

Testimony of Frank J. Fahrenkopf, Jr.
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Mr. Chairman, distinguished members of the committee, thank you for inviting me to testify today about the American Gaming Association's position on Internet gambling.

I am Frank J. Fahrenkopf, Jr., president and CEO of the American Gaming Association (AGA). The AGA is the national trade association of commercial casino companies, gaming equipment manufacturers, and other vendor-suppliers to the gaming industry. The association acts as a national clearinghouse for information about commercial casinos and as an advocate on federal and national issues for those it represents, including tens of millions of employees, patrons and shareholders. Other trade associations represent Native American casinos, the lotteries, the pari-mutuel industry, and other legal gaming entities. Our members are the companies with household names such as Harrah's, MGM MIRAGE and Park Place Entertainment. They operate land-based and riverboat casinos in 11 states across the country.

On behalf of the AGA, I appreciate this opportunity to address the topic of Internet gaming given the spread of e-commerce generally, the rapid rise in the number of Internet gambling sites and the concern that unregulated offshore Internet gaming sites now in operation circumvent state laws.

Some (particularly those now in the business of taking bets and wagers over the Internet or those with libertarian political views) argue that Internet gambling is no different from other forms of electronic commerce and that prohibition is impossible. However, consideration of questions about Internet gambling must be viewed in light of the nature of gaming and how decisions about public policy issues concerning legal wagering have been handled since the founding of the country and should continue to be resolved going forward.

As even the National Gambling Impact Study Commission reaffirmed in its final report in 1999, except for certain limited areas such as Internet gambling and Native American gaming, states (not the federal government) should decide whether to permit legal wagers by persons within their states, and if so, how to license those in the wagering business and how to tax and regulate their operations.

As we know, different states have decidedly different policies toward legal gambling, even among states that permit the same general type of legal wagering. For example, while all but three states (Hawaii, Tennessee, and Utah) have some form of legal wagering, and, as I indicated earlier, only 11 states have authorized commercial casinos and only one state has legal wagering on sports (other than horse and dog racing). Thus, unlike the use of the Internet to purchase a book, make a travel reservation, or even buy or sell stocks and bonds — all of which are legal transactions in each of the 50 states — the same is not true for each of the various forms of legal wagering.

As a result, our major concern with Internet gambling as it exists today is that it allows offshore of Web sites that accept bets and wagers to frustrate important state policies, including restrictions on the availability of gaming within each state. Similarly, unregulated Internet gambling that exists today allows an unlicensed, untaxed, unsupervised operator to engage in wagering that is otherwise subject to stringent federal and state regulatory controls. These controls are vital to preserving the honesty, integrity and fairness that those in the gaming industry today have worked so hard for so long to bring about.

According to published reports, confirmed by the casual use of any Internet search engine or the review of many publications catering to gaming patrons, there are over a thousand Web sites that accept bets and wagers, even from U.S. residents in states where such wagering is illegal. To the best of my knowledge, the most popular are, first, those that accept bets and wagers on the outcome of sporting events, and second, those that offer so-called cyber versions of casino-style games, such as slot machines, blackjack, craps and baccarat.

Sports betting is probably the most popular form of Internet gambling because unlike casino-style games over the Internet, the correct outcome of the wager can be determined by an independent event, namely the publicly available score of the game. However, the Internet allows U.S. citizens to place bets on sporting events in all 50 states, the District of Columbia, and U.S. possessions, even though Congress banned such wagering in the Professional and Amateur Sports Protection Act of 1992 (except in states such as Nevada, where sports wagering was expressly grandfathered, as it was already legal and carefully regulated at the time of the 1992 Act.)

Even in the 11 states where commercial casinos are legal, they are not permitted to operate without prior state approval, including exhaustive background checks on major investors and key personnel. Some states do the same for major vendor-suppliers. Each state with commercial casinos considers their operation to be a privilege and not a matter of right. Most states with commercial casinos only permit them in certain designated counties or other geographically limited areas, often by decisions of local voters in a referendum. Thus, New Jersey has commercial casinos, but only in Atlantic City. Mississippi has commercial casinos, but only in those counties where it has been approved by voters, such as near Tunica in northwest Mississippi or along the state's Gulf Coast. Some states do not limit the number of licenses within those areas where casinos are legal, such as Mississippi, while others such as Illinois, Indiana and Louisiana have a statewide cap on the number of commercial casino licenses to be issued.

As with sports wagering, the existence of the Internet in its present form permits wagers to be placed outside of those areas where state and local decision makers have made it legal to do so. In addition to allowing players to place bets and wagers outside of the bounds of state limitations, the Internet at present allows persons to engage in the business of taking bets and wagers without complying with the extensive licensing and operational regulations imposed by states to protect the public and the integrity of the games.

