justifiable in e-commerce. For instance, it is possible that a consumer inadvertently "clicks twice." In such cases, the money spent inadvertently will be returned but there is no objective reason to refuse to transact with this consumer in the future.

4 A "URL" is a web link ("URL" stand for Uniform Resource Locator).

5 "IP address" stands for Internet Protocol address. Every computer connected to the Internet is assigned a unique number known as an Internet Protocol (IP) address. Since these numbers are usually assigned in country-based blocks, an IP address can often be used to identify the geographic location from which a computer is connecting to the Internet.

6 All credit card data is encrypted and managed in accordance with the requirements of the Payment Card Industry Security Standard (PCI)

- To protect against the risk of money laundering, UC Group's high risk e-commerce clients are contractually obliged to:
    - Fully disclose the identity of company directors and beneficial shareholders and report any changes to that.
    - Take all reasonable steps to verify the identity of a consumer (e.g. by collecting a copy of a drivers licence or passport or by using online identification services such as Verid).

  When a merchant is found in breach of its contractual obligations in this regard a penalty payment is withheld from the merchant's "rolling reserve" escrow account.
- In the specific case of Internet gambling merchants, UC Group limits the payment of winnings to the card holder (by a bank draft check in the card holder's name or through a transfer to his bank account), and screens names of payees against applicable sanctions lists. As a result, no money is at risk of being paid to individuals or organisations listed on the lists of persons, groups and entities subject to financial sanctions published by the European Union (EU)[7] and the "Specially Designated Nationals list" published by U.S. Department of the Treasury.[8]
- In the specific case of Internet gambling merchants, UC Group only deals with merchants who are licensed under applicable local laws and who are in good financial and legal standing, based on banking and legal references.
- Likewise, if a merchant fails to cure any breach of the contractual anti-money laundering obligations or is determined to no longer be in good legal standing, or financially sound, UC Group will terminate all services to that merchant.

Thus, UC Group has already in place systems that effectively counter fraud and money laundering pertaining to Internet gambling, as well as other forms of potentially higher-risk online consumer transactions. The same sets of processes can be used to combat underaged gambling and compulsive gambling, by defining criteria that require age verification or which impose limits on the basis of required personal identifications, to enforce such limitations as they are imposed by any jurisdiction's particular regulatory regime. I address this process further in my testimony below.

IV. SPECIFIC CONCERNS ROUTINELY RAISED BY INTERNET GAMBLING

As stated in other witness testimony, there are five main areas of public interest concern with respect to Internet gambling transactions – underage gambling, compulsive gambling, and involvement of organized crime, money laundering and fraud. These areas of public concern are not unique to the United States – they are concerns faced by a multitude of jurisdictions. Many of these jurisdictions, including the United Kingdom, have legalized Internet gambling. They have not done so by turning a blind eye to these concerns – rather they have employed technology to protect cardholders and financial institutions against potential liability. As other nations have found, these risks can be countered and contained, if those institutions operating Internet gambling payment gateways choose to adopt, or are required to adopt, technological systems specifically designed to address each of these problems, such as those provided by the UC Group.

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7 Available at http://europa.eu.int/comm/external_relations/cfsp/sanctions/list.htm

8 Available at http://www.treas.gov/offices/enforcement/ofac/sdn/index.html

- **Technology exists to address the risk of underage gambling.**

Underage persons cannot play on an Internet gambling site when payments are handled by UC Group. Underage persons do not normally have their own credit cards. To the extent that they do, currently only their issuing bank is aware of the card holder's age. In the event that the issuing banks and the credit card companies are required to either disclose underage card holders or assist in the prevention of underage Internet gambling, the UC Group system can enforce prohibitions on underage gambling through immediate refusal of authorization of any such transaction. Furthermore, underage persons seeking to make unauthorized use of another person's credit card (for instance, their parents' credit card) must overcome a series of significant hurdles, the final one of which goes to the heart of the system designed by the UC Group: they cannot receive any winnings, as they are not the authorized owner of the card.

The UC Group system incorporates three barriers to prevent abuses by underage persons. The first barrier is at the merchant's website, which must have age verification mechanisms in place to qualify for services from the UC Group. The second barrier is password verification for credit cards which typically includes the Verified by Visa and MasterCard Secure Code systems. Finally, underage persons are denied winnings because UC Group only pays winnings to the card holder.

UC Group recognizes that no regulatory or enforcement system is or can be perfect, and for that reason has established further protections for credit card holders against possible abuses by others. Under the system established by UC Group, should an underage person succeed in playing on an Internet gambling site with another person's credit card, and somehow evade the rigid and significant barriers put in place against unauthorized use, UC Group's system will impose no financial liability on the principal card holder. This is due to the fact that the principal card holder can request a refund or chargeback which will be accepted as a matter of course by UC Group on behalf of the merchant. Any funds spent by an underage or otherwise unauthorized person are simply returned to the principal credit card holder.

- **Technology exists to address the risk of compulsive gambling.**

UC Group's payment system offers a number of opportunities to address compulsive gambling that are as good as or better than those available for bricks and mortar gambling.

  - *First*, credit card holders can be offered the possibility to restrict their own spending on Internet gambling, for instance, via a self-exclusion program. Casinos in the United States already maintain such self-exclusion programs but the effect of such a program is normally limited to one casino. When self-exclusion from Internet gambling is put into effect via the payments system, it becomes impossible for the person concerned to participate in *any* gambling on the Internet that uses traditional credit card payments. Furthermore, individuals may fix limits on the amounts they can spend on Internet gambling. Increasing such limits could be made subject to cooling off periods of, for instance, three days after which the individual would need to reconfirm that he or she effectively wants to increase the spending limit.

- *Second*, UC Group's system can prohibit individuals from registering more than one credit card to pay for Internet gambling transactions. This would prevent individuals from running up excessive debts by using multiple credit cards.

- *Third*, it is relatively simple for UC Group's system to detect an unusual increase in an individual's spending on Internet gambling. When such an unusual pattern is detected the person at issue could be put in contact with an organization such as Gamblers Anonymous. This makes it possible to monitor compulsive gambling much more closely than in the case of traditional forms of gambling where the casinos, lotteries and racetracks normally do not know the identity, or the spending pattern, of most of their customers.

- **Technology exists to address the risk of abuse of Internet gambling by organized crime.**

UC Group's system maintains a complete and detailed audit trail of all transactions conducted using its payment network. Furthermore, prior to paying any winnings, UC Group's system screens the payee against the EU's lists of persons, groups and entities subject to financial sanctions and the United States' list of "Specially Designated Nationals." Additionally, UC Group also screens the beneficial shareholders of the Internet gambling companies that use its services.

In such a context, these protections prevent Internet gambling from being an attractive vehicle for organized crime. Using systems such as those provided by UC Group, makes Internet gambling a much less attractive vehicle for organized crime than the anonymous, cash-intensive world of traditional gambling with casinos, lotteries and racetracks because Internet gambling transactions processed by the UC Group system can be tracked by authorized regulators and law enforcement in connection with their criminal investigations.

- **Technology exists to address the risk of abuse for money laundering.**

UC Group does not accept cash payments from consumers or Internet gambling businesses. All transactions are recorded. All parties are clearly identified. As a result, UC Group's payment system virtually eliminates the attractiveness of using Internet gambling transactions for money laundering. As the U.S. General Accounting Office has reported:

> "Banking and gaming[9] regulatory officials did not view Internet gambling as being particularly susceptible to money laundering, especially when credit cards, which create a transaction record and are subject to relatively low transaction limits, were used for payment. Likewise, credit card and gaming industry officials did not believe Internet gambling posed any particular risks in terms of money laundering. (...)

[9] The term "gaming" used by the GAO in its report is retained here. The term "gaming" is generally used in the UK to refer to what in the U.S. is ordinarily referred to as "gambling." In deference to this U.S. forum, my testimony uses the term "gambling" throughout.

> "In general, gaming industry officials did not believe that Internet gambling was any more or less susceptible to money laundering than other electronic commerce businesses and noted that the financial industry – which is responsible for the payments system – is better suited to monitoring for related suspicious activity in the area than the gaming industry itself."[10]

The United Kingdom, which has spent considerable time and effort studying the feasibility of Internet gambling, takes the view that "there appears to be a paucity of proof" that money laundering through Internet gambling sites is "a significant problem" and that "[i]t is safe to say that gambling transactions completed online can be more secure than cash business conducted in traditional gambling outlets."[11]

- **Technology exists to address the risk that Internet gambling operators might defraud consumers.**

Fraud against consumers will inevitably result in a high level of chargebacks. UC Group's practice of accepting chargebacks as a matter of course, using the funds in the merchant's "rolling reserve" escrow account to refund these chargebacks to the consumers, virtually eliminates the incentive for merchants working with UC Group to defraud their customers. In the sector of Internet gambling, UC Group has and will only deal with properly licensed, reputable, and authorized gambling operators.

Although it is not possible to totally exclude fraud in any area of economic activity, Internet gambling fraud can be minimized through the use of payments systems that require authentication and verification of both parties to any transaction. UC Group's payment system for high-risk e-commerce transactions reduces the risk of fraud against consumers, which when applied to the Internet gambling sector is much lower than that occurring in many other sectors.

V. POLICY ISSUES

As I have stated, UC Group does not believe it appropriate to express an opinion regarding what types of gambling should be permitted or prohibited in the United States. However, to the extent that H.R. 4777 contemplates permitting intrastate and intra-tribal online gambling transactions, we believe the current obligations under the bill – that states and tribes require use of only age verification and location technology – may well be insufficient to address all of the concerns with online gambling previously discussed.

Additionally, UC Group recognizes that mobile phones and other similar wireless devices are increasingly being used to conduct Internet transactions. While some have identified this mobility as a problem for verification of the identity and location of a consumer, in fact, use of mobile devices introduces additional opportunities to resolve the identity and location of the

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[10] *See*, United States General Accounting Office, "Internet Gambling. An Overview of the Issues", December 2002, GAO-03-89, p 37 (available at http://www.gao.gov/new.items/d0389.pdf).

[11] *See*, United Kingdom Department for Culture, Media & Sport, "The Future Regulation of Remote Gambling: a DCMS Position Paper", April 2003, para. 69-70 (available at http://www.culture.gov.uk/global/publications/archive_2003/gamb_position_paper.htm).

user through the mobile device's unique identification reference, which would enable confirmation of the location of the user through commercially available location service applications for the purpose of meeting regulatory requirements.

For example, such location services would be a necessary first step in ensuring jurisdictional boundaries have not been breached in any permissible intrastate or intra-tribal transaction under H.R. 4777, if enacted by Congress in its current form. Likewise, we believe technology can and should be used to address other policy concerns with online gambling transactions wherever Congress permits such transactions to occur in a regulated fashion.

In the view of UC Group, the most serious of all the concerns is the possibility of organized criminal activity involving online gambling, such as money laundering and fraud. As discussed previously, without appropriate safeguards, online gambling transactions might be susceptible to such abuses, but the bill does not seem to address these for intrastate and intra-tribal transactions that may remain legal.

UC Group recognizes that banks and operators of credit cards are already subject to sufficient federal requirements to combat money laundering, and when applicable, to state requirements to combat fraud. But other types of current and developing Internet payment methods may not be under any existing federal or state obligations to apply these types of protections.

For this reason, UC Group suggests that the Committee consider whether, for any intrastate and intra-tribal online gambling that is deemed permissible, H.R. 4777 should also mandate that states and tribes require use of technologies to combat organized crime, money laundering and other fraudulent activities. Technologies do exist today that can be applied to accomplish these goals. Furthermore, if Congress requires use of such technologies to protect the public interest, the market will inevitably create further products designed to address these risks for any businesses that wish to handle any such lawful transactions.

VI. CONCLUSION

Regardless of the position that Members of Congress take on the prohibition or legalization of Internet gambling, we can all agree that there are certain "ills" that must be prevented. I suspect one would be hard-pressed to find an advocate *for* underage gambling, compulsive gambling, money laundering or fraud. I sincerely hope that my testimony today has demonstrated that there are ways to protect against these exact harms and ills that the opponents of Internet gambling regularly cite as reasons to prohibit Internet gambling. UC Group has developed and implemented a robust and 'fail-safe' payment system which has withstood the test of time. The system has been found to work successfully by regulators and law enforcement in other countries, with whom UC Group can work with great effect, as UC Group has done with officials in the UK.

