



A Hearing to Discuss the Future of Internet Poker in New York State

New York Senate Committee on Racing, Gaming
and Wagering

Kevin Cochran, Senior Legal Analyst

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A brief summary of regulatory approaches to online gaming in U.S. and European jurisdictions, key policy questions that may be considered as part of Internet gaming legislation and a forecast of the New York Internet poker market.

Mr. Chairman and members of the committee, my name is Kevin Cochran and I am a Senior Legal Analyst for Gambling Compliance, a subscription service that provides information on regulatory issues in gaming markets around the world. The purpose of my testimony is to update the committee on the status of online gaming in the United States and a few key international markets, the possible size of the New York Internet poker market and the licensing models that could be adopted, In addition, I will offer Gambling Compliance's views on how U.S. Internet gambling law and regulation will evolve in the near-to-medium term future, and highlight certain policy questions that you may wish to keep in mind should the state consider regulation of Internet gambling in future months.

Regulation in the United States and around the world

While not operating in the manner that gained major media, and federal agencies' attention in the 2000's, Internet gaming is happening.

Internationally, more than a dozen European countries, including the UK, Italy, France, Spain, Denmark and Belgium have legalized and regulated Internet gambling within their borders and a number of others are considering reforms. Meanwhile, Canadian lottery corporations in Quebec, British Columbia and Manitoba were joined by Ontario in 2015, to offer government-run online casinos.

While still in its infancy following the U.S. Department of Justice's advisory memorandum stating that the 1961 Wire Act applied only to sports betting, the rollout in the U.S. has been limited to three states (New Jersey, Nevada and Delaware) and the U.S. Virgin Islands.

Regulators from the three states where Internet gaming has gone live have gone on record as stating that operations so far are running smoothly and that geo-location safeguards and player protection measures put into place are working.

Additionally, three states are operating some form of Internet lottery sales, with a fourth state shutting down online sales a few weeks ago after the legislature prohibited the activity in 2015.

So far in 2015, 10 state legislatures and Congress are considering or have considered legislation that would legalize Internet gaming or Internet poker. At the federal level, one bill has been introduced in 2015 that would authorize states to participate in a nationwide regulatory regime for Internet poker, but has not advanced. Also this year, two pieces of legislation to ban Internet gambling throughout the country by amending the 1961 Wire Act have been introduced.

Of course, the Empire State is no stranger to debating expanded gambling issues, having approved commercial casino gambling a few years ago, and in 2015 allowing six of the states' nine racinos to offer video lottery games including elements of skill and player interaction.

Regulatory Models

As New York continues to evaluate online poker, perhaps the most important question for lawmakers is what kind of regulatory model the state should adopt.

There are at least three possible models to consider.

First, in Nevada and New Jersey, online gaming licenses are limited to the states' existing operators of land-based casinos, who run their own systems subject to the oversight of independent regulatory agencies.

The second model, adopted by Delaware, allows the state's lottery to procure and control a single Internet gaming platform that is offered on a white-label¹ basis to Delaware's land-based casinos who market games to consumers.

Finally, the third model is what has been proposed in Senator Bonacic's S 5302 — an open licensing scheme. This model is the one adopted by various western European countries which issue licenses directly to Internet gaming companies, without requiring any local partnerships with land-based operators or lotteries.

In choosing which regulatory model to pursue, it may be important to consider how each sector of the state's gambling industry fits into the puzzle, especially in New York, which boasts a strong lottery, racing industry, video lottery

¹ "White-label" refers to the ability to procure and control a single Internet gaming platform, on which Delaware's land-based casinos market games to consumers.

establishments, tribal casinos and the emerging commercial casinos that carry substantial investment requirements. Among other issues that have impeded progress on online poker in California, a major sticking point has been which of the state's gaming interests should be eligible for licensure.

Casino games or Poker only

The bill currently introduced to allow interactive gaming in New York would only allow poker. This is similar to Nevada's current operating model and the model being considered by California. However, as commercial casinos in the state commence operations, should New York also consider allowing casino-style games such as blackjack and slots, [which currently account for more than four-fifths of all Internet gaming revenue in New Jersey]?

Alternatively, the legislature could consider a broad authorization of online gaming and grant regulators the authority to set rules only for those specific games they consider appropriate. This is actually the route the Nevada legislators took.

The legislature could also consider allowing online poker and just a limited range of online casino products, excluding, for example, slots-style games. This approach has been taken by Italy and Spain in Europe.

Other Major Policy Issues to be Considered:

- Number of Licenses and License Fees (different markets have proven to only support a few poker operators).
- Taxation (the proposed 15 percent ranks on the higher side, although not quite as high as Pennsylvania where one proposal has proposed a 32 percent tax).
- Licensing and Suitability (treatment of "bad actors", licensing procedures for non-gaming technologies like identity-verification software and payment solutions, etc...).
- Player 'liquidity' and offshore competition (interstate agreements and the review by lawmakers and gaming regulators to apply existing state laws on

illegal gaming to the unregulated competition to help grow legal online gaming).

Market Update

Turning now to our market update.

From a revenue perspective, in 2014, national Internet gaming revenue — that is, the amount of revenue generated from Internet gaming activity in the three states where such gaming is operational — was approximately \$135m, with New Jersey accounting for roughly 91 percent of the national total. In 2015, we expect national Internet gaming revenue to rise to approximately \$160m, driven primarily by a 19 percent year-over-year increase in New Jersey Internet gaming revenue.

From a New York-only perspective, we expect the state's Internet poker market to generate revenue of \$122m in its first full year of operations, rising to \$164.1m in its fourth full year of operations. Our base-case estimates, meaning our middle-of-the-road estimates, assume that New York will not be as severely impacted by payment-processing issues as New Jersey, but that such issues will serve as a significant drag on the market's size in Year 1 before partially alleviating over time.

To put those figures in a New York-relevant perspective, we expect New York Internet poker revenue, at the market-maturity phase, to make up less than 5 percent of the state's overall gaming revenue mix, given that the state's lottery, commercial and Native American gaming activities currently generate more than \$7bn in gaming revenue, annually.

Moving Forward

Finally, moving forward, I wanted to provide a brief update on where, and when, Internet gaming is likely to expand. Between 2008 and 2013, the number of states considering legislation that would legalize Internet gaming or Internet poker, only, increased from two to 10. That increase was driven largely by the state budget-deficit crisis, which arose during and continued after the most recent recession.

Since 2013, the number of states considering legislation that would authorize Internet gaming or Internet poker, only, has settled at between nine and 10, annually. Of note, New York has considered legislation that would permit Internet poker, only, since 2014.

The four jurisdictions having already passed some form of Internet gaming enabling language form what we call Wave 1 of Internet gaming legalization in the U.S. In the 2015-2017 period, we expect there will be a second wave of such legalization, in which one of California or Pennsylvania are most likely to legalize Internet gaming, whether that be online casino games or online poker only. We, at GamblingCompliance, believe New York could potentially fit into the end of our second wave of online gaming authorizing states or be placed into the third wave of online gaming states, likely to legalize a form of online gaming by 2020.

Conclusion

To conclude, if New York continues to evaluate online gaming and considers allowing online poker, a regulatory model that fits the state must be chosen. This will likely require policy discussions similar to the expansion of land-based gaming, involving fundamental questions as to the economic and consumer-protection benefits of regulation versus any perceived negative social impacts.

But, New York is also a unique gaming, lending itself adaptable to different types of Internet gaming licensing schemes, particularly as it relates to online poker, due to its large population.

Once again, I thank you for this opportunity and welcome any questions you may have.