

PUBLIC ROUNDTABLE
ON
I-GAMING

Before the
Committee on Finance & Revenue
Council of the District of Columbia

The Honorable Jack Evans, Chairman

June 29, 2011
10:00 a.m.
John A. Wilson Building, Room 120



Testimony of
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Good morning, Chairman Evans and members of the Committee on Finance and Revenue. I am Natwar M. Gandhi, Chief Financial Officer of the District of Columbia. I am pleased to be here for the Committee's hearing to testify on i-Gaming.

Buddy Roogow, Executive Director of the Lottery, and Ridgely Bennett, Associate General Counsel, are here with me to answer any questions you may have relative to i-Gaming.

Definition of i-Gaming

i-Gaming in the District refers to games offered solely by the District of Columbia Lottery and Charitable Games Control Board (DCLB) on its website for adults aged 19 and over who access the website from within the jurisdictional boundaries of the District. Games may be offered on a free play or cash basis and may be based on chance or incorporate elements of skill.

Legislative History

The FY 2011 Supplemental Budget Support Act was introduced by Mayor Fenty on November 23rd, 2010. The Council added as a provision, the Lottery Modernization Act of 2010 (Title VII, Subtitle G). As stated above, this Act allows the DC Lottery and Charitable Games Board to offer games of skill and games of chance over the internet, only within the geographical limits of the District. As is required, on December 21, 2010, the OCFO's Office of Revenue Analysis produced a fiscal impact statement in which it identified issues that

should be considered when discussing this matter. These issues were outlined as follows:

1. Legal: There is no consensus on whether federal statutes on gambling would prevent the states and the District of Columbia from implementing online gaming.
2. Implementation: Intralot, the on-line gaming vendor, has implemented online gaming in other countries but lacks online gaming experience in the United States, where technical challenges of implementing at the state and local levels could be different from nationwide implementation.
3. Revenue forecast: FY 2011 estimates from i-Gaming would be negligible given that the implementation would take the bulk of the year. The Office of Revenue and Analysis estimates that revenues would be \$2.2 million in FY 2012, and approximately \$13 million over the four-year financial plan period. However, these estimates rely on aggregated data from global online gaming trends from a single source. Player level data and estimation methods are not publicly available. Therefore, the Office of Revenue Analysis does not have access to any other data for its usual checks on plausibility, reliability, or validity of the revenue estimates presented here. (See Attachment 1 for the full text of the Fiscal Impact Statement – the Lottery Modernization Act of 2010).

The Council approved the Supplemental Budget Support Act on December 21st, 2010 and it was signed by Mayor Gray on January 27th, 2011. The required thirty-day Congressional review ended on April 8th, 2011, and the Act became law.

Implementation Timeline

The timeline for implementation of i-Gaming is as follows:

- On or about July 26th the Free Play site will be operational and accessible through www.dclottery.com. Only two (2) games, Blackjack and Victory at Sea, will be available for play.
- On or about August 23rd the free site will be expanded to include Texas Hold-em Poker, Bingo, e-scratch and Random Number generated games. At this stage, all games will be directly accessed through the website, www.igamingdc.com. (See Attachment 2 for a complete description of the games offered)
- On or about September 8th, the free games will also be available for cash play on igamingdc.com

Requirements of Play (Free Play or Cash)

The DCLB will incorporate rigid requirements for play on its website whether play is free or for cash. These requirements include the following:

- a. Players must be 19 years of age or older
- b. All play must originate and end within the District's boundaries
- c. All play must be from a trusted Internet Provider address
- d. Player registration is required
- e. No anonymous play will be permitted

Location Verification

Location verification is a key component of the i-Gaming program. To ensure compliance with applicable federal law, all play must take place within the District.

The DCLB is working with DC Net to ensure all play does, in fact, originate within the District. DC Net is uniquely able to provide this service in a way not easily duplicated anywhere else within the U.S.