I am confident that UC Group and other providers could develop additional approaches that would address whatever regime the United States and, as applicable, individual U.S. states or tribal areas may adopt.

Accordingly, if Representatives and Senators choose to allow *any* Internet gambling transactions to occur, they should do so knowing that technology exists to protect their constituents from falling victim to underage gambling, compulsive gambling, and involvement of organized crime, money laundering and fraud. It exists, it is being utilized, and it is working very effectively.

I remain available to provide further information to the Chairman and other Members of this Committee, as well as to other Members of Congress, regarding the mechanics of our approach to combating fraud, money laundering, underage gambling, compulsive gambling, and organized crime involving online gambling or to review the various approaches undertaken to manage these issues worldwide.

Mr. Chairman, I thank you and the Committee for its time and appreciate the opportunity to submit my remarks for the record.

LETTER TO THE HONORABLE HOWARD COBLE FROM THE HONORABLE BOB GOODLATTE

BOB GOODLATTE
6TH DISTRICT, VIRGINIA

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DEPUTY MAJORITY WHIP

CHAIRMAN, HOUSE REPUBLICAN
HIGH TECHNOLOGY WORKING GROUP

CO-CHAIR,
CONGRESSIONAL INTERNET CAUCUS

Congress of the United States
House of Representatives

COMMITTEE ON AGRICULTURE
CHAIRMAN

COMMITTEE ON THE JUDICIARY

VICE-CHAIRMAN, SUBCOMMITTEE ON
COURTS, THE INTERNET, AND
INTELLECTUAL PROPERTY

SUBCOMMITTEE ON
IMMIGRATION, BORDER SECURITY,
AND CLAIMS

REPUBLICAN POLICY COMMITTEE

April 11, 2006

The Honorable Howard Coble
Chairman
Subcommittee on Crime, Terrorism, and Homeland Security
207 Cannon House Office Building
Washington, D.C. 20515

Dear Howard:

Thank you again for holding a legislative hearing on H.R. 4777, the Internet Gambling Prohibition Act. I would respectfully request that the enclosed letters of support from numerous conservative and family groups be made part of the record of the April 5, 2006 legislative hearing.

Thank you for your consideration and please do not hesitate to contact me if I may be of further assistance in this matter.

Sincerely,

Bob

Bob Goodlatte
Member of Congress

RWG:br
Enclosures

PRINTED ON RECYCLED PAPER

LETTER TO THE HONORABLE BOB GOODLATTE FROM WENDY WRIGHT, PRESIDENT, CONCERNED WOMEN FOR AMERICA

April 3, 2006

The Honorable Bob Goodlatte
2240 Rayburn House Office Building
United States House of Representatives
Washington, D.C. 20515

Dear Representative Goodlatte,

Concerned Women for America (CWA) strongly supports the Internet Gambling Prohibition Act (H.R. 4777). Preventing the spread of gambling is a cause of vital importance to the health and well-being of American families. Internet gambling is an easy way for struggling citizens to amass burdensome personal and credit card debt that can damage their futures, families and financial security.

Provisions within the Wire Act need to be clarified and I appreciate your leadership in working to update it to reflect the onset of the internet into the gambling market of mainstream America. H.R. 4777 does not change current law, but it does modify it to reflect the ever-changing digital market.

Gambling is a severe threat to the economic and cultural fabric of America, and I strongly support your leadership in working to prevent the problem from harming additional vulnerable citizens. Thank you for your leadership to protect the moral culture of this country, and thank you for your sponsorship of H.R. 4777.

Sincerely,

Wendy Wright

Wendy Wright
President

CONCERNED WOMEN FOR AMERICA

1015 Fifteenth Street, N.W. • Suite 1100 • Washington, D.C. 20005 • Phone (202) 488-7000 • Fax (202) 488-0806 • www.cwfa.org

LETTER TO THE HONORABLE BOB GOODLATTE FROM PETER BRANDT, SENIOR DIRECTOR, GOVERNMENT & PUBLIC POLICY, FOCUS ON THE FAMILY

8605 EXPLORER DR, COLORADO SPRINGS, CO 80920 (719) 531-3400

February 16, 2006

Dear Congressman Goodlatte:

Focus on the Family enthusiastically supports the Internet Gambling Prohibition Act. This forward-thinking legislation will clarify ambiguities in the Wire Act regarding the illegality of gambling transactions through wireless communications and give the Department of Justice greater authority to prosecute illegal Internet gambling.

Internet gambling is an ever increasing threat to millions of American families with Internet access. Gambling Anonymous members are younger and younger as a growing percentage of adolescents become addicted to poker games and online gambling. Internet gambling has grown to a $12 billion industry, increasing at a rate far beyond any other form of gambling worldwide as addiction plagues families, college campuses and senior citizen communities.

It is imperative that we put an end to the exploitation of children and families by off-shore and commercial gambling interests over the Internet. And as the recent gambling-induced corruption in our Nation's Capitol reinforces, the time to act is now. Congress must take action to stop the addictive cancer of Internet gambling by passing the Internet Gambling Prohibition Act.

Sincerely,

Peter Brandt

Peter Brandt
Sr. Director, Government & Public Policy

LETTER TO THE HONORABLE BOB GOODLATTE FROM PHYLLIS SCHLAFLY, PRESIDENT, THE EAGLE FORUM

PHYLLIS SCHLAFLY
PRESIDENT

February 16, 2006

EAGLE FORUM *Leading The Pro-Family Movement Since 1972*

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CAPITOL HILL OFFICE: 316 PENNSYLVANIA AVE., S.E., WASHINGTON, D.C. 20003, (202) 544-0353, *fax*: (202) 547-6996
OPERATIONS CENTER: P.O. BOX 618, ALTON, IL 62002, (618) 462-5415, *fax*: (618) 462-8909, *eagle@eagleforum.org*

The Honorable Bob Goodlatte
U.S. House of Representatives
2240 Rayburn House Office Building
Washington, D.C. 20515

Dear Representative Goodlatte:

On behalf of Eagle Forum members nationwide, I am happy to support your *Internet Gambling Prohibition Act* and work with you toward its passage.

Your legislation will be a major step forward in the fight to protect children and families from the dangers of internet gambling. Eagle Forum appreciates your leadership on this important issue.

Faithfully,

Phyllis Schlafly

LETTER TO THE HONORABLE BOB GOODLATTE FROM RICHARD D. LAND, PRESIDENT, THE ETHICS & RELIGIOUS LIBERTY COMMISSION

THE ETHICS & RELIGIOUS LIBERTY COMMISSION
OF THE SOUTHERN BAPTIST CONVENTION

Richard Land, D.Phil. (Oxon.), President

February 24, 2006

MAR 6 2006

The Honorable Bob Goodlatte
United States House of Representatives
2240 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Goodlatte:

Please know of our complete support for your recent bill, the "Internet Gambling Prohibition Act", to expand and modernize the prohibition against interstate gambling. Internet gambling enterprises have swept our nation. It is estimated that there are 1,800 Internet gambling sites worldwide and that revenue might have been as much as $12 billion in 2005.

Clearly, Internet gambling is a growing menace to millions of good, hard-working Americans. Your bill is a common sense approach to this predatory industry. We look forward to assisting in any way possible with its swift passage.

Thank you for the excellent leadership you have given over the years to rein in destructive gambling activities. We appreciate your dedication.

Sincerely,

Richard D. Land

Main Office • 901 Commerce Street, Suite 550, Nashville, TN 37203 • *phone* 615.244.2495 • *fax* 615.242.0065
Leland House on Capitol Hill • 505 Second Street, N.E., Washington, D.C. 20002 • *phone* 202.547.8105 • *fax* 202.547.8165
faithandfamily.com

LETTER TO THE HONORABLE BOB GOODLATTE FROM DR. GUY C. CLARK, CHAIRMAN OF THE BOARD OF DIRECTORS, THE NATIONAL COALITION AGAINST GAMBLING EXPANSION

THE NATIONAL COALITION
NCAGE
AGAINST GAMBLING EXPANSION

100 Maryland Avenue NE, Room 311, Washington, DC, 20002 ~ (800) 664-2680 ~ ncalg@ncalg.org

February 16, 2006

The Honorable Bob Goodlatte
United States House of Representatives
2240 Rayburn House Office Building
Washington, D.C. 20515-4606

Dear Representative Goodlatte,

On behalf of the Board of Directors of the National Coalition Against Gambling Expansion (NCAGE), I would like to express our appreciation for your tireless efforts to prohibit gambling on the internet. You have been a consistent leader on this very important issue.

I am pleased to inform you that NCAGE has decided to support your legislation, the *Internet Gambling Prohibition Act,* and we are working to organize support for your bill among like-minded organizations.

NCAGE believes this legislation is critical in the fight against the proliferation of online gambling and we hope that our combined efforts will accomplish the passage of this important bill.

Sincerely,

Dr. Guy C. Clark

Dr. Guy C. Clark, Chairman
Board of Directors
NCAGE

PRESS RELEASE: FAMILY RESEARCH COUNCIL, DATED FEBRUARY 16, 2006

News

FOR IMMEDIATE RELEASE: February 16, 2006
CONTACT: J.P. Duffy or Bethanie Swendsen– 202.393.2100

FRC STANDS IN STRONG SUPPORT OF THE "INTERNET GAMBLING PROHIBITION ACT"

"If Congress is sincere about true lobbying reform that puts the public interest first, they must move quickly to pass the Internet gambling legislation." ~ Tony Perkins

Washington, D.C. – Today Congressman Bob Goodlatte (R-VA) unveiled his effort to combat illegal Internet gambling by introducing the "Internet Gambling Prohibition Act." **Tony Perkins, President of Family Research Council**, issued the following statement:

"Today's introduction of the 'Internet Gambling Prohibition Act' is welcomed and Congressman Goodlatte should be commended for his tireless leadership on this important issue.

"More than six years ago, the National Gambling Impact Study Commission reported to Congress on the dangers posed to minors by Internet gambling. An international gaming industry, relying upon the anonymity afforded Internet gamblers, has accumulated immense wealth at the expense of our youth and our families. The Commission requested that Congress act, and after several attempts, Congress failed to pass legislation.

"Recent news stories about the behind-the-scenes maneuvers to defeat Internet gambling legislation only emphasizes the need for Congress to act now. Law enforcement agencies and financial institutions must be provided with the commonsense tools necessary to enforce laws addressing this illegal activity.

"I thank Congressman Goodlatte and those joining him for ensuring that our nation's laws are enforced. If Congress is sincere about true lobbying reform that puts the public interest first, they must move quickly to pass the Internet gambling legislation."

-30-

FAMILY RESEARCH
COUNCIL
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PRESS RELEASE: CHRISTIAN COALITION OF AMERICA, DATED FEBRUARY 15, 2006

Coalition of A

Leading Grassroots Organization Defending

www.cc.org

Press Release
Wednesday, February 15, 2006
Roberta Combs, President

For further information contact: Michele Combs 202-479-6900

Christian Coalition Applauds Congressman Goodlatte's Internet Gambling Prohibition Act Introduced With Over 100 Co-sponsors

Washington D.C. -- Christian Coalition of America commends Congressman Bob Goodlatte, (R-VA), for introducing his **"Internet Gambling Prohibition Act"** with over 100 co-sponsors. The Wire Act passed years ago by the United States Congress prohibits gambling over telephone wires. However, it is unclear as to whether or not using the Internet to operate a gambling business is illegal. Congressman Goodlatte's bill amends the Wire Act to make it clear that its prohibitions include Internet gambling by modernizing the Act after the many new technological developments since the Act was passed. The Goodlatte bill when it becomes law will expand the existing prohibition to include all bets or wagers, not merely bets or wagers on sporting events or contests.

The President of the Christian Coalition of America, Roberta Combs said, **"Christian Coalition of America commends Congressman Goodlatte for introducing and the over 100 Members of the U. S. House of Representatives for co-sponsoring the "Internet Gambling Prohibition Act" which will do much to stop the scourge of gambling on the Internet. It behooves Congress to pass Congressman Goodlatte's "Internet Gambling Prohibition Act" this year before gambling on the Internet spirals out of control."**

The Goodlatte bill has several goals including: updating the Wire Act to cover all forms of gambling and new technologies; increasing penalties for violations of the Wire Act including up to 5 years in prison; prohibiting credit card use for illegal gambling; and providing additional law enforcement tools to combat illegal gambling. The **"Internet Gambling Prohibition Act"** also respects states' rights and the bill leaves the regulation of wholly intrastate betting or wagering to the states with tight controls to be sure that it does not extend beyond their borders or to minors.

