

# Feature Interviews



GORDON MEDENICA



MAY SCHEVE



DANIEL CAGE



MARK HICHAR

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PGRI Institute is much more than a news aggregator. We follow-up on the news to deliver the perspective and genuine insight you need to understand the gaming industry and how it is likely to evolve. Any questions or comments, e-mail Paul Jason at [pjason@PublicGaming.com](mailto:pjason@PublicGaming.com) or call U.S. + 425.449.3000.

Thank you!

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# From the Publisher

*Paul Jason, CEO, Public Gaming International Magazine*

The European lottery and gaming markets have been evolving and maturing in steady fashion over the past number of years. That is not to say without fits and starts and lots of controversy over regulatory frameworks. But, the court rulings of the past couple years have reaffirmed that member states do have the right to protect the consumer with higher regulatory standards. Internet gaming is now regulated in most markets, has been for many years, and the thoughtful leadership of EU Internal Markets Commissioner Michel Barnier gives us confidence that progress will continue. The European Lotteries Association and its leadership deserve recognition for successfully pushing the interests of member-states and their lotteries onto the agenda of the EU Commission. The European Parliament has recently formulated a consensus statement that regulatory and taxation policy should be left up to the member states, and that there should be no international regulatory framework imposed by the EU on the member states. Further, effective law enforcement does not require interference from the supra-governing body, like the EU or the federal government in the U.S., into the issues of licensing, regulation, and taxation policy of the state.

But still, an interesting question is raised. What exactly constitutes “progress” in the lottery and gaming industry? According to offshore operators like those just kicked out of the U.S., and those continuing to persist in their violation of regulatory laws in jurisdictions around the world, “progress” would mean having the EU Commission force all member states to lower their tax rates to the lowest common denominator, which would be practically zero as

determined by Malta and other ‘safe harbour’ states, and minimize regulatory constraints in the guise of defending “free market capitalism and open borders”, and implement policies that would support boundless growth and profits for the benefit of private interests. For others, it would be allowing the market to expand to meet consumer demand, channel existing demand away from illegal, unregulated, and untaxed operators and towards a legal, regulated and taxed economy; evolving regulatory frameworks to meet the needs of changing markets and technologies, adherence to a sustainable growth philosophy that values consumer and player protection, and in markets where permissible, channeling the economic benefits back to public service causes. This last is the advocacy position of PGRI.

Evolution and progress in the U.S. internet gaming market has been held in abeyance by regulatory constraints. Of course, there is not consensus on what constitutes “progress” in the U.S. But removal of regulatory confusion will at least allow all of us to focus on what is the best system for society and the industry instead of wondering what is permissible under federal law. Internet gaming is still an unregulated market, though that will be changing as a result of the statement by the U.S. Department of Justice that the Federal Wire Act applies only to sports-betting, and does not prohibit states from regulating other forms of internet gaming. 2011 has set the stage for a big leap forward for the gaming and lottery industry in the U.S. First there was the indictments of Pokerstars, Full-Tilt Poker, and Absolute Poker in March. Better late than never to demonstrate the power and effectiveness of the UIGEA to enforce the laws against these criminal enterprises. Next was the memorandum from the U.S.D.O.J.

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This issue focuses on the state of i-gaming and regulation in the U.S. The interviews with **Directors Gordon Medenica** (who is also the president of NASPL) and **May Scheve Reardon** (who is also chair of the MUSL finance committee) do touch on that, but also drill down into a wider range of initiatives that are contributing to a healthy and sustainable industry in the U.S. Events that will have tremendous impact on the future of the U.S. lottery industry include the agreements between states to work together to build a multi-state portfolio of gaming products. And we hope to have a recurring update on the progress of the Northstar - Illinois Private Management Agreement (PMA) like we have in this issue.

**SMART-Tech 2012** is convening a very special group of industry leaders to capture the magic of this special time in our business and set us on a course to be the preeminent industry leaders that our players and lottery beneficiaries and Good Causes expect us to be. The Lottery is now entering a business climate in which the opportunities are going to come and go more quickly than ever. The need to act decisively is critical for lottery just as it is for all businesses everywhere. One of the obstacles to acting quickly and decisively is uncertainty about the future. That's why the mission of SMART-Tech 2012 is to remove as much of the uncertainty as possible.

