

Casino in a Box – By Matthew Kirsch

Do you like the lights, the thousands of flashing, glowing, glittering bright lights? Do you dig the mirrored walls? The complete lack of exit signs, and clocks? Do the incessant sounds of bells, the clanging of coins on metal, the mechanical whistles and sirens really rev you up? How about the smell of smoke, and the cool taste of watered down well drinks? Do these things make your heart beat harder, your blood run faster, your brain race?

Or is it really just the bet? The captivating, palpable, awesome tension as you wait for the next card, wait for the wheels to stop spinning, wait for the ball to find its resting place, wait for the dice to stop rolling? Isn't it really just the betting that you love? Come on, you're a gambler, betting is what you do.

And now, thanks to the Internet, you can bet 24 hours a day, seven days a week, from the comfort of your own home, on your very own personal computer. Online gambling is here, and from all signs, it's here to stay. Numerous estimates have the number of websites that offer online betting and gambling at well over 800. Only two years ago, this number was thought to be around 250, and in 1997 there were only 40 such sites.¹ And with new sites popping up virtually every day, who knows how many will be online next year.

The Online Gambling Industry

Online gambling reminds me of an elementary school joke I remember: "How do you know if an elephant has been in your refrigerator? Footprints in the Jello." It might be hard to actually catch the elephant in the act of raiding the fridge, but those darn footprints sure do give him

away. Online gambling is much the same: the footprint is clear, as sites are everywhere, but finding the actual animal is much tougher. Online gambling is unregulated, at least by the United States government, and is, most agree, illegal in the U.S. For this reason, e-gaming companies have located themselves in places like Costa Rica, Antigua and other Caribbean islands, and more recently Australia. Monte Carlo and South Africa are reported to be close behind.ⁱⁱ The fact that almost anyone with about \$25 grand for a software package and a few servers can open a cyber casino is both wonderful and frightening. Of course, different countries charge differing amounts in licensing fees and such to operate an online gambling operation. Antigua, for instance, charges a firm \$100,000 annually for an operating license, while Costa Rica has yet to charge a dime to any company.ⁱⁱⁱ Further, virtually all countries open to online gambling companies have liberal, or non-existent, tax laws.

Supply or If You Build It, They Will Come

A site which offers some form of online gambling, whether it be betting on sports, horse races, or casino-style games, can be found at nearly any and every conceivable variation of “casino,” “sportsbook,” or “onlinegambling”.com. A search for “online gambling sites” conducted at Google recently returned well over a quarter of a million responses. You say you like country music? Check out KennyRogersCasino.com. You wish you could get a date? Type in SinglesCasino.com. There truly is something for everyone in online gambling. In fact, some companies run multiple websites,^{iv} presumably to maximize their shares of the market. In some cases, this strategy is transparent, as a hub website allows links to numerous, differently themed, casinos. In other cases, it is only through reading a lot of fine print that one can identify multiple sites as being operated by one owner.

The issue of regulation is, of course, no small one. Consumers like to know that they are getting what they pay for, and that there is someone out there ensuring, for instance, that the meat-packing plants have had their equipment inspected, or that the airplane they're on has been carefully maintained. Likewise, regulation of the Internet gambling would no doubt increase consumer confidence. To this end, a number of regulatory, or "watchdog," groups have popped up on the web to help manage the explosion of websites.

Industry "Watchdogs"

SafeBet – safebet.org

Ethical Online Gaming Association - eoga.com

Offshore Gaming Association – osga.com

Electronic Gaming Commission – egamingcommission.com

Internet Gaming Commission - internetcommission.com

With the exception of SafeBet, whose address is some proof of its non-profit status, all the groups that I was able to find are presumably for profit and most likely linked to companies with interests in this sector, such as the casinos themselves or various support companies such as software developers or transaction facilitators. SafeBet, based in Atlanta, Georgia and founded in 1998, offers three levels of certification to websites, based on their "Standards of Fairness." All of these organizations provide dispute resolution functions, in addition to offering codes of ethics or fairness. While all claim to be "independent," the Ethical Online Gaming Association, the Offshore Gaming Association and the Electronic Gaming Commission all accept money from sites to be accredited. Further, one finds a significant number of advertisements for gaming sites, as well as "helpful" information on how to gamble online, thus bringing into question their independence. The Internet Gaming Commission is devoid of all advertising and claims to accept no money from gambling websites, though "real Casino and Sportsbook players" can

become members for \$10, and by doing so receive access to the organizations useful content and such things as free email. It is telling that The Internet Gaming Commission is also an American company. It was impossible to find any contact information for the other three organizations, even further impugning their credibility.^v Countless other organizations, websites really, offer portal functionality and bill themselves as casino hubs or gambling supersites. They list a number of “member” or “approved” websites and also provide a variety of content related to online gambling.