Financial Transactions

The Office of Finance and Treasury (OFT) will assist the DCLB in its efforts to launch the i-Gaming initiative. OFT is working with DCLB, the OCFO's Chief Risk Officer, and Wells Fargo, our bank representative, to determine the optimal method for providing secure payment processes and collections. At this time, due diligence is being performed to allow the launch of paid games in September.

Responsible Gaming Program

The DCLB is working with the National Council of Problem Gaming to provide the most robust and comprehensive responsible gaming program possible. The program will offer ways to identify play patterns that raise red flags and thus limits the potential financial exposure of players exhibiting particularly risky behavior in the following ways:

- Voluntary exclusion for those who seek to be excluded from play
- Player monitoring program

Revenue Projections

The Office of Revenue and Analysis (ORA) has developed revenue projections for i-Gaming for the fiscal years 2012, 2013, and 2014. For fiscal year 2012 the revenue is expected to total \$2.2 million; for FY 2013, \$4.4 million; and for FY 2014, \$6.5 million. The cumulative three-year total is approximately \$13 million. Full implementation is expected in FY 2015 and is projected to generation \$8.9 million per year.

CONCLUSION

This concludes my remarks. I would be pleased to answer any questions you may have.

Subtitle (VII)(G) – Lottery Modernization Act of 2010

Background

The proposed legislation would amend The Law to Legalize Lotteries, Daily Numbers Games and Bingo and Raffles for Charitable Purposes in the District of Columbia¹ to allow the District of Columbia Lottery and Charitable Games Control Board (“Lottery Board”) to offer games of skill and games of chance over the internet only within the geographical limits of the District of Columbia, provided that the ways in which such games were offered did not violate the Johnson Act² or any other federal statute.

According to the Lottery Board and Intralot, its contractor, if this proposal were enacted, the District would offer online poker games (cash poker games and tournaments), bingo games, and fantasy sports. Players could access these games from home or at approved hubs such as hotels, bars, and restaurants. In both cases, players would be required to use their own computers to participate in the games.

To comply with federal laws, the Lottery Board would be required to make online gaming available only within the geographical limits of the District of Columbia. According to Intralot, verification of player location would be done through Internet Protocol (IP) address checks.

Intralot expects to start offering games within four months of the enactment of the legislation, and expects to reach full implementation in four years.

Financial Plan Impact

Funds are sufficient in the FY 2011 through FY 2014 budget and financial plan to implement the proposed legislation. The proposed legislation would allow the District to collect revenues from online gaming implemented by the Lottery Board and Intralot. These programs could generate approximately \$13.1 million General Fund revenue in the FY 2011 through FY 2014 financial plan period.

While the proposed subtitle could result in additional revenue, there are three important caveats with respect to this estimate.

1. **Legal concerns:** No consensus exists on whether federal statutes on gambling would prevent the states and the District of Columbia from implementing online gaming.
2. **Implementation risk:** Intralot has implemented online gaming in other countries, and stands to gain from successful implementation. But the company lacks online gaming experience in the United States, where technical challenges of implementing at the state and local level could be different from full nationwide implementation.
3. **Lack of data:** Estimates for gross revenues and player winnings rely on aggregated data from global online gaming trends. Player level data and estimation methods are not

¹ Effective March 10, 1981 (D.C. Law 3-172, D.C. Official Code §§ 3-1301 – 133).

² Johnson Act (15 U.S.C. §§ 1171-1178) is the popular name of the Transportation of Gambling Devices Act of 1951 (Act of January 2, 1951, ch. 1194, § 1, 64 Stat. 1134), which prohibits the shipment of gambling devices to a state where such a device is prohibited by law.

publicly available. The Office of Revenue Analysis does not have access to any other data for checks on plausibility, reliability, or validity of the revenue estimates presented here.

These points are discussed more extensively following the revenue table.

The District could realize revenue from the implementation of online gaming in two ways. First, the Lottery Board has a 50-50 revenue sharing agreement with Intralot. The Lottery Board could transfer its portion of the gaming revenues,³ minus any associated marketing costs, to the General Fund. Second, the District could levy income taxes on the winnings of District residents.