One of the themes is that *Everyone Wins with Internet distribution of lottery products*. Everyone wins when the player-base is expanded. The internet will bring in new consumer groups and that should be everyone's goal. And by everyone, we mean:

- ▶ **Advocates for responsible gaming:** The Internet creates the foundation for the kind of dynamic and interactive dialogue between operator and player that supports effective communication and implementation of Responsible Gaming tools.
- ▶ **Retailers:** Expanding the player-base and bringing in new consumer groups translates directly into increased store traffic and sales. This is not theory - it is evidenced in markets where retailer

sales growth has been occurring right alongside of internet sales initiatives, and has been for many years (like in Canada, Finland, Sweden, Norway, Austria, U.K., Australia, and many other jurisdictions). The land-based retailers will always be the life-blood of lottery's relationship to its players and channels like internet will augment and support that special relationship.

- ▶ **Consumers and Players:** The consumer wants and expects options. Successful consumer product companies do not try to limit the distribution of their products and over-control their customer. At least not the ones who intend to stay in business. Instead of thinking of the market as a zero-sum game, successful business models focus on innovating and collaborating to expand the market and consumer base.

Thanks so much to all of our contributors for helping to sort these issues out. 2012 is shaping up to be an amazing year and we appreciate the insights of **Daniel Cage, Mark Hichar, Philippe Vlaeminck, Michelle Carinci, Global Betting and Gambling Consultants, Frank Fahrenkopf, GTECH** and **Northstar Lottery Group, Spielo International, and NeoGames** to help us deliver a peak performance for all of our lottery stakeholders.

*Congratulations to the two recipients of the 2012 PGRI Major Peter J. O'Connell Lottery Lifetime Achievement Award. Join us at SMART-Tech in New York City to honor **Gary Grief** (Executive Director of the Texas Lottery) and **Tom Shaheen** (Executive Vice President of Linq3). Both have served the industry for over twenty years. For all that they have accomplished already, they are just hitting their stride and so we look forward to another twenty years of inspired leadership from them!*

Thank you all for your support. I welcome your feedback, comments, or criticisms. Please feel free to e-mail me at [pjason@publicgaming.com](mailto:pjason@publicgaming.com).

capture — the value of their lottery purchases on their own cash register. Now our agents have a clear and integrated view of their sales by product line, and The Lottery retains full visibility of lottery product sales.”

**Jim O'Connor**, Key Account Manager, The National Lottery, Ireland

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*Jim O'Connor*

## Gordon Medenica

Director,  
New York Lottery  
President,  
National  
Association  
of State  
and Provincial  
Lotteries (NASPL)



**PGRI Introduction:** In December of 2009, the Deputy Director and General Counsel for the New York Lottery (Bill Murray) sent a letter to the U.S. Department of Justice requesting clarification of the Federal Wire Act. Better late than never, the U.S. DoJ responded on Dec. 23, stating that “the Department’s Office of Legal Counsel (OLC) has analyzed the scope of the Wire Act, and concluded that it is limited only to sports betting.” Coincident with this letter is a comprehensive memorandum by the OLC (view in its entirety at [www.PublicGaming.com](http://www.PublicGaming.com)) that eliminates whatever confusion may have existed over the interpretation of the Federal Wire Act. By clarifying that the Wire Act applies only to sports-betting, this U.S. DoJ memorandum clears the way for states to implement a regulatory and taxation framework for internet gaming and internet distribution of lottery products. This opinion is a turning point in the lottery industry and also in the broader gambling industry.

The following interview is in three parts. First, Director Medenica addresses the implications of the U.S. DoJ memorandum. The second and third parts of the interview were actually conducted prior to December 23. We discuss the reasons why the internet will be as transformational for the gaming and lottery industries as it has been for so many other industries. Indeed it will be more so. And lastly, we discuss how NASPL has transformed itself into a genuinely relevant and impactful organization; and how NASPL will help its membership truly optimize what will be a most memorable year for state-sponsored gaming.

Gordon Medenica was appointed Director of the New York Lottery in September, 2007. As Director, Medenica serves as the chief executive officer of a \$7.9 billion organization whose

mission is to earn revenue for education in New York State. Under his leadership, the New York Lottery has set new revenue records every year. The New York Lottery is the largest and most profitable state lottery in North America, generating a record \$3 billion in education funding in the past year. Before coming to the Lottery, Medenica had been a longtime executive at The New York Times Company, serving as a member of the Management Committee of the company, as head of strategic planning, corporate communications, and as Group Publisher of several of its sports magazines. More recently, he was the Executive Vice President of Philadelphia Media Holdings, LLC, an owner of the Philadelphia Inquirer and Daily News. Prior to that, Medenica acted as an independent advisor to the Blackstone Group on newspaper acquisi-

tions, as the President and CEO of DornaUSA, a sports marketing company, and as a Senior Analyst at the Marriott Corporation. Medenica earned his A.B. from Harvard College, where he majored in government, and his M.B.A. from Harvard Business School.