#

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Christian Coalition of America
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www.cc.org

To stop receiving these emails, go to https://www.cc.org/unsubscribe.cfm.

LETTER FROM A COALITION OF ORGANIZATIONS IN SUPPORT OF H.R. 4777

March 8, 2006

Dear Member of Congress,

As organizations committed to the rule of law and the enforcement of those laws, we write today urging your support of the "Internet Gambling Prohibition Act" (H.R. 4777) sponsored by Congress Bob Goodlatte of Virginia and "The Unlawful Internet Gambling Enforcement Act of 2005" (H.R. 4411) sponsored by Congressman James Leach of Iowa.

In 1999, the National Gambling Impact Study Commission released its report addressing the social and economic impact associated with gambling. One area of gambling investigated by the Commission was Internet gambling. The Commission reported that efforts preventing underage and pathological gambling were "particularly challenging" due to the high level of anonymity afforded Internet gamblers.

The Commission further acknowledged that "general concerns about the relationship between gambling and crime…become particularly acute when considering gambling on the Internet." These general concerns and others regarding the broader damage inflicted upon society by Internet gambling compel us to ask for your support of legislation that addresses these concerns.

Currently no state has authorized Internet gambling, and federal laws support state efforts for enforcement. However, a lucrative international gambling industry greatly undermines the efforts of state and federal agencies to uphold our domestic laws. Furthermore, current federal statute governing this activity has proven to be ambiguous and out-of-date. This has all led to the false perception that Internet gambling is legal, and the result is the entrapment of our youth and society at large by this destructive activity.

The proposed measures would provide law enforcement agencies and financial institutions common-sense tools necessary to identify and prevent unlawful Internet gambling. Gambling businesses and financial institutions would be prohibited from receiving or approving financial transactions for the purpose of Internet gambling. Law enforcement officials would be granted new injunctive authority to prevent the intentional or unintentional violation of the law. Congressman Goodlatte's legislation provides important additional provisions to update the "Wire Act" to encompass other styles of Internet gambling and new technologies.

These provisions found in both H.R. 4777 and H.R. 4411 assert the government's authority to enforce the laws needed to deter and prosecute illegal Internet gambling. A nation of laws must find those laws enforced by all means necessary and legal. Please support the enforcement of illegal Internet gambling by supporting "The Internet Gambling Prohibition Act" and "The Unlawful Internet Gambling Enforcement Act of 2005."

Respectfully,

American Association of Christian Schools

American Family Association of Indiana

American Family Association of Pennsylvania

American Values

Arkansas Family Council

Center for Moral Clarity

Citizens for Community Values

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Family Leader Network

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North Carolina Family Policy Council

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The Family Foundation (Kentucky)

The Family Research Institute of Wisconsin

United Families Idaho

NEWS ARTICLE FROM *THE HILL*, ENTITLED "ABRAMOFF GETS PAYBACK IN GAMING BILLS," DATED MARCH 29, 2006

Abramoff gets payback in gaming bill The Hill March 29, 2006 Wednesday

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HEADLINE: Abramoff gets payback in gaming bill

BYLINE: By Patrick O'Connor

BODY:

A handful of gambling lobbyists have already called it Jack Abramoff's payback. Others are less direct.

But the central irony remains: The same Internet gambling legislation Abramoff fought so hard to defeat on behalf of a client that helped states conduct lotteries over the Internet now includes an exemption to protect those lotteries.

Now Abramoff's infamy and legal woes are driving anti-gambling legislation across Capitol Hill, even though one of the most prominent bills includes language that would protect his former client.

Two House bills, introduced separately by Reps. Bob Goodlatte (R-Va.) and Jim Leach (R-Iowa), seek to reinforce existing anti-gambling rules by respectively updating telecommunications and financial-services laws to give enforcement agents more power to prosecute gamblers who place bets on websites based outside the United States.

A previous version of Goodlatte's bill was defeated on the suspension calendar in July 2000 after a last-minute push by Abramoff and his team to spread misinformation about the bill on behalf of his client at the time, eLottery, a Connecticut-based firm.

Abramoff is now out of the picture, but gambling interests remain powerful on Capitol Hill and the current crop of anti-gambling legislation reflects that sway. Versions of this legislation have passed the House twice and the Senate twice, but never in the same year. Both chambers now appear intent on bringing bills to the floor this year.

The Goodlatte and Leach bills, along with legislation introduced in previous years by

Sen. Jon Kyl (R-Ariz.), attempt to crack down on the estimated $12 billion annual overseas gambling business, but none of those bills would regulate some closely related industries, in an attempt to avoid potential roadblocks.

In addition to the lottery exemption in Goodlatte's bill, both pieces of legislation include language to protect fantasy sports from current anti-gambling laws, and the two bills also avoid a decades-long dispute between Congress and the Justice Department over the legality of interstate pari-mutuel betting on horse races.

"The underlying principle of this legislation is not to change the legality but to change the enforcement mechanisms," said Martin Gold, a lobbyist with Covington & Burling who represents the National Football League, an ardent supporter of anti-gambling legislation. "It doesn't make anything illegal that was legal, and it doesn't make anything that was legal illegal."

JUNE 2000

Goodlatte is staunchly opposed to gambling and first introduced a bill to improve the federal enforcement mechanisms for Internet gambling in 1997.

In June 2000, Abramoff and his team defeated the Goodlatte bill after a companion had already passed the Senate and his legislation appeared on its way to swift passage, according to a story in The Washington Post last fall.

Abramoff reportedly convinced a former aide to Rep. Tom DeLay (R-Texas) to help get the bill on the suspension calendar, which would increase the number of votes necessary to approve it, and directed funds to various religious groups to help him pressure conservative members to oppose the bill on the grounds that it would actually expand Internet gambling - a false charge, Goodlatte maintains.

The bill eventually fell short by 25 votes.

"It's now clear to a great many members of Congress that they were hoodwinked by Mr. Abramoff," Goodlatte said. "He effectively killed it in [the] Judiciary [Committee] by getting some amendments offered."

In the intervening years, Goodlatte added language giving states the right to conduct lotteries over the Internet. The change was part of an ongoing effort by the lawmaker and his staff to craft the legislation around a specific task: to update the 1961 Wire Act to prohibit anyone from placing bets over the Internet so that the 45-year-old law would apply to current technology.

Goodlatte reintroduced the bill in February of this year, and the legislation now has 130 co-sponsors. The Judiciary Committee is expected to address it in the coming months.

"It is a bill we intend to consider," committee spokesman Jeff Lungren said.

HORSE RACING

In addition to updating the Wire Act, Goodlatte's bill also gives Treasury officials more oversight of financial institutions to track illegal bets. This latter provision is the entire thrust of Leach's bill, which parallels legislation Kyl is expected to introduce in the Senate sometime this year.

The Leach and Kyl bills would require the Departments of the Treasury and Justice to establish "policies and procedures reasonably designed to identify and prevent restricted transactions" relative to Internet gambling. That would include monitoring of credit cards, electronic fund transfers and any checks or bank withdrawals.

Leach said his initial version of the legislation avoided any mention of horse racing, but the current version has a clause explicitly exempting any bet that adheres to the Interstate Horseracing Act.

Passed in 1978, the Interstate Horseracing Act governs all interstate betting on horses. The law creates a specific carve-out in the Wire Act to protect state-to-state betting on horse races provided it is legal in both the state where the bet is cast and the state where the race is run and provided all wagers are placed with a regulated pari-mutuel service.

Despite those protections, federal law-enforcement officials have argued that the law does not pertain to online betting.

In December 2000, despite strong protests from the Justice Department, Congress amended the Interstate Horseracing Act to include wagers placed "via telephone or other electronic media" provided both the sender and the receiver are licensed pari-mutuel providers.

Initially unaware of this dispute, Leach said, he was told early in the process to leave horse racing out of his legislation because it was a separate issue governed by previously established laws.

"It wasn't in the initial bill," Leach said of the horse racing exemption. The congressman said he wanted to limit his own legislation to betting that is already illegal under current law, adding, "Don't ever underestimate the power of the gambling lobby."

Goodlatte said he did not explicitly address the horse racing issue for the same reasons. "We don't address it, nor do we try to repeal it," he said.

The National Thoroughbred Racing Association (NTRA), which is both the trade association and governance body for breeders, owners and racing officials in the United States, sent out a release March 15 announcing that the organization "has secured language ... to protect Internet and account wagering on horse racing" after Leach's bill passed through the House Financial Services Committee earlier this month.

The same release said that NTRA officials had worked with Goodlatte to "ensure that [his bill] also contained language that protects online and account pari-mutuel wagering."

The organization's political action committee had already contributed $79,000 to members of Congress this cycle as of Jan. 23 of this year, according to the Center for Responsive Politics. Neither Goodlatte nor Leach was a direct recipient of those funds, but Goodlatte's PAC, the Good Fund, did receive a $5,000 donation in July.

In addition, Federal Election Commission records show that Kyl refunded a $5,000 donation from the group late last year, according to politicalmoneyline.com. His office did not return repeated phone calls for comment.

FANTASY SPORTS

Almost 15 million people participate in fantasy sports leagues annually, according to the Fantasy Sports Trade Association (FSTA), which represents most of the online fantasy sport providers like CBS SportsLine and ESPN.com.

The average player participates in six separate leagues in two different sports each year, according to a recently completed survey by Prof. Kim Beason of the University of Mississippi. Participants are overwhelmingly male and spend an average of $493.60 on league fees every year.

The professional sports leagues, particularly the NFL and Major League Baseball, draw some revenue from fantasy sports participants, but much of that is tied up as part of larger broadcast or marketing deals.

The leagues now appear to be repositioning themselves after a recent boom in fantasy sports participation.

In 2005, big-league baseball paid its players union $50 million for the fantasy rights to its players for five years. Last year, St. Louis-based CBC Distribution and Marketing, Inc. sued the league for requiring companies to secure a license to operate fantasy baseball leagues online, arguing that statistics are part of the public record. That suit is pending.

In addition, the NFL has a deal with CBS SportsLine to operate its website, but the fantasy rights are up next month and the NFL can now renegotiate its deal.

Fantasy sports are protected in each piece of Internet gambling legislation because the results are an aggregation of individual statistics in multiple games over an entire season; therefore, backers argue, winning and losing is contingent on skill in picking players and the financial rewards are almost always determined before the season.

The results of fantasy sports contests are nearly impossible to influence because the standings are determined by too many players over too many games for outsiders to

influence those results, a number of lobbyists said on background.

Goodlatte said it is unfair to criticize the entire bill on the basis of the single exemptions.

"It all goes back to Abramoff," Goodlatte said. "We were never trying to expand gambling. Clearly, it would contract Internet gambling. ... [The legislation is] tighter now that it has ever been."

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28th Annual Symposium on Racing

Friday, December 7, 2001

Morning Session 3

"NATIONAL THOROUGHBRED RACING ASSOCIATION"

Speakers: Greg Avioli, Deputy Commissioner and Chief Operating Officer, NTRA
Chip Campbell, Senior Vice President, NTRA Media and Sponsorship
Keith Chamblin, Senior Vice President - Marketing and Industry Relations, NTRA
D.G. Van Clief, Jr., President, Breeders' Cup, Ltd.; Vice Chairman, NTRA
Tim Smith, Commissioner and CEO, NTRA

MR. F. DOUGLAS REED: I'd like to make a couple quick announcements and then get this panel started. Every year at this time I look at my watch and my body tells me I ran into a wall, I start to come down from the week's activities and the month's activities, and I always kind of get a little sad at this time, because this week just flies by for me.

And there's so many friends and acquaintances of mine that come here and I want to spend a lot of time with everybody, and I never get enough time to spend with everyone; and so this is always kind of a mixed emotion time for me, you know.

It's - my body's getting tired and - but I hate, I wish this could last longer for me. It's certainly I think the high point. I think I can speak for everybody in the RTIP, this is our peak, this is our Derby, this is our Hambletonian, All American Futurity and Night of Stars and everything wrapped into one for us.

A quick thank you to our sponsors, again that make everything happen. Like to thank our refreshment break sponsors this morning, the NTRA and Lone Star at Grand Prairie, like to thank the sponsors for a lovely evening last night, the reception IGT; the entertainment, the Daily Racing Form and TVG; and the banquet, Mountaineer Race Track and Gaming Resort.