The importance of this concern cannot be overstated. As the U.S. Department of Justice has stated before the U.S. Congress on several occasions, the law should treat physical world activity

and cyber activity over the Internet in the same manner, whether when it comes to gambling or otherwise. As the Department pointed out to the Senate Indian Affairs Committee on June 9, 1999, “If activity is prohibited in the physical world but not on the Internet, the Internet will become a safe haven for that criminal activity.” Accordingly, the Justice Department has joined the National Association of Attorneys General in supporting efforts to amend federal gambling statutes to ensure that emerging technologies are not allowed to make legal in the cyber world what is already illegal if conducted over the telephone or in person at the corner tavern.

In addition to state-level restrictions on where legal wagering may take place, and extensive licensure and regulation of those who may engage in the business of taking legal wagers, there are important federal requirements applicable to commercial casinos and other forms of legal wagering. For example, U.S. commercial casinos are subject to federal corporate taxation, publicly traded companies comply with financial disclosure and other Securities and Exchange Commission rules, casinos file information reports on larger winnings with the IRS and withhold federal taxes on certain winnings, and casinos adhere to anti-money laundering statutes and regulations administered by the U.S. Treasury Department’s Financial Crimes Enforcement Network. By contrast, those engaged in the business of illegal Internet wagering in the U.S. from offshore are not subject to U.S. law enforcement jurisdiction on these important matters of public administration.

There are those who claim that, even taking all of the above to be true, there is nothing that can be done to prevent the circumvention of federal and state law by offshore Internet gambling sites. However, this is not the first time that technology has threatened to allow persons to evade and avoid federal deference to state choices about the availability of legal wagering and how it is conducted. With respect to the telephone, the Wire Communications Act has been on the books since the early 1960s to prevent the use of the wires by a person in the business of betting or wagering to place or receive bets or wagers, or to transmit information assisting in the placing of such bets or wagers.

The previous U.S. Justice Department believed that “much of Internet gambling is already prohibited under existing laws,” including the Wire Act. However, the statute as written in 1961 could be interpreted as applying only to sports wagering, calling into question its applicability to other types of wagers, and by its terms only to the use of a “wire communication facility.” While most Internet transmissions presently use a “wire communication facility” at one or more steps along the way, the emerging technology of satellite transmissions and other interactive technologies might be interpreted as operating outside of the “wire communication facility” covered by existing law. Thus, ever since legislation to amend the Wire Communications Act in response to the Internet was first introduced in 1995, its sponsors have argued that it is merely designed to update federal statutes to preserve the same federal “back stop” of state decisions about legal wagering that has existed for decades.

In addition to a conflict between Internet gambling as we know it today and the traditional and well-founded approach of state regulation of legal wagering, it is important not to lose sight of why states that have legalized wagering have elected to do so. There are compelling positive economic benefits from various forms of legal wagering, including commercial casinos. This conclusion is also shared by the final report of the National Gambling Impact Study Commission

and the independent research it has produced, including a report by Professor Adam Rose of Penn State University on the economic impacts of legal gambling.

However, unlike the highly capital-intensive and labor-intensive forms of wagering in the physical world, such as those associated with casinos and pari-mutuel facilities, Internet gambling sites are very low in both capital investment and on-going demand for labor. Similarly, all forms of legal wagering produce significant tax revenues to federal, state and local governments for important public purposes, such as education, community development and benefits to special populations such as the elderly.

At this point, let me hasten to add that, despite the best efforts of some to argue the contrary, the commercial casino industry is not concerned about Internet gambling because we are worried about the supposed competition from Internet gambling sites. First, were Internet gambling to be made legal, the well-branded casino companies would be well-positioned to garner the major share of the market. Second, and perhaps more important in today's world, there is no comparison between the social-oriented, group-oriented entertainment experience of visiting a casino resort and the solitary experience of placing a bet or wager using a personal computer. Third, today's casino entertainment experience is about much more than legal wagering opportunities: whether measured by how people spend their time or how they spend their dollars, guests of U.S. commercial casinos are increasingly attracted as much or more by restaurants, shows, retail, recreation, and other non-gaming amenities. The fact that Internet gambling is not a competitive threat to U.S. commercial casinos is publicly shared by financial analysts at major Wall Street firms, whose job it is to analyze the competitive impact of market developments on the industries and firms they cover, including the major publicly-traded gaming companies AGA represents.

While the American Gaming Association could support appropriately drafted legislation to update federal statutes to preserve the traditional policy of state regulation, it is important to define key terms to be certain that we are all on the same song sheet as to what is meant by "Internet gambling." As discussed in this statement, "Internet gambling" refers to the use of the World Wide Web and other technologies by businesses to engage in wagering.

By contrast, new technologies, some involving the Internet and others involving non-Internet interactive computers, are in use or will soon be in use by licensed, regulated, legal gaming companies within the jurisdictions where they are permitted to operate under federal and state law. Examples include common pool wagering (where pari-mutuel wagers are pooled between a casino or other off-track betting facility and the track where the race is physically conducted); interactive computer systems; and the use of the World Wide Web to advertise and promote casino resort locations, including the taking of reservations for rooms and shows, without the use of the Internet for betting or wagering. Additional examples include new technology to facilitate and actually safeguard the operation of intrastate account wagering on sporting events.