**Paul Jason, Public Gaming:** *What is the major implication for state lotteries of the memorandum from the U.S. Department of Justice that clarifies the meaning of the Federal Wire Act?*

**Gordon Medenica:** It simply clarifies what we have been saying all along – regulation of gaming is a state-level function. Each state can now decide for itself how, or if, to pursue an internet gaming strategy.

*It may be too early to reveal a detailed ac-*

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tion plan, but what are the next steps that the NY Lottery will be taking to integrate i-gaming into its portfolio of products and channels, and what are the likely timelines for those steps?

**G. Medenica:** We're reviewing our plans now, but we're not ready to announce any specifics yet.

*Scale and liquidity are actually not necessary for many i-games. But scale and liquidity are everything in the social game space. That is especially true in i-poker where the big get bigger and the small get marginalized. Even for the state of New York, won't it be to your advantage to collaborate with other states to create massive scale? And, can NASPL perform a role in coordinating a multi-state approach to i-gaming?*

**G. Medenica:** It's one of the many issues that we look forward to answering in the near future.

*Does this U.S. DoJ memorandum leave any loose ends, any unanswered questions that advocates for federalization will use as grist for pushing their campaign federalize the regulatory framework?*

**G. Medenica:** It is such a clear statement that any changes would probably now require new legislation.

*It would seem like the best way, if not the only way, to codify this memorandum into the firmament of gambling law is for states to take action, to implement i-gaming regulatory and taxation frameworks that demonstrate the willingness and ability of states to take control of this industry. Do you feel that it is important for states to move quickly to do that in order to prevent the well-funded Big Casino interests from trying to interfere and insinuate the federal government back into the business of regulating and taxing the states' gambling business?*

**G. Medenica:** States clearly have an important window of opportunity now, and should decide for themselves how to react.

*What is the next step for this U.S. lotteries as regards to i-gaming? In spite of all the public debate, U.S. Congressional action does not appear imminent.*

**G. Medenica:** Yes, but it is imperative that we all remain vigilant, active, and vocal. Remember that Senator Reid attempted to slip a bill into the lame duck congress at the end of 2010. We barely dodged that bullet. Even the way that UIGEA was passed in 2006 is indicative of the way things can happen, under the

radar, becoming a reality without anyone realizing that it was even being considered. We were concerned that the deficit-reduction Super Committee might look at the revenue-generating potential of internet poker. We sent letters to whomever we could to try to prevent that from being considered. So this is no time to relax.

That said, it does appear that we have a little time to rally support for defense of states' authority over gaming. This year is an election year and so it is not likely that candidates will want to tackle a controversial issue like this. But we need to be vigilant and actively engaged and continue to push the message out there. And we need to take full advantage of this period to educate everyone on the issues because the question of who determines i-gaming regulatory policy still needs to be addressed and will be answered at some point. We have just been focused on making sure that misguided legislation does not get passed at the federal level. That does not change the fact that there are millions of people playing i-poker. That's a fact of life. As is often the case in business and in gambling in particular, the legal and regulatory framework takes a while to catch up with the consumer. The next step is for states to take responsibility for implementing a regulatory and revenue framework that protects the players and channels economic benefits back to the public. Of course, some states, perhaps many states, will choose to prohibit i-gaming altogether, and that is fine, that is their right. But we need some states to move forward with a regulatory framework so that it becomes crystal clear to all states that they have the right to regulate and tax i-gaming. And, of course, the letter from the U.S. DoJ does clarify that states do have the authority to enable their lotteries to implement internet gaming. Now we just need a few states to implement an i-gaming platform to lock this in.

*I attempted to quantify the impact of federalizing i-poker on states' lottery businesses. Our conservative projection is that there would be a minimum of \$4 billion in lottery spend that would be lost due to migration over to a new game offering like i-poker. And, as we emphasized in our response to those who contend that lottery players do not play poker, our projection is based on a relatively small percentage of lottery spend that migrates over to an exciting new game offering like i-poker. In your speech at NASPL you point out that the impact of i-gaming on lottery would in fact be much greater than the direct loss of \$4 billion in lottery revenues. How so?*

**G. Medenica:** We see internet gaming as

being the next growth vehicle for the lottery industry. The lottery industry has always benefited from great waves of product innovation that may only happen intermittently but are the source of years of continued growth. Look at how cross-sell ushered in not only a period of growth but more receptivity to the concept of multi-state collaboration. That one innovation is spawning new ideas that are driving continued growth and additional innovation. The internet, though, will clearly be far more powerful than anything that has preceded it. Now that the confusion has been largely lifted by the memorandum from the U.S. DoJ, I think we can expect the pent-up demand for new and more exciting games and ways to access the games to cause a big spike of change and innovation. And we can be confident that there is a pipeline of innovation, new products, new games, new ways to deliver those games, just waiting to be launched to meet that demand.