I'd like to give you a brief of the auction results. They are posted in the registration office, and I'd like to read off just a couple — the top couple prizes. First of all the two trips, Gaile Fitzgerald really

opened up her pocketbook. She actually won both trips, the Arlington Park Breeders' Cup World Thoroughbred Championship went for $2,200, and the trip for — to the Festival of Racing at Woodbine went for $2,000, so Gaile took down both of those prizes. She's going to do a lot of traveling.

The weekend at Yosemite National Park went to Dottie Davis, the VIP Package to Hong Kong Racing Festival went to Susie Sourwine, and the bronze sculpture by Veryl Goodnight went to Dottie Davis again.

And I do want to make one announcement. We kind of mis-advertised the Fred Stone. We had a reserve bid on that, it didn't reach the reserve bid. But what we want to do is correct it, because it was kind of mis-advertised. Actually that's a mural that Fred Stone will come to your facility, track or whatever, it's not the actual one out there. That's just an example. And he will come and put that in place, or a similar one like that at the facility. You've seen plenty of those at racetracks and other OTBs, casinos, etcetera. So that's one that he will actually come to the facility and do a very — these things are immense, they're large.

So what I think we'll do is — we'll figure out the logistics, but we'll do a mailing, maybe to all the attendees and let you get another bid at that in case there's an interest in that. Because it really was kind of falsely advertised and some people told me that they certainly would have bid a lot more knowing what it actually was. So more on that later.

Here we are again, and if memory serves me right, I'm not sure, about 1997 I think this marriage has been going on - and I look at this as a win/win, and I certainly lecture my students and faculty and staff, they get tired of hearing me talk about win/win relationships. This is certainly one of those.

And I want to get us off on time. Everybody's familiar with our next presenter, and I think it's great that they're here again to present an update on what's happening, Tim Smith, the commissioner and CEO of the NTRA. Please welcome him.

(Applause)

MR. TIM SMITH: Good morning, everyone. Thank you, Doug, for this annual opportunity to share some plans for 2002 and the NTRA's next phase. It's really been a year of records in horse racing. We had Monarchos with the second fastest Derby time ever, and the horse racing book's been the bestseller list for months, and you can just go on and on.

Breeders' Cup Day set a one-day wagering record for Belmont Park, and I'd just like to recognize one other record. I think clearly John Roark and Remi Bellocq calling an HBPA-NTRA meeting two days ago at 6 a.m. clearly sets a Symposium and possibly all-time horse racing record.

It was actually eerily calm and quiet at that time of the morning, coming through the lobby, not a — not a sound, not a person. Unless you count Shane Sellers at the Sega machine —

(Laughter)

— where he was from the night before, I think. Before we get started with our program, I'd like to say just a very few words about the headline topics for this year's Symposium: medication and drug testing.

We think the group stepping forward to tackle these complicated, sometimes emotional and yet so important issues are to be thanked and commended by all of us. The winds of progress clearly are blowing, and in quite a constructive way.

For our part, the NTRA Drug Testing Task Force will expand somewhat to add regulators, but continue to focus — stay focused on the one specific piece of the puzzle we feel is most appropriate for

our group to tackle, and that's the goal of improving and making more uniform drug testing in North American racing.

Based on our own experience, we'd also counsel patience and perseverance and very thick skin by all involved. Predictably there will be those who will point to the lack of complete or instant progress; and there's one guarantee, it won't be easy, but it's crucial. So keep up and build on the very good work started here.

Turning to the main part of our presentation this morning we've adopted the theme of presenting Phase Two. Phase Two of our association's short life, of the NTRA's strategic plan, Phase Two of our new combination with the Breeders' Cup, of our consumer research and marketing plans, and of our legislative and political efforts.

Phase Two will look and be different in some important respects. For example, as you will hear shortly in more detail, we've moved on to a new phase of research. In Phase One the emphasis was on our threshold problem, that was awareness. And we continue to track awareness, literally every month; the number of people who say they're at least somewhat interested in horse racing.

And awareness has grown, as you'd expect if you spend a lot more on increased television exposure and start a $25 million, $30 million co-op advertising campaign.

We've also emphasized segmentation. And as a result we know a lot about who participates, how often, what these fans look like, demographically. From this research we know that our best target of opportunity is the 19 to 20 million light fan group, most of whom attend or participate just once or twice per year. So we have a clear target, the light fan, and a clear goal, increasing frequency.

But in reviewing lessons learned from Phase One, we realize the need to probe more deeply the fundamental additional research question. "Why? Why do infrequent fans not participate more often? What are the barriers? What kinds of messages and marketing tactics would be most effective?"

All this and similar questions and steps flow from a planning process started earlier this year. After three years of operating experience we gave considerable attention this year to developing an updated business plan, really a strategic plan for the NTRA's next four years, starting with an expanded board of directors.

Earlier this year we reviewed the results of Phase One, where we had made progress, where we had made mistakes or fallen short, where the industry had gained ground and where strategic problems and opportunities remained.

We settled on five strategic priorities for Phase Two. Each is consistent with something that hasn't changed, our two-part mission: increasing the popularity of horse racing and proving improving economic conditions in the industry.

The five priorities for 2001 to 2005 were defined as follows: Refocus on core marketing programs, back to basics you could say; strengthen our legislative and political capabilities for multiple purpose — multiple purposes, including economic, deregulation; establish a new brand and competitive framework for the Breeders' Cup and the Road to the World Thoroughbred Championships, presenting the best of our sport more coherently, both the fan, sponsors, etcetera; help the industry achieve the potential of account wagering, new sources of revenue; strengthen the organization, and the rights and resources necessary to achieve the mission.

Overall the feedback was very supportive of those goals, and quite valuable. So was the fact that input and participation came from a number of members who, as recently as a year ago, had questioned their continued involvement.

Just as historical trivia, but also to show you what multi-year planning exercises can be about, we took a look at the projections made in this room in 1997 of where the organization would be, at least

from the financial perspective, by the end of 2001, i.e., now.

And we came pretty close in most areas, with a major boost on the revenue line from the association with the Breeders' Cup. The handle-based dues from tracks and horsemen's associations we said would be 13 and a half, a little less. We hoped to be over $20 million in our part of the advertising and marketing area, not counting co-op, and just a little bit under that. We'll be back on track in 2002.

Legislative and regulatory also pretty close, and a major increase for 2002. And after some pretty deep startup cumulative deficits, it's looking okay or better on the operating reserves. We hope we can come as close, if we're back here in 2005, telling you how we did on the new projection; the new five-year pro forma will be contained in the new plan.

It calls for $70 million in total revenues by 2005, with all of the growth coming from new sources versus industry dues, so we'll — at the very least it will be a scorecard for us going forward. We'll complete a few remaining issues with discussions with our board this week, and in just a few days share the plan in final form with the industry later this month.

I'll be back at the end to wrap up, but let me conclude this introduction by happily reporting that we also had a good year in rebuilding our membership base, and indeed in adding to it. We'll be some members going forward, we anticipate, who we've not had in Phase One at all. We fully recognize there's a lot of room left for improvement.

You'll hear today we believe there are many challenges that remain. But in important ways I think we're stronger and more unified than at any time in the NTRA's history. Well, by almost any measure if we're comparing Phase One to Phase Two, the original plan with how things have worked out, one of the most visible changes made to our original business plan was the NTRA's combination with the Breeders' Cup effective January 1 of this year.

In fact, when we went to NBC to, as a courtesy call, brief them on this change. What they basically said was, "Who were the geniuses who left this out of the original plan?" And —

(Chuckles)

So it's now my pleasure — I called him a lot of things, but it's now my pleasure to introduce the co-genius who, along with yours truly, took three years to put the two organizations together, but we did and it's been a positive step for both the organizations, and we think, the industry. To tell you more, please welcome D.G. Van Clief.

(Applause)

MR. DANIEL G. VAN CLIEF, JR.: Thank you, Tim. And good morning, Ladies and Gentlemen. As both Doug and Tim have pointed out, it was two years ago at this Symposium that we unveiled the concept of combining the operations of Breeders' Cup and the NTRA. Last year we spoke about the upcoming reality of that combination, and onto — on schedule we did ink an agreement and create a formal joining of these two corporations January 1st of this year.

In my opinion that combination is going to be viewed in the future as one of the most fundamentally important steps undertaken by this industry.

Before giving you a report on our joint progress I'd like to just briefly review the thinking behind the decision to combine the two.

What we had previously was two not-for-profit corporations, both dedicated to the same mission, and one working to fulfill that mission with very few rights to marketable product, the other having developed a major national and international racing event to which it owned the rights. It was a bit like having a major league office or an NFL office without the Super Bowl.

So obviously combining the two was a natural and, as Tim pointed out, it took us about 36 months to get around to it, so perhaps we were a little behind schedule on that. Obviously we had a number of expectations.

Seemed obvious, and we mentioned it at the time here, that there'd be financial advantages in avoiding duplication and creating efficiencies. But most importantly, we were looking to use the natural synergy's between the two organizations to develop a structure which could bring our national racing programs together in one cohesive unit, one which, A, would be more understandable to the average sports fan; and B, would give us the ability to go to the marketplace with packaged product that would be understandable and marketable to potential sponsors and corporate affiliates as well as the public at large.

Last year in this room while we were still developing those strategies, I indicated that we felt we were already seeing the benefits. Today we can begin to quantify some of them.

First, both organizations began sharing office space this past July. While it seems a little mundane in the overall scheme of things, it is, from a practical viewpoint, a major step forward. What it means in simple terms is, amongst other things, our joint staffs are now saving over 2,000 man-hours annually, and accelerating the frequency and quality of internal communication.

The accounting administrative functions as promised have been combined into a single department avoiding duplication of effort and expense, and the various marketing disciplines are being assigned to interlocking mutually supportive teams.

I can tell you that the resulting synergy is real, and it was highlighted by the June 26th announcement in New York of the rebranding of the Breeders' Cup as the Breeders' Cup World Thoroughbred Championships, coupled with the associate brand of "The Road to the World Thoroughbred Championships."

That new branding emerged as a direct result of the joint sales planning involving Breeders' Cup, the NTRA, and our marketing partner, Host Communications, and it was supported by NTRA-driven research. That research showed that the Breeders' Cup has been poorly understood by the majority of sports fans outside our three million core base. And even within that base, there are many whose ideas about what that championship event was were unclear at best.

Equally important, sports fans recognized virtually no progression towards the event. They didn't understand the various racing divisions nor did they understand the linkage between Breeders' Cup and other races which now define the various roads to the World Thoroughbred Championships.

So together, NTRA and Breeders' Cup have forged the opportunity to create a framework and a marketing structure which brings more coherence to the best quality racing in different divisions and relates that structure to the World Championship event. This divisional identification leads to increased understanding of how major post-Triple Crown racing fits into the championship picture annually.

Fortuitously, just four months after that June 26th announcement, what had been known simply as the Breeders' Cup Championship reached a new level of maturity as the World Thoroughbred Championships, with the strongest international participation ever
.
In the meantime, the concept of selling corporate affiliations with the various racing divisions on a package basis was also working. Bessemer Trust embraced the principle with their sponsorship of the Juvenile Division, including a series of seven major 2-year-old races across the country, televised and promoted as the Bessemer Trust 2-Year-Old Challenge, culminating with the Bessemer Trust Breeders' Cup Juvenile.

Penske Auto Centers stepped forward to sponsor the sprint division, and became title sponsor of the

Penske Auto Centers' Breeders' Cup Sprint.

John Deere became presenting sponsor this year of the Breeders' Cup Turf; and one of our most consistent supporters over the years, Alberto Culver, renewed their affiliation as a presenting sponsor of the Breeders' Cup Filly and Mare Turf.

So in short since meeting here with you all last year, we've implemented one sponsorship renewal, and more importantly, we've added three new seven-figure multi-year corporate affiliations in support of thoroughbred racing.

In June our combined organization staked out a bold marketing position, in October it worked. The first formally titled World Thoroughbred Championship Day was successful beyond our expectations. But the shadow of totally unrelated events hovered over that occasion in New York.

With the rest of the world we were stunned by the atrocities of September 11th, and like most Americans, we all looked for a way to play a positive role in coalescing support, sympathy and aid for those most directly affected by the events.

We launched, within days, NTRA Charities New York Heroes' Fund, and in association with the New York Racing Association, dedicated the Breeders' Cup to the families of the New York firefighters, police officers, emergency service personnel, and other victims who lost their lives in the events of September 11th.