In short, any changes to federal or state laws in the pursuit of making "Internet gambling" illegal, need not and should not be drawn so broadly as to lump the use of technology within otherwise legal limits in the same prohibited status as those who are doing so outside state law. This position is consistent with the policy of the Wire Communications Act, which, since the 1960s,

permits the use of the wires for wagers and information assisting in the placing of wagers where the transactions are entirely intrastate or between states in which the wagering in question is legal.

In other words, there is a difference between using technology to circumvent federal and state restrictions and regulations (as is done today by those operating offshore Internet gambling sites) and the use of technology by licensed operators to more efficiently deliver their services where, to whom, and under what conditions they are authorized by federal and state law to do so.

There are clearly understandable enforcement concerns, just as there are with most pieces of federal legislation that attempt to address the potential activities of millions of people. However, at this juncture, the choice is between sanctioning illegal Internet gambling by default, or carefully crafting amendments to update the Wire Act to prevent the circumvention of federal and state regulation of gaming activities. The latter course will allow state and local governments to retain their right to set policy and enforce state law for gaming activities by persons within their boundaries, both those in the business of betting and wagering, and for the protection of those individuals who choose to place bets or wagers.

When properly regulated, casino gaming and other forms of legal wagering are an enjoyable entertainment option for the vast majority of the American people. However, we know from the colorful history of wagering in America, from the lotteries of the last century to the operation of casinos before they were taken over by publicly held companies in this century, that unregulated, illegal wagering, if left unchecked, will lead to fraud and abuse given the sums of money involved. The Internet is a new and exciting vehicle, as was the telephone before it, but we lose sight of the importance of well-regulated gaming, supervised at the state level, at our peril.

The commercial casino industry's position on this issue has become somewhat obscured in recent months with the passage of Internet gambling legislation by the state of Nevada. Headlines in *The New York Times*, which said "Nevada Legalizes Internet Gambling," not only misrepresented our industry's position, but also misrepresented the content of the Nevada bill. I'd like to take a few minutes and explain to you what, in fact, this legislation does. The legislation authorizes the Nevada Gaming Commission, the state body that sets regulatory policy, to promulgate regulations IF — and that's a big IF — certain conditions can be met: 1) The state must be in compliance with all federal laws; 2) There must be an effective way to restrict access to those under age 21; 3) There must be an effective way to restrict access to only those residing in jurisdictions that permit Internet gambling; and 4) It must be determined that Internet gambling promotes the general welfare of the state.

The legislation also establishes a licensing framework similar to the stringent requirements already in place to acquire a casino operators' license. Only existing Nevada licensees will be eligible to become licensed Internet gambling operators. There are other requirements, depending on the location of the establishment within the state, that require existing licensees to have either a resort-hotel, a certain number of rooms or seats or have held a license for at least five years. Each licensee would be required to pay a fee of \$500,000 for the first two years, in addition to a renewal fee of \$250,000 a year. In addition, each operator would be required to pay a 6.25 percent tax on gross gaming revenue. The same licensing requirements would apply to

equipment manufacturers and suppliers. Any operators who create a site without the proper license will be subject to felony prosecution.

While they're not spelled out in the legislation, other factors will be considered by the Nevada Gaming Commission to provide additional safeguards for customers who might not be able to gamble responsibly. The commission will ensure self-exclusion for individuals who want to prevent their access. It will also establish betting limits and time limits that would apply to not just one site but across all Nevada Internet gambling sites.

These requirements make what Nevada is exploring very different from what is currently being conducted by offshore operators. As Brian Sandoval, chairman of the Nevada Gaming Commission, said, "This is not going to be the Oklahoma Rush" — although some Internet gambling supporters were hoping that would be the case. As stated explicitly in the legislation, Nevada is not seeking in any way to defy the federal government. In the coming months, after a thorough legal analysis, the Nevada Gaming Commission will be seeking a meeting with the U.S. attorney general to discuss the legality of Internet gambling as set forth by this legislation.

With 1,800 sites worldwide, generating between \$3 billion and \$4 billion annually, Internet gambling is growing by leaps and bounds. But this illegal activity remains largely unregulated. As the world leader in the gaming industry, Nevada believes it has the responsibility to step forward and act to determine what current and future regulatory actions might be taken regarding Internet gambling.

The AGA's role, meanwhile, is to keep our members informed of the latest developments on Internet gambling as a means of setting the association's policies. As recently as May of this year, the board of the AGA indicated by consensus that we would continue to oppose unregulated Internet gambling because we believe the technology does not currently exist to prevent underage gambling, to protect against pathological gambling, and to permit the strict regulation and law enforcement oversight required for integrity.

Thank you again for the opportunity to discuss our views on questions surrounding Internet gaming. I would be pleased to answer any questions you may have on this matter.