*Other industries have been absorbing the impact of the internet over the past fifteen years. The gaming and lottery industry has some major catching up to do.*

**G. Medenica:** Exactly. The PGRI report on the impact of i-poker on lottery was good because it put some numbers to the direct impact that i-gaming would have as a result of migrating a relatively small portion of total revenues over to i-poker. But it underestimates the actual impact that the internet will have on this industry. It is, of course, difficult to quantify the impact of something that has not happened yet. We can expect that the internet will be an integral part of the gaming business just as it is in every other walk of life. Look at how it has completely reshaped the way business is done, the way consumers behave and engage in commercial activity. And look at the tremendous popularity of non-money internet gaming. No amount of consumer surveys or analyses of past consumer behavior can predict the impact of the internet on the gaming industry.

Lottery also has the benefit of a tremendously powerful land-based retailer network. Integrating this network into an i-gaming strategy will be a top priority for lotteries. Lotteries which have highly evolved i-gaming and distribution markets, as in Canada and Scandinavia, have shown that the internet complements and supports the retailer channel. By accessing new consumer groups, bringing new players into the games, leveraging this access to cross-sell other product tie-

...continued on page 32

# We Speak Lottery





## May Scheve Reardon

Executive Director, Missouri Lottery

Chair of the Multi-State Lottery

Association (MUSL) Finance Committee

**PGRI Introduction:** Appointed to lead the Missouri Lottery in December of 2009, May Scheve Reardon was, according to Commission Chair Kevin Roberts, charged with “moving the agency in a new direction.” After a career in private finance, and serving as head of the state Democratic Party, director of development at the Richard A. Gephardt Institute for Public Service at Washington University in St. Louis, adjunct professor of political science and communications at Webster University, and twelve years of service as a St. Louis County state representative, Executive Director Scheve Reardon has embraced the spirit of her current call-to-action with enthusiasm and focus.

The Missouri Lottery set sales and funds transfer records in fiscal 2011, generating over \$1 billion a year in sales (for the first time ever) and \$259 million in funding for the Missouri public education programs.

**Paul Jason, Public gaming:** *First, let's start out with a question about the recent memorandum from the U.S. Department of Justice. By clarifying that the Federal Wire Act applies only to sports betting, it would seem to open the door for states to implement a regulatory and taxation framework for internet gaming. It may be too early to know this, but do you have any thoughts on what this will mean to the state of Missouri and perhaps the Missouri Lottery?*

**May Scheve Reardon:** We feel the December 23 DoJ opinion clarifies a states' right to sell lottery products online within its borders. We are monitoring and researching the issue and how other lotteries are proceeding. If Missouri chooses to conduct online sales of its existing games, we will do so responsibly.

*Congratulations for a great fiscal 2011. The Missouri Lottery generated over \$1 billion in sales resulting in over \$259 million in the funds transferred to education. What*

*are your sales and funds transfer targets for fiscal 2012? Do you have ambitious percentage increases?*

**M. Scheve Reardon:** The legislature has asked that we return \$267 million to elementary, secondary, and higher education. The challenge is that we need to generate that increase when our advertising dollars have been cut by about \$2 million, from \$8.3 million down to 6.3 million. That's about 25% which really impacts our entire advertising program. So we are motivated to get creative, effectively use all the resources we do have at our disposal, and fulfill our commitment to Public Education.

*How will you accomplish it?*

**M. Scheve Reardon:** First we focus on basic execution with retailers. Make sure we are doing everything we can to optimize sales and productivity at the retail level. New games are launched with high-impact promotional blitzes. Sales rep's make sure there are never outages, the stores always stocked with the right products. Second, we are really working hard to add entertainment value to our all our games, and especially the Instants. Our holiday scratchers are nearly 30% over last year.

*30% - That's insane.*

**M. Scheve Reardon:** It's true. We're very excited about the possibilities. Necessity being the mother of invention, I think our team is really psyched to find creative new ways to grow the business. Get all our channel partners to work hard to achieve stretch goals. Create bold and entertaining new products that will excite our players. And along with the pressing need to increase sales, we are increasing our attention to Responsible Gaming. For instance, we embraced the multi-state media campaign to discourage giving scratchers as gifts to people under 18, making sure this RG campaign was implemented for maximum impact in the Missouri market. We always make sure our advertising and promotions are geared towards the adult audience, never doing anything that could be construed as appealing to anyone other than a mature consumer.