This NTRA-produced PSA does about as good a job of capturing the essence of what we were trying to achieve in New York this fall as anything I've seen. Some of you will recognize it.

(A Tape was played)
(Applause)

Thank you. As you can see, that spot really in essence defined much of what our marketing position was about this past fall, how we hoped to identify the event, particularly in the eastern marketplace, and how we hope to put a good foot forward for the industry.

Our initial goal — you saw a $3 million number on this spot. Our initial goal in the early days was to raise a million dollars, and that was basically blown away when Harry Mangurian called and made a million-dollar pledge just days after the fund was created.

I'm pleased to say that as of this morning, and as we announced in New York last week, that fund is expected to reach $5 million including the remaining pledges. And at this point, three and a half million dollars has already been disbursed to those in need.

On behalf of the organizations which have received this aid, on behalf of all of us involved in the fund, and particularly on behalf of the families who were receiving assistance as a result of these disbursements, we want to thank all members of the thoroughbred community who've been so generous to this cause, whether it's been through the New York Heroes' Fund or through similar efforts organized throughout this industry.

World Thoroughbred Championships Day at Belmont Park was thus a day of phenomenal racing, of drama, of pride and of poignancy; it was quite an event.

Now I want to turn briefly to the future. As Tim pointed out, we're going to concentrate today on Phase Two of our combined efforts. We think we've jumped off to a good start this year, and following the early success in simple terms we plan to press the advantage.

We're going to place renewed emphasis on promoting what everybody in this room already knows, and that's that every major race between the Triple Crown and the Breeders' Cup is a mile marker

along the road towards the World Thoroughbred Championships.

We're going to gear our marketing initiatives to further defining and promoting these races in ways that will lead to greater understanding of what the racing season is all about and how the contests are connected. We aim to give fans a better knowledge about the horses as well running along the Roads to the Breeders' Cup Championships, both here and New York — or here in North America and overseas as well.

We plan to include those overseas runners, most of which are anticipated, at least near term, to come from Europe, in our year around rankings. In effect we plan to globalize those rankings so the names like Fantastic Light, Sakhee, Bank's Hill and Johannesburg don't come out of the blue to the American racing fan.

We also have under consideration a number of initiatives to enhance and strengthen the championship races as well as the races leading up to them. Such initiatives include increased Breeders' Cup purses. Those of you who've had a chance to look at the updated business plan, particularly the pro formas in there, will see those numbers included.

We are also looking at the concept of a multi-million dollar bonus. For the time being we're looking at a $10 million operative number. A bonus offered to a horse or horses which can win specified races linked with the Breeders' Cup Classic, and we're looking at that linkage occurring both in Europe and in North America.

And as I mentioned already, we're working at ways to internationalize, if you will, our ranking systems which recognize the championship's elevated international status achieved this year at Belmont Park.

In other areas, we plan to break new ground with first time World Thoroughbred Championships' venues. We confirmed this past Monday in Chicago the event will take place at Arlington Park next year. It will be our first visit to America's third largest marketplace, and we look forward to working with our new racetrack, metropolitan and corporate partners in Chicago.

Texas remains on schedule for 2005. We met briefly with Corey Johnsen yesterday and agreed to work towards a formal letter of intent with Lone Star Park within the next few weeks.

Supporting all these initiatives the combined NTRA Breeders' Cup team will continue developing and integrating marketing programs which you'll hear a little more about later in this program. These are going to include weekly media teleconferences, our ongoing televised racing series, the redevelopment and improvement of our Internet presence and others.

And finally, we're going to use our enhanced stature and program continuity to secure more divisional sponsors, improve the value and viability of our television presence and signal, both domestically and internationally, expand our simulcast signal globally, continue to build our championships brand and strengthen the NTRA Breeders' Cup organization in lines with the strategic goals that Tim pointed out a few minutes ago. So our goals are set.

Our combined methodology has, we believe, been successfully tested over the last 11 months and we feel confident we can look forward to the future with optimism. I think it's fair to say that in its relatively short existence, the NTRA has been responsible for more effective national market research than our industry as a whole has undertaken in the past.

When it comes to understanding our potential customer, knowing who they are, what they like, what they don't like, we've undeniably lagged behind when compared to market knowledge being generated and updated by our competitors.

Professional research is a vital guide to key decision-making. It's imperative as a prerequisite to the effective deployment of the industry goal with which we are entrusted. The rebranding of the

Breeders' Cup for example, and other programs I outlined a few minutes ago, were not conceived in a vacuum. They have been and are being developed along the lines that research tells us has the best chance for success.

We believe our combined organizations made a good start but there's a lot left to do. And doing it right is going to depend on appropriately designed and targeted research.

Earlier this year we retained the consumer research firm of SWR Worldwide to assist us with the next phase of our marketing efforts. SWR's a national leader in opinion and consumer behavior research and has worked with organizations such as NASCAR, Major League Baseball, and the PGA Tour.

Over the last two decades there's been a considerable amount of both quantitative and qualitative research undertaken by various organizations in racing, so rather than walk the same ground that others have already covered, we asked SWR to review all of our industry's existing consumer research data, give us a comprehensive analysis of that data before embarking on the next phase.

This is now complete, and SWR is working on the next phase. It includes a recently completed national telephone survey and focus groups are underway in select major markets.

To tell you more about the program, its objectives and its findings are Greg Schneiders, chief executive officer and John Della Volpe, senior vice president of SWR Worldwide. I'm sure that you're going to find their remarks both interesting and provocative. Greg? John?

(Applause)

MR. JOHN SCHNEIDERS: Thank you very much. I don't have a slide that pertains to my first comments because I wasn't intending to make them, but as we were watching the film from the Breeders' Cup about September 11th and the fund that you all created for the victims of that, I was reminded that it's worthwhile putting any research that we do for any client into the context of the times, and certainly the context of our times today are very different than they have ever been in the past.

And I just wanted to take a moment and tell you that we've been tracking the mood of America on a weekly basis since September 11th. And we found a very interesting thing, and frankly a very encouraging thing right now. We're seeing increasingly the mood of optimism growing.

In the last survey that we completed just about 48 hours ago we found by a margin of five to one, Americans are more likely to say that they expect the quality of life to improve over the next four months rather than to deteriorate. And by a margin of four to one they say they expect their financial and economic situation personally to improve over the next four months as opposed to deteriorate.

So we see that indomitable American spirit that we've been hearing so much about over the last — oh, since the 11th being played out in terms of Americans' expectations, and that's good news. It's good news for all of us as Americans and it's good news for everybody who depends upon the public coming out and returning to normal and doing what they love to do, and that includes going to the track and enjoying thoroughbred racing.

We have — we are in the middle of this research project, it's a very large and ambitious one, involving both qualitative and quantitative research. It's such a big project it takes two of us to present it. And I want to start by explaining to you what we have been doing and how we went about it, how we designed it, how this is different from what's been done before, and then go on and tell you about some of the specific results.

As D.G. said, we started off most importantly by not wanting to re-invent the wheel, not wanting to re-tread old ground, we wanted to be sure that we built on the very solid and fine research that has been done over the last several years. And so we reviewed the ESPN tracking, the focus groups that

been done, the track intercepts.
And then we wanted to go beyond that and using that knowledge, take the next step to dig more deeply into the underlying attitudes, knowledge and motivational factors, drivers and barriers to attendance.

We did that by first designing a telephone survey, and I want to tell you the most important aspect of this, which has to do with the sampling methodology. I mean, any research design is only as good as the sampling that underlies it.

Who are you talking to? In the past the research has focused on a definition of your market based on behavior. We will show you in a moment the segmentation that many of you have seen before of core fans and light fans and lapsed fans and social fans and so on, and that's where the research has occurred.

What we wanted to do is go beyond that and talk to all potential fans, and so the way we did, an actual screening of the general population who live within 50 miles of a track. And we asked them, "If you were invited to go out to a thoroughbred racetrack on a nice weekend and you didn't have anything else to do, how likely would you be to go, on a scale of zero to 10? Ten, 'I would definitely go enthusiastically,' and zero is, 'There's no way you could drag me out there.'"

(Chuckles)

We dropped out the zero through fives, those would include people who might be morally opposed to gambling, people who have absolutely no interest in horses or horse racing, people who for whatever reason, you know, age, infirmity or whatever, may not be able to; and we took the six through tens, and those are who are included in this sample.

So all the information that we give you going forward in this presentation pertains to those people who, on a scale of zero to 10, say a six through 10 in terms of the likelihood to go if invited.

Now about 57 percent of them it turns out have already been to the track, but 43 percent have never been. So that's 43 percent of that potential audience that in the past, if we had only been talking to people who'd been to the track, we would miss. And we think that's a very important part of the population. We want to figure out how to get them to try the experience and enjoy the experience and then come back.

MR. JOHN DELLA VOLPE: I want to talk a little bit about some of the specifics associated with the survey. The survey was ambitious, it was 90 questions long, and it took about 15 to 17 minutes to complete it over the telephone, and we had seven or eight main sections that we delved into.

First one was to understand the traditional habits of fans; how often they go, how much money they spend, do they have the impression that they win more often than they lose or lose more often than they win?

We then moved on to ask a series of questions about their favorite activities, includes trying to get a better understanding of what the competitive set was against horse racing.

We then went into a number of attributes to understand how these attributes apply to both the favorite activities as well as a to the sport of horse racing.

We then went into some information asking them how they perceived themselves, and we then asked the same series of questions about how they perceived fans at a racetrack, to understand some differences, which we'll talk about.

We then asked, when people went to the track, what were the aspects that were most enjoyable, most appealing? Was it watching, was it wagering, was it — was it socializing with friends, those sorts of

things. After that we went into a series of about a dozen or so reasons or factors that the industry would think would try to improve or increase attendance.

We ended the survey with three or four different positioning statements, and then we closed it with a series of demographic questions. So there is a tremendous amount of data that we have begun analyzing; we'll have a full report in the next couple of weeks.

We finished, by the way, a couple days after Thanksgiving. We are currently conducting focus groups. We're conducting six focus groups across the country. Two were conducted last week at Hackensack to talk to folks in the New Jersey and New York markets, we completed two Wednesday night in Los Angeles, and then on next Tuesday we'll be in Dallas conducting groups.

The important thing about those groups, as Greg indicated, we've got two groups per night, and one of the groups are what we would consider the light fans, those are the ones who have been two, three, four times over the past couple years, as well as those who have an interest in attending but have never been. So that's one group.

And then the second group we have every night is those who attend more often, anywhere from a dozen or so times to up to 20 in some cases, to see kind of what the differences are between the two groups. So thank you.

MR. SCHNEIDERS: Many of you if not all of you have seen these numbers before, this is a segmentation that Tim referred to earlier. Core fans, who go frequently and bet heavily, make up four percent of the fan base, and that's 3.2 million individuals. There are 19.5 million who are light fans, they've been within the last couple years. They have bet but they don't go frequently and they don't bet heavily.

Lapsed fans have been to the track but not within the last two years. Social fans have been to the track within the last two years but haven't bet. And then you have a category called inactive fans. Now you know, some might call these non-fans. These are people who have said that they have at least a slight interest in horse racing but they've never been to the track.

What we wanted to do, as I mentioned in going beyond just looking at these individuals, is to find those people out there who, though they may never have been to the track, or may only have gone very infrequently and perhaps a long time ago, expressed a fairly strong interest in going, that's six through 10 on the zero to 10 scale.

MR. DELLA VOLPE: And Greg, just a couple of things about the core. Two thirds of the core group is made up of men. The core group, unlike the light and unlike the potential fans, include more minorities; they're less educated, as a group less attended college, and they're slightly older but not much older than the general population.

MR. SCHNEIDERS: One of the interesting things that we saw when we looked at, we compared those people who passed the screen and became a part of our study by saying six through 10, and we compared them with those people who said only zero through five and therefore were screened out.

And demographically we found, for example, that the people interested in attending tend to be younger, as you can see in the 18 to 24 category; there are twice as many who qualify through their interests as who fit the non-qualified category, and they also are more likely to be single. Thirty-two percent of those who expressed an interest were single compared with just 18 percent of those who did not.

So we found that encouraging, that we don't want to focus only on the young and the single, but there certainly was a social aspect to the way that these people looked at this experience. They saw it as an alternative to going to a nightclub or going to a ballgame with their friends or something to do that was social, that was fun, that was outdoors, that was exciting, and had had a social component to it, and we wanted to zero in on that.