Another significant aspect of the online gambling industry is the software that allows the gaming sites to operate. Needless to say, this is itself an industry, and one that is exploding right along side of the gambling websites, if not a bit ahead of them. The fact is that with the right software, and the leasing of some not-so-nice office space in Antigua, one person can become a casino company over the course of a couple of hours. While there are reports of dozens of software providers, only five leading companies could be confidently identified in this sector.^{vi} They are:

Software Providers

CryptoLogic, Inc. – cryptologic.com

Boss Media – bossmedia.se

Starnet Communications International, Inc. – starnetc.com

MicroGaming – microgaming.com

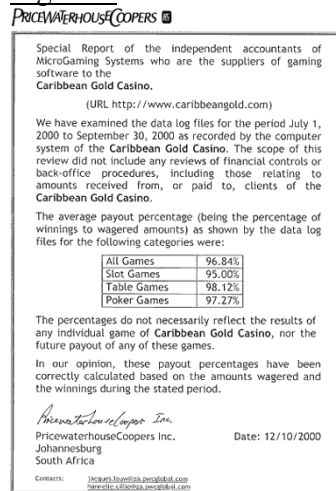
Chartwell Technologies, Inc.– chartwelltechnologies.com

The problem with locating other companies comes down to the simple fact that any search which mentions “gambling” and “software” turns up every casino on earth, as each casino offers its users downloadable software to improve the gambling experience. These five, however, seem typical of what is available to eager entrepreneurs and established companies alike. All companies offer casino-style game products and packages, which are the driving force of these

sites. Also, one can purchase software that enables sports and other event betting. At least two of the companies listed also offer software that facilitates and/or tracks financial transactions (eCash from Cryptologic; CyberBanx from Chartwell). Three of the listed companies are publicly held, one on our very own Nasdaq exchange (Cryptologic, under CRYP). A few of the online gambling companies are also publicly held, in countries outside of the United States, though the majority appears to be privately held companies.

Despite the proliferation of online gambling sites, I came across no accusations of criminal behavior from any online sportsbook or casino. Certainly the issues of credibility, trust, and legitimacy are paramount online. Indeed, there are mentions of casinos suddenly shutting down, and not returning customers' deposits, which are certainly believable given the ease in which a person can open a casino. The issue of a casino's motivation to deceive will be addressed later, but there is some real evidence that casino's will take steps to verify their integrity. A casino, CaribbeanGold.com, underwent an audit by the reputable firm of PriceWaterhouseCoopers, in order to verify its payout rates, and thus ensure that its electronic games obeyed odds consistent with their physical counterparts in places like Las Vegas. Figure 2 below is a copy of this audit.

Figure 1



Demand or Hey Buddy, Can You Spare a Dime?

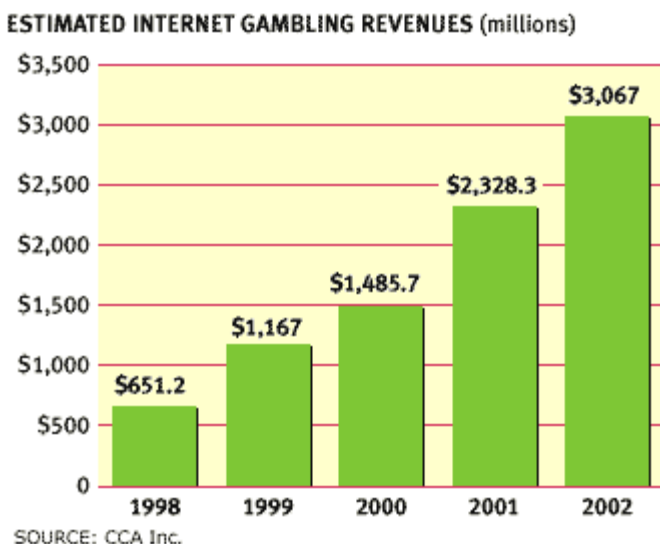
Given a fragmented industry, with no centralized regulation or oversight and no reporting laws, with companies in dozens of countries, and all access to products obtained over the Internet, it is an understatement to say that it is difficult to gather accurate information on usage. The few sources most often cited are at best somewhat questionable. Access to these sources methodologies, for instance, is non-existent. So we are left with estimates.