*Does it seem that regardless of the level of success, and the adherence to high RG standards, that lotteries are always vulnerable to criticism?*

**M. Scheve Reardon:** It's not about avoiding criticism. It's about sustainable expansion, building the market by increas-

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ing the player base, promoting lottery as a fun and healthy way to pique the imagination, indulge in the dream. Responsible gaming really does not conflict with a strategy of sustainable growth. They go hand-in-hand.

*What else are you doing to increase productivity in the retail channel?*

**M. Scheve Reardon:** Same-store sales growth is one measure of productivity. The other source of sales growth is expansion of the network, adding retailers. We are adding traditional retailers but our primary focus for expansion has been to add keno retailers. The Arkansas Lottery come online and that impacted sales of our Instant in-state lotto games at our Arkansas border. So we ramped up our focus on game categories that are not offered in the Arkansas market, like Keno. We created a new mix of promotions, creating exciting elements that are constantly being refreshed. We shortened the draw times to four minutes. We dropped an alternate game, Lucky Dough, in order to focus on straight keno. We toured with a team, including myself, doing personalized hands-on publicity with radio, TV, and newspaper backup. This was all done in the smaller communities where it made a big impression, drawing huge crowds, making high-profile news, and bringing awareness to how fun, fast, and exciting a game keno is. This was a consumer-focused campaign and brought in lots of new players. But it also had a huge impact on our channel partners. We saw huge growth in both participating retailers and also in new customers. We also worked with the Department of Revenue to ease the process of licensing. Then we streamlined the entire process, creating an informational and sign-up packet that makes it fast and easy for the retailer to start selling lottery products. So, retailer recruitment was a big issue last year.

*You took lemons and made lemonade. Isn't it the case that a little adversity can be the catalyst to doing everything a little better, and perhaps doing a lot of things that might not otherwise have been done? It would seem that the things you did to attract new retailers probably motivated your current retailers too, improving same-store performance.*

**M. Scheve Reardon:** Absolutely. Making the retailers feel like we are true partners, like we appreciate their reason for being is to run a good business and make money. One of the retailers from the Arkansas border called

to say they had lost \$60,000 in sales in just one weekend. He said, "doesn't anybody in Jefferson City care". I called him back right away. Of course, it was fun because he was quite surprised to have a real person actually call him back, and for it to be the executive director of the Lottery made it even more fun. We turned it into a PR opportunity, engaging the sales rep's, a team from our corporate office, and the local GTECH rep's. One thing led to another, and we put on a tour, garnering local news coverage for the store tour. We sold product in the store, we spun the wheel, I did live radio and we all had a great time and know that our retail partners also had a really great time. We are working hard to really connect with our retail partners, engage them in a healthier relationship so that they know we are a part of their profit picture and want to do everything we can to help them accomplish their goals. And honestly, it's working.

*Are there ways in which your response to a specific challenge or competitive threat actually resulted in the discovery of new and better ways to operate that can be applied across other geographical regions or product categories?*

**M. Scheve Reardon:** Yes, but we don't just replicate the promotional campaign from one place to another. We create new approaches that are tailor-made for each situation. For instance, we calculated the ROI of the Border Tour, that's what we called that campaign, to be more than 13 to 1. Hugely successful. So we thought, wouldn't it be great if we could just replicate that everywhere? Of course, it's not that easy. Circumstances vary from place to place and from one point in time to another etc. Right after that we launched our 'anniversary cruise promo'. It was the 25th anniversary of the Missouri Lottery so we teamed up with our mall stores to sell tickets inside the mall, just to do something fresh and new and to create an interactive experience for the consumers. We gave away prizes, did drawings, and tried to reach out to new consumer groups. We did that at four different malls and measured the return on investment to be 18 to 1. After that we did a Route 66 tour. Just trying to mix it up and create a more dynamic sense of fun. Learn from each experience, but look for ways to improve and customize each promotion.