We were very interested in the competitive set, when — if these people are not going to the track very often or perhaps have never gone, despite having expressed a relatively strong interest in it, why is that and what are they doing instead? You know, what choices are they making?

And so we asked them to self-identify on a volunteered basis what is their most important or most attractive favorite pastime when they are looking for an event to attend or an activity to engage in? As you can see, the top two here are football and baseball, at 26 and 16 percent; moving over just a little bit basketball at 12 percent, and then you get farther down, hockey and general sports. And so sports is a very clear leader in terms of alternative activities to attendance at the track.

In third place was going to a casino; not surprisingly, because the people expressing an interest in going to the track, many of them if not most of them also have an interest in gaming and gambling. And then — or to movies, cultural events farther down.

The real significance of this, beyond just wanting to know a little bit more about who these people are and what their interests are, is to see what we can learn about the things they are interested in, the qualities of those activities that may be applicable to racing or maybe we can find ways to make them more applicable to racing.

We — and the last slide ones say we, as D.G. mentioned, have done a lot of work with Major League Baseball. We recently conducted studies in 13 markets to find out what draws people out to the games. And one of the most important features that we're seeing currently is that teams, markets, venues that can create an experience that transcends baseball alone, it becomes a family experience.

You know, you think of Camden Yards and some of the other newer parks are doing much better in terms of attracting new people out, and that's something important I think we can learn in terms of thoroughbred racing.

MR. DELLA VOLPE: As well as the casinos, as well as the casinos are spending more and more, they're advertising a lot of family-type of events and atmosphere and so — .

MR. SCHNEIDERS: We then asked these respondents to tell us a little bit about how they viewed their favorite activity that they had just identified for us, and how they view thoroughbred racing. And where we could see differences.

And we asked them about these specific attributes, and they are in descending order, from where the greatest gaps exist between the perception of their favorites activities and the perception of thoroughbred racing.

So for example, you know, as a place to take my family, there's a 29-point gap between their attributing that to their favorite activity and attributing that to thoroughbred racing. It's for people like me, again, a 29-point gap. Fun and exciting, clean, smaller gaps, and convenient and easy to get to, not much of a gap at all.

But when you consider that we drew the sample only from those people within 50 miles of a track, and most of them knew that they, you know, were near a track, so convenience did not seem to be a major factor.

And then upscale, no statistical difference; no significant difference; in sleazy, no significant difference. So those top ones are the ones you really want to focus on.

As a family activity and as a place for people like me there is a major deficit at this point in the way these individuals who have expressed a strong interest in going to the track view thoroughbred racing compared to football or baseball or whatever their other favorite activity is.

Similarly we wanted to find out how they look at themselves, qualities they think they possess, and

whether they think those are qualities that are possessed by people who go regularly to the track.

And again you see by looking at the left-hand side, the black lines, the gaps that exist. They're much more likely to see themselves as responsible, family-oriented, intelligent and enjoying tradition, than they are to see what they consider to be the regular track attendees to be — to possess those qualities.

And then if you go all the way down to the bottom you see the one place where they say this quality applies much more to people at the track than it does to me is as a risk taker. So much of their perception of thoroughbred racing and attendance at the track clearly is driven by the ability to gamble there, and so they see regular attendees at the track as heavy gamblers, as people who are risk-takers and different from themselves in that way, and that's a perception that I think we need to try and work on and deal with.

MR. DELLA VOLPE: As we said in the introduction, one of the last sections of the survey included a dozen or so factors that we wanted to test to increase attendance, both with the current fan base as well as with the potential fan base.

Of those dozen or so, these six factors were the ones that resonated best. The numbers in the boxes represent the people who said they'd be much more likely to attend if; so if we walk down the list they're color coded by three different themes. The top box says they'd be much more likely to attend "If more of my friends were interested." Thirty-six percent found that to be a very convincing or a reason to attend the track. Near the bottom there's another blue box that says, "If more people like me were there." So those two together indicate some of the initial drivers of attendance.

The next three boxes which we coded as black is, "If there were special windows for experienced wagerers." And in the focus groups they talked about not only special windows but maybe special sections of the track, maybe where there's some handicap lessons or some of those things, they'll be much more likely to go.

If there was some easy-to-find racing information, not only about the races but also about the jockeys and the horses and some of the background, if that were available at the tracks 32 percent would be much more likely to go.

And the third block black box is, "If there was a system, an easy to understand system in place to teach us how to handicap as well as bet." It goes beyond the handicapping, just what's an exacta, what's the difference between win, place or show; those sorts of things.

Those black boxes seem to indicate for us what some of the barriers — what some of the barriers are, what some of the intimidation factors are.

And the third, the third color code is yellow, and that refers to more big races and events. And that's not only the quality of racing and events at the individual tracks, but according to the focus groups it's promotion-driven as well.

If there was a Bring-a-Friend-for-a-Day, a T-shirt or a hat, discounted beverages and food, that would be an important promotional tool to increase attendance. So again, there are really kind of three sections here to concentrate on.

What are the drivers? "People like me, more of my friends." Second are the intimidation factors that need to be overcome, and third is a traditional public publicity campaign.

MR. SCHNEIDERS: Very briefly, the highlights from the focus groups and sort of a summary of where we are at this interim stage of the research. Again, we were very much by design talking about both current and potential fans. This reflects a belief that the future of thoroughbred racing has to be dependent upon both attracting new people out who are going to be there for the first time, it's a new experience, they're trying it out; as well as finding out how to get those people who have tried it to come back.

MR. DELLA VOLPE: And again, Greg, the 42 percent, I don't mean — the 42 percent of the population that live near the tracks, it's just a big number.

MR. SCHNEIDERS: We wanted to explore the drivers and barriers in greater depth. We had — an earlier research had identified many of these and we wanted to understand them better. We were surprised to find that the barriers were less significant than the drivers.

And what I mean by that is that particularly in the focus groups we did not have a lot of people saying, you know, that they found it, you know, an unpleasant experience.

Yes, there is intimidation, particularly having to do with handicapping, but we did not find a lot of, "I don't like the atmosphere, I don't like the people there, I don't like the experience," and largely that's because we had already excluded a large number of them in our screening process. We didn't need to talk to them if they for some reason or other found the experience or the prospect of it so negative that they had ruled it out.

But we've been talking to these people who had expressed an interest, they — if they've been, they liked it, they liked the experience, they found it exciting, they found it fun; if they hadn't been there they were sufficiently curious and interested in and drawn to it that they answered six through 10. So we really want to focus other drivers of the attendance.

One hypothesis, an important one I think that came out of this is that really what so far has been a failure to convert from the trial fan to the more frequent fan. Let me tell you briefly what I mean by that by way of reference to some other activities.

If you think about television shows like Friends or The Sopranos, you know, what brings people back to the sets, you know, every week to watch a particular show? It's engagement, it's involvement, they know the characters, they identify with the characters, they follow the plots and they want to — they follow the story line.

If you look at baseball, you know, and one that came out very high in terms of the competitive set, activities, you know, people come back to baseball for a lot of reasons, but in part it's maybe their — their home town team, they know the players, they know the other teams that they play against, they follow the story line. And now increasingly, through fields like Camden Yards and others, they're coming for that as well as a broader experience.

NASCAR is a good example of a sport that has very consciously, and we've done a lot of work for NASCAR over the years, they have very consciously moved in the direction of trying to make it something that is more easily engaged by the fan, so that they know more about the teams, they know more about the drivers.

And NASCAR has begun to restructure much as you have with "The Road to the Championships," to make it more of an ongoing, continuous experience so that people get more engaged. And that's the sort of thing that we believe is going to be necessary.

Again, two steps; get them out there to try it the first time, but then find a way to get them sufficiently engaged that it's not just seen as, "Well, it's something I might do if somebody invites me to go," but, "That's something I want to be sure to follow and to go back to."

The way to do it is through the positioning, the advertising, the programs that convert from the trial to more frequent fan. And it has to be integrated, it has to be suffused through all of these different kinds of activities in order to both bring out the new fan and then turn that new fan into a regular and frequent fan.

We are, as I said before, in the middle of all this, it's been very exciting. We found lots of interesting things, some that reflect what you've seen before and some very, very new things that we're

continuing to explore and we will be back to share all that with you at a future date. Thank you very much.

(Applause)

MR. KEITH CHAMBLIN: Thank you very much, Greg and John, that was a great report. I want to just start by saying that we'll be providing their final report and their executive summary to all NTRA members, and the slides that they showed here this morning are in the folder that you can pick up on your way out of the room this morning. So we do have a copy of the slides that you just saw.

It's really been great working with these guys and look forward to a long association with SWR. As you can see from the preliminary findings, we're learning even more about what motivates participation in our sport. This learning will go a long way toward defining our goals and objectives for marketing and advertising in Phase Two of the NTRA.

So what will we do with the SWR report? First, we're relating it to our existing marketing programs, consumer promotions and public relations efforts. Second, we're relating it to some of the innovative things our member tracks and horsemen are currently doing. Third, we're relating it to our new internet strategy and our e-marketing strategy, that is largely about fan education and player development.

And finally, the next phase of NTRA advertising will be based on this learning and our expanded understanding of our target audiences and our potential audiences. We know more about our existing fans and target audience than at any time in our sport's history. But we still have you a long way to go.

The overall goal is to work together with the industry to increase the number of core fans and increase the number of light fans. In short, which messages and marketing programs will make more people say, "Horse racing is for people like me?"
As we look ahead to Phase Two of the NTRA, I'd like to quickly take you through some of our existing programs and how we'll expand them going forward.

In 2000 you might recall the NTRA planned and coordinated our first national promotion, a $1 million Mystery Mutuel Voucher. This year we conducted two promotions with similar positive results, bar coded pieces sent this year alone to nearly two million homes across the country.

The first three promotions resulted in double-digit attendance increases and handle increases at the vast majority of participating sites. So we're doubling the number of voucher promotions with four scheduled in 2002. And we're raising the grand prize $250,000 each time to give it that carryover effect and keep the promotion fresh, and we'll do that until one lucky patron wins the big ticket.

Just to let you know the winning prize this past month, the November 23rd promotion, would have been redeemed at Delta Downs by a patron on the Delta Downs mailing list but it was not redeemed.

The 2002 promotional dates are February 16th, April 13th, August 3rd and October 5th. And all the voucher promotions are scheduled on dates when our sport offers high-quality racing from coast to coast.

Each of the vouchers are bar coded so our participating members, after nearly two years of this project, are beginning to measure trends and habits of customers on their mailing lists.

This year the NTRA Mobile Marketing Experience spent less time at the track and more time at high traffic destinations. They visited non-traditional venues like the Super Bowl, spring break in Florida, Times Square, the Alamo, and five college campuses as part of a promotion with Sports Illustrated. Attracted more than 100,000 on-board visitors; and programs like the Mobile Marketing Experience are introducing new and potential fans to our great sport.

While the truck is aimed at attracting new fans, programs like the Daily Racing Form/NTRA National Handicapping Championship are dedicated to existing fans, that group of 3.2 million core players that are so vital to our game today.
Qualifying tournaments for the Handicapping Championship have grown by 50 percent in over two years, and we're looking for more ways to freshen the tournament and make it even better in 2002 and beyond.

We also introduced e-marketing and Internet track newsletters that have resulted in monthly online communication to more than 125,000 customers, a nearly 60 percent increase since the project was launched in May. We currently have 18 participating members, we'll have 30 beginning in January.

We'll also introduce online promotional templates and other programs that will make it easier for tracks to communicate with their fans at the touch of a button. Segmentation and profiling of these consumers indicates a large segment of this database consists of light fans, so again we've established an ongoing communication and relationship as we try to move them up the ladder.

This year our second Breeders' Cup Online Challenge Contest resulted in a 42 percent increase in participation over the previous year. Nearly a third of the participants, 15,000 people, described themselves as light fans. Early next year we'll relaunch the NTRA and Breeders' Cup Websites, under the NTRA.com banner, in addition to promoting the World Thoroughbred Championships brand; our focus over multiple platforms of the Website will be on fan education and player development as we try to use the Web to address some of the drivers that Greg and John talked about just a few minutes ago.

Let's take a look at just one of the slides — or a couple of them; actually, this first one is the home page and shows how it will prominently display games and online curriculums that teach people how to play, participate in our sport.

That "Bet the Net" you see there, that's just a — the working title of a project that will be part of the online curriculum. The ultimate goal is to deliver users to the doorstep of a racetrack, or to a racetrack's preferred account wagering provider. We're hopeful that distance learning on the Internet will break down some of the intimidation barriers that we hear about from light and lapsed fans time and time again.