The table below outlines the gross and net revenues that could be generated through online gaming. In FY 2011, the proposed programs are not expected to generate significant revenue. The Lottery Board’s projected revenues of approximately \$400,000 would be mostly spent on marketing the new games. Income taxes levied of the winnings of DC residents would not be collected until the next fiscal year.

In subsequent years, the market could grow quickly if implementation goes in accordance with Intralot’s plans and the proposed legislation could generate \$13.1 million in revenues in the FY 2011 through FY 2014 financial plan period. This estimate assumes that all federal and legal hurdles are cleared, and the District faces no significant market competition.

Lottery Modernization Act of 2010 - Estimated Net Revenue Impact ¹					
(in thousands of dollars)					
	FY 2011	FY 2012	FY 2013	FY 2014	Four Year Total
Gross Revenue from Gaming ²	\$815	\$5,381	\$8,494	\$11,810	\$26,500
Lottery Board Share (50%)	\$407	\$2,691	\$4,247	\$5,905	\$13,250
Marketing Costs	(\$400)	(\$750)	(\$750)	(\$750)	(\$2,650)
Transfer to General Fund	\$7	\$1,941	\$3,497	\$5,155	\$10,600
Income tax on winnings (DC residents only) ^{4,5}	\$0	\$274	\$889	\$1,320	\$2,483
Revenue Impact	\$7	\$2,215	\$4,386	\$6,475	\$13,083

Table Notes

¹Estimate assumes all federal and legal hurdles are cleared, and the District faces no significant market competition.

²Estimate based on data from H2 Gambling Capital of revenue generated by U.S. offshore players in 2009, adjusted for implementation plan. The legislation is assumed to be in place in January 2011, and Intralot is assumed to deploy games by the end of April 2011. The customer base growth is projected based on the experience in and customer data from Italy, where Intralot implemented online gaming.

³In FY 2011, marketing costs could exceed the revenues to the Lottery Board. It is assumed that the Lottery Board would share some of the costs with the contractor to eliminate any negative impact.

⁴Taxing of winnings would be similar to taxing of lottery winnings in the District. Currently only DC residents pay income taxes on lottery earnings to the District of Columbia government. Income taxes for winnings in a given calendar year would be collected the next fiscal year. Tax collection estimated at 6.6 percent of total winnings—the estimated effective income tax rate for the District.

⁵ Estimate based on data from H2 Gambling Capital of total winnings of potential player winnings (not including sports betting) under a regulated U.S. market.

³ Gaming revenues, commonly known as the rake, refer to the collections of the game operator from the pot. Winnings refer to the rest of the pot, which are won by a single player by the end of the game.

Discussion of Caveats

1. No consensus exists on whether the proposal is permissible under federal laws.

The Office of the General Counsel at the OCFO provided the following legal opinion: “Several federal laws potentially regulate online gaming. The Unlawful Internet Gambling Enforcement Act of 2006 (“UIGEA”)⁴ specifically exempts “placing, receiving, or otherwise transmitting a bet or wager where the bet or wager is initiated and received or otherwise made exclusively within a single State” from its prohibitions. There remains some ambiguity in federal law concerning situations in which a state-authorized bet or wager placed and received within a single state with its electronic data intermediately routed outside of the state triggers the application of certain federal anti-gambling statutes, such as the Wire Act.⁵ Because of this ambiguity, at least two states, Illinois and New York, have requested clarification from the U.S. Department of Justice (USDOJ). To date, USDOJ has not provided a written response to those inquiries; nor have they made any efforts to curtail procurements in these states for these types of games since enactment of the UIGEA. Finally, Section 1175 of the Johnson Act makes it unlawful to ‘manufacture, recondition, repair, sell, transport, possess, or use any gambling device’ within the District of Columbia. There is no legal opinion determining that the computer server or related equipment would fall within the definition of a gambling device. However, should a determination be made in the future that such equipment does fall within this definition a change in federal law would be required to make the implementation of the proposed legislation legally permissible.”