*Wouldn't successful campaigns like that produce a much bigger residual ROI that can't be measured? Increased brand aware-*

*ness, positive image for the lottery, exposure to new consumer groups, would all contribute to future sales, wouldn't it?*

**M. Scheve Reardon:** First, I would agree that any kind of success does contribute to the overall positive image of the lottery and that hopefully translates into even more sales in the future. Right now, though, we are focused on a highly specific initiative that is tremendously important to the Lottery. And the results will be measured on a daily basis. That is the launch of "More, Bigger, Better" Powerball. We hope the success we have had with our guerilla-marking-style promotions over the past year has brought us some increased awareness that will support this launch. And we are taking what we learned and building on it this next year. For instance, we are doing a Highway 70 Tour the week of our \$2 Powerball launch. That will include many of the same promotional methods that were used to great effect in 2011, things like creating media events at malls and at retailers to sell tickets and create publicity for the Lottery. We will really get out in front with the kind of campaign that we know from experience works well. We need to stretch our advertising dollar, so we are doing everything we can to leverage PR channels to get exposure for lottery. Creating newsworthy events that are fun for the general public, giving away some prizes, and just doing things that enable us to call the media to cover us on radio and TV. I'd like to have our \$2 million in ad' money back, but the cutback does seem to inspire a new level of ingenuity and resourcefulness!

*It seems that like all good leaders, you are using events like an ad' budget cutback, and the excitement and pressure of new product launch, to inspire a pressing sense of urgency and purpose in your organization.*

**M. Scheve Reardon:** I think of it as more about inspiring a sense of community with our customers and our retailers. That's where the real payoff comes from. The retailers are just so shocked and amazed when they see how responsive the consumer is to lottery promotions that are well executed. We actually have to consider the logistics of traffic control because we have inadvertently created crazy congestion by some of our promotional stops. That's happened a couple times when we have live-radio promotions and prize give-aways. It doesn't really take much in the way of prizes

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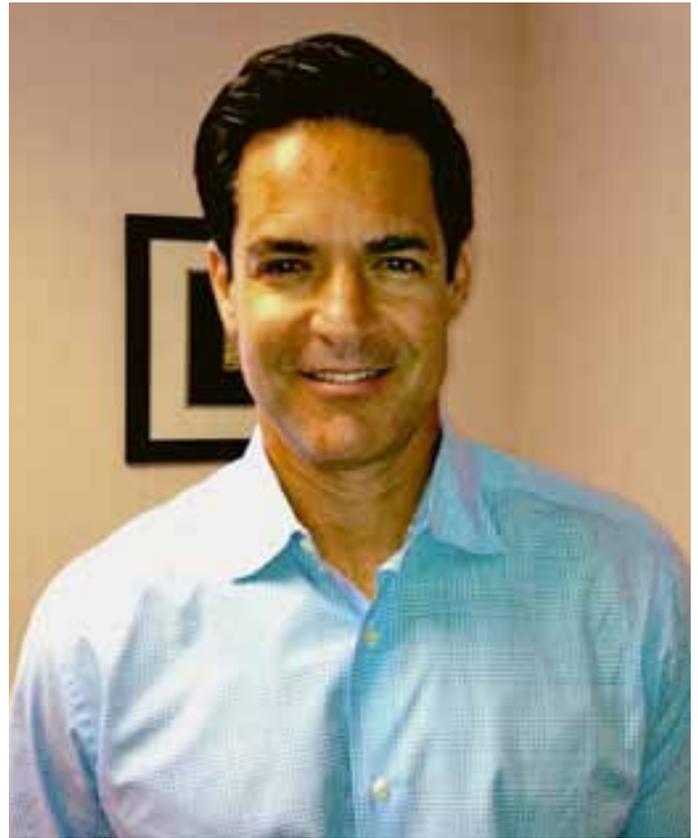
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# ling3

## Daniel Cage

Chief Executive Officer, Linq3

**PGRI Introduction:** Retailer expansion is on the short list of “To Do’s” for practically every lottery. Making the product more accessible to the consumer is probably the fastest and most predictable route to increased sales. That’s the basic premise and the value proposition of Linq3. Only we’re not talking about increasing the number of POS by 10%. Linq3, in collaboration with state lottery commissions and their operators, has developed the secure protocol for lottery transactions on ATMs and other unmanned points of sale (POS). This breakthrough technology will explode the number of POS locations and make lottery accessible to entirely new groups of consumers. Look for lotteries to begin launching in Q2. Visit [www.linq3.com](http://www.linq3.com).



**Paul Jason, Public Gaming:** *Lottery products are presently sold almost exclusively through retail stores. I would suspect that there may be a large percentage of core players who will always want to buy their products from a sales clerk inside a C-store. Expanding the number of retail stores makes the product more accessible to those core players and that can't be a bad thing. But making the product available at alternate POS's like ATM's and fuel pumps would seem to give access to an entirely new group of consumers, many of whom are not even buying lottery products now. This would seem to hit the bull's-eye of two top priorities. One, tapping into new consumer groups would create pure incremental sales increases. And two, the per capita sales increase would stem from new players by broadening the player base.*

**Daniel Cage:** Absolutely. Expanding the player base is key to the long-term sustainable growth of the industry. The platform is designed to significantly grow the retail footprint in a jurisdiction. This is true whether the current retail base is traditional or one that's augmented with an online component. The

Linq3 solution expands the market for the existing portfolio of games as well as to distribute new games, both utilizing our secure delivery methods. Alternate POS make the products available to new consumer groups and that's what delivers real incremental sales growth.