In addition to the national consumer promotions and our e-marketing and Internet strategies, we'll also be using this latest round of research to develop new advertising campaigns. As you heard earlier, we're beginning to probe why light fans don't go more often. After all, these nearly 19 million fans attend the races only one to two times a year. Yet they indicate they have a high interest in our game, and enjoy a day at the track.

In fact, the latest round of research that John and Greg talked about just a few minutes ago indicates that that universe might actually be closer to 40 million fans that indicate they would like to go to the track. We're beginning to end — identify why many of them don't.

The next round of national co-op advertising scheduled to debut in March at our annual Marketing Summit will attempt to address the drivers to attendance. In addition, we'll also be adding more tactical advertising and event-driven advertising as well in 2002.

For the first time we'll be producing TV spots for three, for all three Triple Crown races at a time of year when the majority of our membership are buying media. And we'll continue to conduct our very popular Breeders' Cup co-op advertising program.

You also see TV spots dedicated to promoting account wagering and PSAs promoting not only the sport but also the agri-business side of our industry. So instead of three to four spots that we normally produce in a year by the NTRA, you might see eight to 10 spots or maybe even more.

We'll also continue and in fact expand our national advertising in 2002, whether it be on USA Today, through our national radio buy, or on ESPN, through a multi-year media buy currently in negotiation as we speak.

Let's take a look at one of the spots this year featuring Kenny Mayne that aired during the time period leading up to the Breeders' Cup World Thoroughbred Championships.

(A video was played)

The goal here was simple. We simply wanted to take ESPN's hottest talent, Kenny Mayne, who by the way is a huge racing fan, and have him invite sports fans to try horse racing. After all, past and now this current research indicates our fans are huge sports fans, and they live on ESPN.

The three spots aired more than 600 times with 187 million consumer impressions over a nine-week period leading to the Breeders' Cup.

We'll also be creating a major new racing event in 2002, you might have heard about it yesterday. For several years the owner and breeder sector of our industry has discussed forming a day to bring state-bred horses together to compete in a season-ending championship.

Events like the Maryland Million, California Cup, Texas Champions Day and others, are terrific events featuring high quality, competitive racing, and in most cases large on-track attendance. They're days when the state horse racing industry comes together to promote the game for what it is, a great mix of sport, entertainment, gambling and agribusiness

Next December horses from participating states will compete in the inaugural $1.5 million NTRA Great State Challenge at Sam Houston Race Park in Texas. I'll look forward to working with all of the participating states to promote "The Road to the Great State Challenge" throughout the course of next year.

And much of that promotion will be done by a team in our New York office that works under the banner of NTRA Communications. Their job is twofold. To perform the internal duties inherent in the operation of a league office; and two, to tell the world through the mainstream media what those of us in this room already know, and that is that this is a greater game, with many great stories.

This past year has brought us plenty to promote. That includes a great book, "Seabiscuit," we referred to earlier, that occupied the number one slot on the New York Times bestseller list for six consecutive weeks and exposed our sport to millions of potential new fans.

There was New York Times columnist, Joe Drape who wrote a great book on the Triple Crown that appealed to a general sports fan. And there were two books targeting female fans on horse racing, and a germ of an idea to conduct a promotion with nationally syndicated radio host Don Imus generated about $1 million of publicity for our sport and raised $75,000 for two terrific charities.

We're going to take a look at some of the highlights right here including one that was a network news story that helped turn a negative situation in Kentucky into a positive legislative result in Washington that you'll hear a little bit more about in a few minutes.

(A tape was played)

In 2002 the work of NTRA Communications will take on added significance as we further integrate their efforts with our advertising and promotional initiatives.

Stay tuned. Got a lot going on. It's going to be a great year. Now I'm going to turn it over to Chip Campbell for an update on two areas that also have major implications in our efforts to grow our fan base. Chip?

MR. CHIP CAMPBELL: Thank you, Keith. I'm going the talk this morning about sponsorship and television, which are two areas where I spend most of my time, and 2001 has actually been quite a good year in both of those areas I think.

Let me hit the highlights very quickly for you. We concluded a new arrangement, an extension of our deal with NBC which will ensure that the Breeders' Cup is kept on NBC through 2005. The Triple Crown ratings this year went up dramatically, television ratings, large audiences.

We developed the new series in the juvenile division, the CNBC carried "Bessemer Trust 2-Year-Old Challenge." And finally, the newly branded "Road to the World Thoroughbred Championships" ran for the second half of the year on the ESPN family of networks.

As you've heard before today, The Road to the Thoroughbred Championships leads to the Breeders' Cup, and this was the focus of the rebranding effort that D.G. and others have talked about today.

Let's take a quick look at how two of our broadcast partners treated our new branding graphically. First, "The Road To" was seen on all of the ESPN shows; and secondly, what NBC did on actual Championship Day.

(A tape was played)

And let's take a quick look at how the print media reacted to the branding following the championship day in October. USA Today, "It's a World Cup Kind of Thing." The New York Times, "International Cast Makes its Presence Felt." And finally, back to USA Today, "International Implications." We certainly can't say that the print media didn't get it this time. They certainly did.

Now moving forward to our 2002 television schedule, which has been drawn with an eye on making the Thoroughbred Championships the focal point of all of the divisional stakes racing, we're going to have the most comprehensive schedule, television schedule I think in the history of thoroughbred racing in 2002.

In this first year of Phase Two with NBC we will have three windows, if you will; a 90-minute Triple Crown Prep. in the spring, a fall Breeders' Cup preview show, the Thoroughbred Championships themselves in Chicago next October, and of course earlier in the year, the Triple Crown presentation by NBC.

As an aside, and it does relate back to the International World Championship kind of thing, one of the key things that we did this year I think was to recapture the distribution rights to the Breeders' Cup Championship Day from NBC. They will now be handled by the NTRA Breeders' Cup.

And I think as we go forward with all of the other things going on in racing worldwide, that these rights will have additional value that we haven't seen in the past. Finally, the CNBC series, Bessemer Trust Series which we began this year as part of the ESPN extension, also will be extended for five years, so we know — through 2005, rather — so we know that will go forward.

On CBS this year, there will be three programs in June, the June-July period. Unlike last year, where it focused on one division, we're going to use those again to reinforce the divisional racing and tie it as best as possible to The Road to the World Thoroughbred Championship.

We'll see races from the turf division, the Classic, the Distaff and the Sprint this summer on ESPN, and we will do our best, you heard Keith's promotional schedule, we'll do our best to tie these telecasts into the promotional executions that Keith and his gang will be presenting on some of those July dates.

The ESPN networks again will carry the two live racing series, The Road to the Triple Crown and The

Road to the Thoroughbred Championships; we'll add three hours of live racing this year bringing the total to 32, and with an eye on that world branding that we've talked about so much today, in this year's series on The Road to the World Thoroughbred Championships we'll see coverage of many of the top stakes races from overseas that lead to the World Thoroughbred Championships.

The ESPN Classic Network will continue to carry featured programming on the historic stakes races tied again to this year's schedule. There will be 14 "Today at the Races" shows spanning 10 months during the year. Our objective with television, our — among our objectives with television is to achieve the absolute best presentation of our sport.

For those of you who attended the 8 o'clock session this morning, I heard — I picked up a line, and I promise I'm going to steal it as often as I can, from Glyn Williams from the United Kingdom. He talked about modernizing and demystifying the presentation of horse racing.

And I think in lots of areas, including television, that's the challenge for us, and we certainly heard that from the research guys. In addition to that, the television, we will look to serve some industry needs, build some personalities as best we can amongst the trainers and horses and owners and jockeys, that's something that television can achieve for us.

The World Thoroughbred Championship brand, as D.G. noted, is the cornerstone of all of our efforts, and we'll be again going forward on the television side in 2002.

Let me quickly turn to the sponsorship area, and D.G. gave a pretty good review early on of that. By pretty much all standards, 2001 was a very poor year in the media and sponsorship areas. The New York Times characterized it as the worst media market in more than a decade.

And we know the effect, all of us know the effect that September 11th had on what was already a weak market. Somewhat remarkably, the NTRA had a pretty good year in this area. D.G. described the three new sponsorship relationships that were achieved this year, and interestingly enough those three companies are very, very different in what they do and what their marketing objectives are.

And I think that based on the year-long schedule, the huge attendance figures, we were able to service the needs of those sponsors quite well. You know about Bessemer Trust, private investment firm. They use their sponsorship for hospitality reasons primarily. They're entertaining high net worth individuals who are their clients or potential clients. They did a number of very successful executions during the course of the year.

They also are into television advertising for the first time, and they were very, very helpful and we are all very thankful for the role they played in the fund-raising efforts for the victims on — of the September 11th attack. They managed the money for us, and distributed it to the folks who are going to get it.

Our second partner very, very different from an investment banker's; the Penske Auto Centers Group. They were very active reaching out into our industry with consumer promotional executions, couponing at Breeders' Cup Day at Belmont, at a number of other tracks during the year.

They're interested in getting their message out and they used that tactic to do it, and they will going forward. Their major markets are Maryland, New York, Miami, Chicago, Southern California, and others, and they will be doing more and more of those types of promotion — of consumer-based activities in 2002.

The third commercial relationship I'd like to mention is John Deere. John Deere has been a notch down at Official Supplier status if you will, and they've used it very effectively in their marketing activities.

They've been reaching into our industry through racetracks, through the farms and so on and so forth, in making pricing — attractive pricing available to members. NTRA members, both tracks and others,

have purchased over $20 million of John Deere product in the last two years, which I think is quite a remarkable feat when you think about it.

Today we are announcing that John Deere is taking a step up, and I'm very proud to let you know that. They will go from being an Official Supplier to being the title sponsor of the John Deere Breeders' Cup Turf Race and Turf Division, and we have representatives from John Deere with us today. I'd like to ask Mark Johnson and Dennis Steward and Dan Gough in the back to stand up and be recognized.

(Applause)

If you haven't met these three guys you really must. They are delightful, and we are very, very happy to have them with us.

One thing I'd be remiss if I didn't mention is that Keith talked before about our newest program, the $1.5 million Great State Challenge, and the John Deere folks will become the presenting sponsor of that new event and we are very, very happy to have them there.

That's a sponsorship picture, looking at 2001 and beginning to look forward. One final thing I should tell you is that we're in active discussions with five new companies that we hope that next year when we come here we'll be able to announce to you that they are new sponsors as well.

We're happy to have one of those companies with us this week; the Sega people were nice enough to demonstrate their new game for us, and I know if nothing else, I'm going away from this Symposium with one sound in my ear, "tap, tap, tap, tap, tap, tap, tap, tap."

Thank you very much.

(Applause)

MR. GREG AVIOLI: It falls upon me to give one of the last presentations at one of the last meetings of a very long week, and I will be mercifully brief. Over the last four years we've developed what we think is a very effective national lobbying team.

Our partners in this effort include the American Quarter Horse Association and Dan Fick, the American Horse Council and Jay Hickey, our lobbyist, one of the top lobbying firms in Washington, the OBC Group, Davis and Harman, the long-time lobbying firm for the American Horse Council, and last year's edition, the National Economic Research Associates which is a think tank that's very valuable to us, as we approach various forms of legislation on the state and federal level.

Funding for the NTRA's legislative and regulatory efforts comes primarily from a quarter percent voluntary sales contributions from buyers and sellers at public auction. Last, in 2000, $500,000 went into this program, in the current year we're going to spend a little under a million.

Next year that number is projected to be over $1.8 million. The big jump from this year to next year is in large part due to the NTRA's decision, the board's decision, to allocate money from the sellers' contributions at public auction as well as from the buyers.

$1.8 million is actually a very strong amount of money to spend in these efforts, both in the federal and the state level. We think we're going to grow that, if you've seen our long-term business plan, to continue to increase that, but with that amount of money we can be — we've demonstrated we can be effective at the federal and the state level.

It's a good segue into the federal initiatives, and that's really where we have focused the majority of our time over the last three years. It was just — I think it was two weeks after this conference last year that Congress passed the amendment to the Interstate Horseracing Act, I'm sure you've read a lot

about it and heard a lot about it.

Essentially what this did was answer some disturbing questions raised by the Justice Department about the legality of interstate simulcasting, and on a more positive note, confirm that racing was the only sport in America where you could conduct Internet wagering, if it was lawful in the state where you were living.