One company, Cyber Dialogue, is primarily a provider of CRM (Customer Relationship Management) technology, but also conducts research to complement its products. Cyber Dialogue estimates that 60 million of 75 million online users in the first quarter of 2000 sought out entertainment on the web. Of these 60 million, a little over 5 million participated in online gambling.^{vii} The Pew Internet & American Life Project found that 1 million Americans gamble online every day, and that 4.5 million Americans – about 5% with access to the Internet – have at some time gambled online.^{viii} The Pew numbers come from written surveys and phone interviews, and the Pew Trusts certainly qualifies as a reputable source. Cyber Dialogue seems to support the Pew estimate of almost 5 million Americans who have gambled on the web.

There are also revenue projections out there for online gambling, which are inherently dependent on assumptions about number of online gamblers. One projection that has been cited in at least a dozen articles, from a Bear, Stearns & Co. press release to an MSNBC article, is that online gambling sites are expected to take in nearly \$1.5 billion this year, and \$3 billion by 2002 (see Figure 1 below). These two numbers, it seems, all come from one source: A joint report from The River City Group and Christiansen Capital Advisors (CCA). In fact, Sebastian Sinclair, a

gaming analyst with Christiansen, is probably the most often quoted experts in this area. In a *Wall Street Journal* article, he was quoted as estimating that Americans wagered over \$9 billion online last year, and that he expects that number to triple by next year,^{ix} and in a *Business 2.0* article, he is credited with estimating that 80% of Internet gamblers are from the United States.^x

Figure 2



It doesn't take even an inexperienced researcher too long at any of these organizations' various websites (christiansencapital.com; rivercitygroup.com) to recognize that these are not necessarily the final word in revenue projection, or at least they shouldn't be. Besides that both groups are clearly heavily involved in the online gaming industry, neither group makes it entirely clear where they get their numbers. That withstanding, they do appear to be the leaders in the industry, or at least the most commonly followed.

Two sources cite that consumers spent over \$58 billion on legal gambling in 1999. Christiansen claims "that is more than they spent on movie tickets, recorded music, theme parks, spectator

sports and video games combined.” Of further interest is the Department of Justice’s estimate that Americans spent over \$30 billion in illegal betting.^{xi}

The Legal Arena or I Fought the Law, and the Law Won

Given that such a large percentage of the online gambling population is American (probably), and that the revenue numbers are attractive, isn’t it reasonable to assume that companies will soon be able to operate right here in the good old U.S. of A.? The frustrating answer, as it is for so many questions related to online gambling, is, “Maybe.” Online gambling is currently considered by many to be illegal in the United States under the 1961 Federal Interstate Wire Act, a federal law aimed at organized crime that sought to prohibit betting on sports using the “wires,” or telephones. That this law is a bit outdated goes without question, but it is apparently enough to have scared all the gambling companies out of the States. The states themselves have used various laws outlawing gambling practices and businesses, as well as consumer protection laws, to prohibit online gambling, but the states seem to be looking to the Feds to give them direction. After all, the Internet transcends any one state’s boundaries. On behalf of the government, U. S. Attorney General Janet Reno has been quoted in numerous articles, dating back to early 1998, as having said, "The Internet is not an electronic sanctuary for illegal betting. It's a federal crime to use the Internet to conduct betting operations, and to Internet betting operators everywhere, we have a simple message: You can't hide online and you can't hide offshore."

Pretty tough talk to be sure, and given the timing, I’d say it worked pretty well. It also probably helped that her announcement came on the eve of the only federal indictment for Internet

gambling of which I could find any evidence. Jay Cohen was indicted in March of 1998, convicted February 28, 2000, and sentenced, finally, in August of 2000. Mr. Cohen operated the World Sports Exchange, a gambling website in Antigua, and was sentenced to 21 months in federal prison and fined \$5,000 for accepting bets from Americans. He is appealing. Besides this case, the courts are pretty much empty of any online gambling related cases.

In other legal news, way back in 1997, the Republican Senator from Arizona, John Kyl, introduced and sponsored the Internet Gambling Prohibition Act, which would tighten up weak spots in the 1961 Wire Act, and clearly make online gambling illegal. Further, it would require Internet service providers to cut off access to Web sites that offer gaming once ISPs find out about them. It also would make it a misdemeanor to place a bet over the Internet and a felony to accept a wager. The bill was supported by, among others, the state attorneys-general, most American sporting leagues, consumer advocate and presidential candidate Ralph Nader, ex-head of the Christian Coalition Ralph Reed, and various large, brick and mortar casino companies: a motley and assorted crowd to be sure. Although the Senate passed the bill 90-10 in 1999, it was rejected in the House in July, 2000 by a vote of 245-159, a mere 25 votes shy of the 270 needed for passage.

I'm not sure which is more striking, that over these three years, nothing has legally changed in this country regarding online gambling, or that during the same time the industry has absolutely exploded, and no American company is getting in on the action.