The Office of the Attorney General is currently reviewing the proposal and will provide a legal opinion.

2. The District’s unique geography could pose implementation challenges.

The Lottery Board and Intralot did not present to ORA a detailed technical implementation plan. Once such a plan is made available, the District must ensure that it is technologically feasible, and can be implemented given the unique geographical characteristics of the District of Columbia.

Intralot has discussed some aspects of the technical implementation plan with ORA, and these discussions give rise to some concerns. For example, Intralot informed ORA that it plans to use IP address checks to enforce geographical restrictions. This might prove to be a difficult challenge in the District (especially in contrast to European countries where Intralot has implementation expertise). First, it is ORA’s understanding that geolocation, or the practice of determining the physical location of a person based on information processed through the internet, is not always reliable at the city and state level.⁶ Whether the practice is sufficiently reliable to fulfill legal requirements remains to be seen. Second, Intralot plans to require static

⁴ 31 U.S.C. § 5361 et seq.

⁵ 18 U.S.C. § 1084

⁶ The estimates vary from 99 percent at the country level to less than 80 percent at the city level. No reliable estimate exists at the ZIP code level, because service areas of providers do not always coincide with ZIP codes. For details, see Svantesson, D. J. B. (2008). How does the accuracy of geo-location technologies affect the law? Masaryk University journal of law and technology, 2(1), 11-21. Available at http://mujlt.law.muni.cz/storage/1234798550_sb_02_svantesson.pdf. Accessed on November 15, 2010.

IP addresses from residential players to increase the reliability of geolocation. Static IP addresses are not always available for DC area consumers, and when available, require subscription to business level services, which are considerably more expensive than residential services.⁷

These constraints might delay the implementation of at-home play or require alternative and potentially costlier verification systems, which might lower both gross revenues and the potential income tax collections.

3. Data are lacking for testing the reliability, validity, and plausibility of the revenue model.

Data on offshore gaming are available from H2 Gambling Capital, a market research firm. According to their published data, internet gambling revenue (excluding sports betting) for offshore companies was estimated to be \$3.7 billion in 2009 from players in the United States.⁸ Under a regulated U.S. market, H2 Gambling Capital estimates annual gross winnings in the U.S. to be \$14.4 billion.⁹ The revenues presented here are solely based on the H2 Gambling Capital estimates, prorated by the District's share in US adult population, adjusted for visitor population (See the appendix table). ORA does not have player level data or information on player profiles, and does not have a means for conducting sensitivity analysis on these estimates.

Derivation of DC revenues from US projections, full implementation

Derivation of DC revenues from US projections, full implementation*	
Gross Revenues to Lottery Board	
US Population (18 and over) ¹	232,509,573
Total Gross Rev. from US players ²	\$3,700,000,000
Gross Rev. per capita in US	\$16
Effective DC population (including estimated visitors) ³	868,843
Total Gross Rev. from DC Players	\$13,826,187
Lottery Board's Share (50%)⁴	\$6,913,093
Income tax on winnings (DC Residents only)	
Total winnings in US ²	\$14,400,000,000
Winnings per capita in US	\$62
Effective DC population (DC adults only) ¹	485,947
Total Winnings from DC players	\$30,096,123
Income Tax on Winnings⁵	\$1,986,344
TOTAL REVENUES TO DISTRICT	\$8,899,438

Table Notes

* Expected to reach full implementation in 2015.

¹Data from US Census; ²Data from H2 Gambling Capital; ³Data from US Census and Destination DC;

⁴Per contract between the Lottery Board and Intralot; ⁵Estimated at 6.6 percent of winnings.

⁷ ORA's research of pricing among the top three internet service providers in the District shows that business level services could be \$20 to \$30 more expensive on a monthly basis. Additionally business subscribers generally have to pay for the cost of installation, and might be required to pay a monthly fee on equipment.