Unfortunately, that didn't end it. We thought, "That's great," pat ourselves on the back, "We've got this solved."

But there is a never-ending flow of Internet gambling prohibition bills that go through Congress. There have been a total of seven in the last two years. And most recently on November 1st, Congressman Goodlatte introduced a very broad Internet gambling prohibition bill.

And in its initial form, it had no special recognition of horse racing's status, and as such, if it passed it would have taken away all the gains that the NTRA and the industry had received with the IHA Amendment.

It was a — it is a restructuring of the criminal Wire Act, and it made basically any use of Internet communication facilities in connection with gambling illegal. Because of some of that $1.8 million that you've seen in the previous slide, I think well spent contributions we made in Washington to various campaign committees, excellent work by our lobbyists and just a lot of time spent educating Congressman Goodlatte and his staff, on the day before they introduced the bill they went back and made one final revision to say, "This does not apply to any wagering conducting in according with the Interstate Horseracing Act."

So now the bill, which has a long way to go, this bill will be bantered about and amended multiple times next year, but if it does pass, racing is actively supporting it because it will confirm our advantage over other sports, which will now be specifically prohibited to have wagering on the Internet on an interstate basis.

Another positive note in Washington that many of you have heard me talk about before is international common pooling. Currently the world market for horse racing is about $100 billion total handle. Fifteen billion of that is in the U.S. Of the $85 billion wagered outside of the United States, less than $500 million is wagered on US races. Almost all of that is in Canada and virtually none of that is common pooled.

So of the $85 billion wagered outside the United States, there is effectively zero money coming in common pooled into the US The reason for the — there are a number of reasons for that; one is time zones, one is some restrictive legislation in Hong Kong and in Japan, but one of the main reasons is US racetracks, under a provision of the IRS code, are required to withhold 30 percent of all winnings, regardless if it's a $2 bet or a $1,000 bet, of any wager coming into a US track from outside the US

This is an antiquated rule, it's been around for a long time. Racing has taken three previous shots in the last 10 years at fixing this, and each time for a variety of reasons was unsuccessful.

We made this one of our big priorities last year, got some help from some very powerful people on the Ways and Means Committee in the House and on the Finance Committee in the Senate, again spent a lot of time explaining to them that if they changed this rule actually there'd be more tax revenue in the US rather than less, because of it there's no money coming in.

We're very happy to report that in the last week we've received a scoring of our proposed bill from the Joint Tax Committee, which has come back and confirmed what we said; that if we do change this law there will not be a significant negative tax problem for the United States, that it would actually end up increasing revenues to the United States.

And based on that, while it's never over until it's over, we feel very confident that in the next 12

months we'll get a new federal law passed that will do away with the 30 percent withholding.

Some other areas on federal legislation; we formed — I think one of the best ideas that our commissioner had in the last year was to form a Congressional Horse Caucus. We are as a highly regulated industry, one of the few industries that has no caucuses essentially, educational body where you teach congressmen and senators about your business. There's a Wine Caucus, there's any number of caucuses, but there hasn't been a Horse Caucus.

We formed a Horse Caucus, and at our first meeting we had had 40 attendees. It's been very successful. We had four meetings this year. We took these senators and the congressmen on farm tours in Maryland, we took a congressional delegation to the Breeders' Cup, which included the chairman of the Agricultural Committee in the House, and it's — it's a rewarding experience.

Because all of this, you hear me say this a lot, everything we do is about educating the congressmen and the senators that we're a $34 billion agribusiness, we don't — don't just associate us with gaming. Sort of related to that on mere reproductive law syndrome, you saw some tidbits from NTRA Communications about that, everyone in the room knows what that is.

Because of just the way the laws were written a long time ago, when there is an agricultural problem in the horse racing or breeding business, the breeders and the farms are generally not eligible for federal relief, and that's because all the federal relief that you might see, if you have a hurricane come through Florida wiping out, you know, citrus farms, horses are not defined as agriculture for the purposes of almost all US laws, and because of that we had to go to Washington and pass a separate law, which was actually signed into law two weeks ago, that made farms, farmers or breeders who had suffered losses from MLRS available for — eligible for federal low interest loans, and that's been done.

One of the key players in getting that done was Mr. Combest, the chairman of the House Agricultural Committee, one of the first members of the Horse Caucus who went to the Breeders' Cup this year with us.

Taking it a step further, next year we feel confident that rather than having to do this one off every time we have an agricultural emergency, we will now change the federal code so that horses will be defined as livestock for the purposes of all federal relief.

It — this isn't a very sexy area to talk about, but it's, as Dan Fick will tell you, it's pretty dramatic for the sport; that in the future if horses are defined by livestock they'll be available for the millions and up to billions of dollars of federal relief that's available to other farms and other crops.

Lastly, on the federal legislative update side, there is a — as a result of September 11th there are a number of bills that are going around the House and the Senate for an economic stimulus package. Of note to the racing and breeding industry, in the House version of this that just passed they have a provision for accelerated depression of 30 percent of any purchases.

And what that means is in addition to the depression schedules where you can write off your purchase of a horse, you could take off another 30 percent in the first year. The Senate's version is a 10 percent depreciation rate. It will probably end up closer to the Senate side, but again, that should be helpful to the sales companies as they try to bring new buyers in.

We continue to work on EPA regulations; Jay Hickey at the American Horse Council has really taken a lead on that. He and his team have done a remarkable job. There were some very potentially detrimental regulations that the EPA suggested this year on waste water runoff, and Jay has done a good job of responding to those; and we think that in the next six months we'll get them improved somewhat. They'll still probably be more restrictive than the current law, but better, definitely better than when they started.

Lastly, on immigration issues; we were making some headway on that issue, on basically loosening up

the current immigration laws to allow for better, more year around labor for farms and tracks.

Because of September 11th, loosening up of the immigration laws is not too high on anybody's radar screen right now, so I think you're going to — you're going to probably not see a whole lot of action over the next 12 months. But long-term we know that is a priority for the industry.

Consistent with being brief, I'll briefly talk about Phase Two, sort of the theme of today's presentation. As we continue to raise more and more money through the sales auction program, we spend that money. We spend it on the state level through contributions to candidates and campaigns, and on the federal level as well.

Yesterday at the NTRA board meeting we — the board voted to form an NTRA Political Committee, Political Action Committee Advisory Board, so we're going to now of the subcommittee of the NTRA board that's going to review each contribution. And I think — feel free to talk with your board representative on the NTRA board if you want more information or more input.

We're also, consistent with one of our pledges to Magna about 14 months ago, we're really trying to step up our efforts on the state level, that includes efforts in deregulation. This year we're really focusing in working closely with the flat tracks and horsemen on an omnibus deregulation bill in Florida.

And what that means is the NTRA, kind of by board policy, where all our members are in agreement on a particular issue, we will supply funding, we will supply lobbyists, we will testify, we will do what a good national trade association will do to improve the legislative situation in any state.

Similar initiative in this area we talked a lot about over the summer is tax takeout, not handle. Mike Shagan, who I think is here with us today, has been working closely as an NTRA consultant on that. Overall the concept is that racing is sort of unfairly taxed because it's taxed on — its really not taxed on its revenues, racing's revenues are the takeout and they're not the handle.

This initiative is included in the Florida bill right now; currently New York and Virginia are also looking at legislation this year in that area.

And lastly, this hasn't changed for two years, we're working closely with any state that doesn't have it to expand account wagering. We were privileged to be asked to come and assist the State of California in drafting their account wagering regulations. We will be doing the same thing in Massachusetts.

Any member who wants the — help in account wagering, we've got quite a database of what all the states have done. You can comment on any provision that's in any of the laws because we've studied it pretty closely for about three years.

Lastly, we've talked about in the past an NTRA Legislative Regulatory Task Force with a number of NTRA members on it. This was in 1997 originally formed to deal with the Kyl Bill. It's kind of gone into disuse, and we're going to jump start that again this year, hopefully with the American Horse Council. And you'll be hearing more about that.

I'll just close on the note that the increased legislative spending that we've talked about going from $900,000 this year to $1.8 million next year should allow us to do a lot more. I hope to be able to stand up here every December and announce, you know, major initiatives, major legislative wins like we had in the last year.
Thanks a lot.

(Applause)

MR. SMITH: I'd just like to ad lib two comments. I felt like I commuted to Washington in 2000 and sort of lived there, and in 2001 Greg Avioli is the guy that committed to Washington for the year, and

I think did a terrific job.

The second thing I'd like to ad lib is that, you know, it's a theme that I'll strike in the closing again this year, but a heck of a lot more is possible with collaboration and in numbers, and nothing you saw from Greg would have been accomplished and nothing in the future that we hope to do will get accomplished without our partners at the AQHA.

These issues don't stop at the dividing line of a breed, and indeed the legislative — restart of the legislative task force, probably do this an in alphabetical order, will be the AQHA-NTRA Legislative Task Force. So thanks, special thanks to them.

Well, as usual we've packed a lot into two hours or just under. Thank you for listening today, and for so many of you, looking around the room, for your multi-year steadfast support for the NTRA, and for what we're — what we've been trying to do together.

We're excited, as I hope you can tell, about 2002, about Phase Two. As you've heard, in several respects it will be different from Phase One and it — and it needs to be.

To be sure, there are a number of promising marketplace developments. Internet and account wagering, now clearly legal as a matter of federal law, and expressly so in California, by itself one of the world's largest economies.

The more positive reception by sponsors and networks of the Breeders' Cup, and as importantly, the multi-division, multi-month, multi-continent process that leads up to it, the growth of our political action budgets and capabilities, the NTRA's improved balance sheet and membership roster, long-term extensions of our agreements with NBC, ESPN, and others.

But to sustain this momentum, much less realize the full potential of Phase Two, we also need to be very clear-eyed, candid with each other, and realistic. It's terrific that the NTRA is now more firmly established and I think clearly viable for the long term. It's great that we now have more television, more sponsors, more and better research, increased promotion.

All of these are, to quote Martha Stewart I guess, "Good things," each is badly needed.

But they're not enough. Good television and good marketing will not by themselves provide the capital needed to rebuild our sports' physical plants, to add necessary new amenities, or to raise purses to the level needed to sustain our underlying agribusiness and breeding industries.

The truth is that we need considerably more marketing, more political and legislative spending, more improvement across the board in how we attract and retain customers, and how we deliver our product to them.

This reality also means that new revenue sources and thus even more progress in improving government understanding of our complicated multi-dimensional industry must be pursued and it must be achieved. No one source is a silver bullet, a panacea.

So the reality also is that we really don't have any choice but to rally together as an industry as never before if we want to prosper, and as long as we're being candid and tough-minded, if we want to survive.

If we want to survive for the 472,000 people who make their livings in this industry, for the RTIP students, for the children and grandchildren of owners and breeders who want to continue in this game and continue in this way of life, and for our millions of avid fans.

What does it mean for us? For the NTRA it means firmly rejecting the temptation to become complacent, to avoid confusing a somewhat improved balance sheet with success. Because success needs to be defined not in trade association terms but as doing something really meaningful and

measurable to improve the economics of the industry, which is, of course as we mentioned, our core mission.

For the industry, it means working together on common problems, hard as that may be. And most importantly of all, to me, maintaining the necessary sense of urgency. Overall, I'm optimistic. I think as we've shown this year, this is an industry that can get amazing things done when awakened and motivated, when differences in agendas are set aside for a common purpose.

The NTRA, thanks to the renewed commitments of our members, is in a better position to help tackle these challenges, the challenges of Phase Two. Certainly a better position than a year ago and really, I think, than ever before.

So Phase Two is about a lot of things: More focus by all of us, a shorter list of priorities for the NTRA, new marketing opportunities based on improved insights, some of which you've heard today, on the attitudes and needs of our customers and potential customers; further changes for the Breeders' Cup, continuing to make the world's best day of racing better understood by a wider audience; strengthen political resources and capabilities, better use of the Internet.

But Phase Two is equally about building renewed commitment to each other and to a renewed, sustained sense of urgency about tackling these common problems. So welcome to Phase Two. I hope you've enjoyed this preview, thanks again for having us; thanks again for your support of the NTRA. Thank you.

(Applause)

It's been a great week and as usual, we'll leave you with a brief video which captures, better than D.G. and I can describe, what a special day it was on October 27th.

(Applause)
(A tape was played)

WEDNESDAY December 5, 2001	THURSDAY December 6, 2001	FRIDAY December 7, 2001
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