All-In or You Can't Stop Them, You Can Only Hope to Contain Them, and You Probably Can't Even Do That, To Be Honest

I'm certainly convinced that online gambling is here to stay, regardless of any law passed anywhere. If the Internet has proved one thing it is that people will spend money on what they want to spend money on, even if it doesn't make any sense to the rest of us. Just ask the hundreds of venture capitalists that having been taking a bath since last April market drop began an ongoing mega-correction. It's pretty simple really: Americans have demonstrated a love of gambling, a love of the Internet, and God knows we love to spend money. While Kyl's bill seeks to reduce both supply and demand, I doubt that the government is going to come to my house to slap me with a misdemeanor for betting on my Miami Dolphins in this year's NFL playoffs, or that ISP's would ever agree to a very time-consuming and expensive process of weeding out their customers who offer gambling. And with the advent of strong encryption software and Secure Socket Layers (SSL), detection becomes a much more difficult task. Kyl's bill just doesn't make sense; it's not realistic or reasonable. If you try to shut them down, then they'll simply have to go Napster on you.

And the hypocrisy of the same government that happily rakes in literally billions of state-run lottery dollars, mainly from its poorer citizens I might add, to tell us that we can't gamble online! I'm getting angry. Don't tell us that we can't do what **you** do, and that we can't do what a lot of **us** are currently doing in Las Vegas, Atlantic City, and dozens of Indian Reservations every day. Give me a break! If the idea is to legislate morality, that stinks too. Oh, but it worked so well with Prohibition in the 1920's. Yeah. Right.

And if the argument rests on the difficulty with regulating online gambling, that's weak too. Auditing software, electronic spot-checks, inspection of computer codes, professional audits using actuarial tables, strict minimum standards of operation, and a much greater house control over cheating lead to safer gambling, not more riskier. Heck, online casinos can identify problem gamblers, through the use of ever more sophisticated data tracking technology, much more easily than can brick and mortar casinos. Further, technology is rapidly allowing us to control who enters websites (to avoid letting children gamble, for instance) and it has become fact that financial transactions are safe over the web. If the government would allow online gambling companies to operate legally in the U.S., not only could they regulate the companies, thus protecting the citizenry, but the government could also tax them. Let's see, what the tax on \$3 billion dollars? I'm not sure, but I think it's more than zero. Look, I know that gambling is controversial, and I admit that \$3 billion (by 2003, and if that number isn't inflated) is a lot of money, but it's a drop in the bucket when compared to other commerce activities on the web in the brick and mortar world too. The tobacco industry, for instance, will rake in over \$140 billion this year. I would think Janet Reno would be busy enough making sure they're behaving that she wouldn't have time to shut down some Vegas dropouts living in a small office on the tiny island of St. Kitts.

ⁱ Marci McDonald, "Betting the House: Online Gambling Proves Addictive," *U.S. News & World Report*, October 16, 2000; Bill Rabinowitz, "A Lonely Gamble," *The Columbus Dispatch*, October 29, 2000; Angie Wagner, City Might Get Involved in Internet Gambling Site, *Associated Press*, October 31, 2000.

ⁱⁱ Marci McDonald, "Betting the House: Online Gambling Proves Addictive," *U.S. News & World Report*, October 16, 2000.

ⁱⁱⁱ Staff writer, "Costa Rica, Seeking High-Tech Business, Becomes Home to Web Gambling Firms," *The Wall Street Journal*, October 23, 2000.

^{iv} Chris Allbritton, "A Not-So-Safe Bet," *The New York Daily News*, September 3, 2000.

^v All of the information in this paragraph was gathered by the writer through the websites cited.

^{vi} Stephen Miles, Chartwell Bets Future on Casino Deal: Feds Soften on e-Gaming?," *The Financial Post*, November 7, 2000; Bill Rabinowitz, "A Lonely Gamble," *The Columbus Dispatch*, October 29, 2000.

^{vii} cyberdialogue.com, accessed December 3, 2000.

^{viii} Bill Rabinowitz, "A Lonely Gamble," *The Columbus Dispatch*, October 29, 2000; The Pew Internet & American Life Project website (www.pewinternet.org), accessed December 5, 2000.

^{ix} Michael Allen, "Offshore Sports Bookmakers Find Internet a Winner," *The Wall Street Journal*, August 4, 2000.

^x Elizabeth Hurt, "American Indians Eye the Internet for Casino Growth," *Business 2.0*, November 13, 2000.

^{xi} Chris Allbritton, "A Not-So-Safe Bet," *The New York Daily News*, September 3, 2000.