Our channels are extremely effective at working to support existing game sales through new points of distribution, but also promotions and cross selling initiatives. One example of many, is an ATM selling Powerball at an existing Keno location. This is effective at capturing on-line sales, but also marketing and conversion. “Buy a \$2 PB ticket and receive a voucher for Keno play.” This seemingly simple message has, (1) informed a Keno player that Powerball is now \$2, (2) offered a promotion to play Powerball and (3) given a reason to play Keno again at the retail location, effectively cross selling an instant and on-line game.

Our locations include anywhere a debit swipe or credit card (where approved) swipe or ewallet are enabled, a screen can display images and a printer can deliver a receipt. In addition to these locations, Linq3's process-

ing and transaction capacity also enables mobile and online lottery services. The Linq3 focus is on enabling these terminals to sell lottery products. We're turning those hundreds of thousands of ATM's and transaction processing devices installed at fuel pumps, taxis, grocery stores, airports, and countless other locations, into lottery selling touch points. At the end of the day, the goal is to assist lotteries in generating more revenue for the benefit of their good causes. Increasing the number of POS that sell lottery products goes a long way towards accomplishing that goal.

*Before we go into detail, I have to ask... What are your thoughts on the recent DOJ opinion?*

**D. Cage:** It's obviously exciting for us and for the industry as a whole. We're cautiously optimistic as much is still unknown about what's needed to make it a reality at the state level. As we're going 'full throttle' with our current initiatives, we're thrilled at the prospect of adding our on-line functionality along side it. Linq3's focus is on

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2012 will be a breakout year for U.S. lotteries. A year that marks the beginning of a new era. A year when lotteries consolidate their position as the preeminent operators in the industry. The values we stand for – player protection, security and integrity, channeling the economic benefits back to Good Causes – are more important than ever. But markets, consumers, and competitors won't sit on the sidelines waiting for us to make our move. Team Lottery has all the tools to make it happen now, and the courageous leadership to show us the way.

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**If not now, when? If not us, who?**



# THE PENDING FEDERAL INTERNET GAMBLING BILLS ARE INCONSISTENT WITH CONGRESS' HISTORIC SUPPORT OF STATES' PREROGATIVE TO REGULATE GAMBLING WITHIN THEIR BORDERS

by Mark N. G. Hichar,  
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As is well known, currently pending in Congress are two federal bills that would authorize certain types of interstate Internet gambling. They are H.R. 1174, the "Internet Gambling Regulation, Consumer Protection, and Enforcement Act," introduced in March, 2011 by Representative John Campbell (R-CA) and H.R. 2366, the "Internet Gambling Prohibition, Poker Consumer Protection, and Strengthening UIGEA Act of 2011," introduced in June, 2011 by Representative Joe Barton (R-TX). In addition Senate Majority Leader Harry Reid (D-NV) prepared a Bill for possible introduction in December, 2010, entitled the "Internet Gambling Prohibition, Poker Consumer Protection, and Strengthening UIGEA Act of 2010." It is widely believed that Senator Reid is interested in attaching this bill, in substantially the same form, to other legislation being considered by Congress in this session.

## I. THE DEPARTMENT OF JUSTICE'S DECEMBER 23, 2011 OPINION

Moreover, the Department of Justice's ("DoJ") opinion announced December 23, 2011 (but dated September 20, 2011) has been interpreted by some as creating an urgent need for the federal regulation of Internet gambling. For example, the American Gaming Association ("AGA") has stated that the opinion "validates the urgent need for federal legislation to curb what will now be a proliferation of domestic and foreign, unlicensed and unregulated gaming websites without consistent regulatory standards and safeguards against fraud, underage gambling and money laundering."<sup>1</sup>

The DoJ opinion changed significantly the legal environment related to Internet gaming in the United States. In it, the DoJ examined exhaustively the Wire Wager Act of 1961 (the "Wire Act")<sup>2</sup> – which prohibits gaming businesses from using wire communications facilities such as the Internet to transmit certain wagers and related information across state lines – and renounced its long-standing position that the Wire Act applied to all types of wagering and not solely wagering on sporting events. The DoJ's historic position, coupled with its claim that the Wire Act applies to transmissions between points in the same state when intermediately routed out of the state, had effectively frustrated the efforts of states and state lotteries that sought to expand gaming within their borders via the Internet in order to generate more revenues for good causes and help address state budget deficits.<sup>3</sup>