⁸ Email communication on November 4, 2010 with Simon Holliday, Director, H2 Gambling Capital. The widely cited number is \$5.4 billion with sports betting. Sports betting is illegal in the District of Columbia.

⁹ H2 Gambling Capital expects growth in winnings over time. This fiscal impact statement does not include any growth in winnings as the assumptions underlying the growth prediction are unknown to ORA.

Bingo



For each Bingo game the "System" will generate a sequence of seventy-five (75) bingo numbers ("Numbers") which will be generated in an unbiased and unpredictable manner by the Random Number Generator ("RNG"). The Numbers shall then be revealed one at a time in the order generated. Each Number will only apply to the specific Bingo game for which it was generated. Each Number will be automatically matched to each bingo card that the Player is playing. "Number" means an alpha numeric set of characters from the range of numbers B1 to B15, I16 to I30, N31 to N45, G46 to G60 and O61 to O75 inclusive.

Texas Hold'em Poker



In Texas Hold'em, there are two face-down cards for each player and five face-up community cards. The player who makes the best five-card poker hand with any combination of their two face-down cards and the five community cards wins the round. In a Texas Hold'em game, a marker is used to indicate which person is the "dealer" for the round. Before the cards are dealt, the person to the left of the dealer posts a bet called the small blind, a forced bet that is of a predetermined amount. The person to the left of the small blind posts the big blind, another forced bet which is usually double the small blind. The first two cards are dealt to each player face down (these are called the hole cards), and the person to the left of the big blind starts the first round of betting. (Notice that the big blind and small blind do not get to look at their cards before betting, thus the term "blind"). In the first round of betting, each player has three options: call, raise or fold. To call, the player must place a bet that is equal to the last bet placed. (For the first player in the round, this would be equal to the minimum bet.) A player may choose to raise their call bet by an additional amount, which the other players will then have to call. If one's hole cards are not favorable, the player may simply choose to fold and sit out the round.

Black Jack



Blackjack is played between a dealer and group of players. The object of the game is to beat the dealer (not the other players) with a hand of cards that does not go over a total of 21. Blackjack can be played with a single deck or multiple decks. The game commences with each player placing his bet. The dealer then distributes two cards to himself and each player at the table. Player cards are both face up. The dealer holds one face up (up card) and one face down card (hole card). The player to the dealer's left begins the action by deciding if he wants to receive or decline additional cards (hit or stand) and the action continues counter-clockwise. The round concludes when all have refused additional cards. The dealer then exposes his hole card, hits or stands, and awards wins accordingly.

Victory at Sea



You and the enemy each have five ships:

Carrier (length = 5); Battleship (length = 4); Destroyer (length = 3); Submarine (length = 3); Patrol (length = 2)

Select your fleet configuration in the screen at the upper right.

During battle, each side launches a round of four bombs in quick succession. If a bomb hits a ship, the entire ship explodes and sinks. Follow the status of your ships on the screen at the upper right, and follow the enemy ships in the center of your screen. Rounds continue until one side's fleet is destroyed. If the last ship of each fleet is destroyed at the same time, the outcome is a draw.

Betting Types

There are three bet types: Battle Outcomes, Winning Ships and Number of Rounds

- The Battle Outcomes tab lets you bet on the three possible outcomes: You, Enemy, and Draw.
- The Battle Outcomes tab also lets you bet on the number of rounds the battle will take: 2-6.
- The Winning Ships tab lets you bet on which ships will remain in the winner's fleet.

Random Number Generated Games



The player begins by selecting how much he/she would like to bet and how many lines to play. In the game above you can play from 1 line to 5 lines. Once the bet has been placed, the player will click on the spin button and see if he or she has a winning combination.

E-Scratch



How to play:

The player picks the e-scratch game he/she would like to play. Once the game is selected, the player then selects the amount to wager and in some games the number of boxes to scratch. The player then uses his/her mouse to click on a box to reveal what is in the box. The player continues to reveal until there are no boxes remaining.