While the DoJ opinion was written with respect to certain games sought to be implemented on the Internet by the State Lotteries of New York and Illinois, because it declared the Wire Act applicable only to betting on sporting events, the opinion removed all doubt as to the legality under federal law of state-authorized non-sports Internet gaming conducted on an intrastate basis (i.e., where the wager is made and received within the same state, regardless whether intermediately routed out of the state). As a result, states and state lotteries may now conduct wagering games via the Internet on an intrastate basis if authorized to do so by their respective constitutions and state laws. In addition, by entering into compacts with other states, state lotteries could conduct such Internet gaming on an interstate basis.

1) The American Gaming Association's "Statement on Department of Justice Letter Clarifying Scope of the Wire Act" dated December 23, 2011. See also the statement of John Pappas, Executive Director of the Poker Player's Alliance, reading in part: "[T]his ruling makes it even more important that Congress act now to clarify federal law, and to create a licensing and regulation regime for Internet poker. ..."  
2) 18 U.S.C. § 1084. 3) See, for example, letter dated May 13, 2005 from Laura H. Parsky, Deputy Assistant Attorney General, U.S. Department of Justice, Criminal Division, to Caroline Adams, Illinois Lottery Superintendent, in which the DoJ's representative stated: "Although [wagering via the Internet] might be considered to be lawful in the State of Illinois, we [the DoJ] believe that the acceptance of wagers through the use of a wire communication facility by a gambling business, including that operated by a component of the government of a state, from individuals located ... within the borders of the state (but where transmission is routed outside of the state) would violate federal law." Similar letters in respect of proposed intra-jurisdiction Internet gambling were written by DoJ representatives in 2004 (to the U.S. Virgin Islands Casino Control Commission) and in 2002 (to the Nevada Gaming Commission).

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## II. SALIENT FEATURES OF THE FEDERAL BILLS

As discussed below, the bills introduced by Representatives Campbell and Barton, and the bill drafted by Senator Reid, would federalize Internet gambling (“Igambling”) and establish a federal infrastructure unlike any other in history with respect to legal gambling conducted within state borders. Moreover, in certain respects the bills would dictate to the states and limit them in regard to what types of Igambling they could conduct or license – i.e., they would limit the effect of the DoJ’s December 23rd opinion. This article shows that passage of any of these bills would be a departure from positions Congress has taken in the past with respect to states’ prerogative to regulate gambling.

While comprehensive summaries of each of the foregoing bills have been provided elsewhere, it is useful to mention certain salient features of each bill.

### A. H.R. 1174 (the “Campbell Bill”)

The Campbell Bill would authorize the licensing of Igambling operators to conduct all types of gambling via the Internet other than wagering on sports events (although currently lawful pari-mutuel wagering on racing events would remain lawful). States that did not wish to permit Igambling by persons within their borders would be required to “opt out” of the scheme within a specified period of time. The Department of the Treasury would have regulatory oversight over the licensing of operators, and would delegate much of the licensing and investigative responsibilities to state and tribal regulators that qualified under later-promulgated Treasury regulations. A companion tax bill, H.R. 2230, sponsored by Representative Jim McDermott (D-WA), would impose two principal taxes – a 2% tax on player deposits to be paid to the federal government and a 6% tax on player deposits that would be distributed among participating states in the same proportion as the amount of player deposits from each participating state bears to the total of all player deposits.

The Campbell Bill is expressly made inapplicable to intrastate Igambling conducted by state and tribal lotteries in accordance with the intrastate and intertribal Igambling exceptions (collectively, the “UIGEA Intrastate Igambling Exception”) contained in the Unlawful Internet Gambling Enforcement Act of 2006 (“UIGEA”).<sup>4</sup> Such intra-jurisdiction Igambling is expressly permitted, and operators of any state or tribal lottery conducting such intra-jurisdiction Igambling are not required to be licensed under the Campbell Bill.

### B.H.R. 2366 (the “Barton Bill”)

Unlike the Campbell Bill, the only Igambling the Barton Bill would authorize is Internet poker, and then only poker when played by two or more people playing against each other and not against a “house” or “bank.” Licenses would be issued under the oversight of the Department of Commerce (through a newly-created “Office of Internet Poker Oversight”), although it is contemplated that much of this authority would be delegated to state and tribal regulators that qualified under later-promulgated federal regulations. States that did not wish to allow licensed operators to take wagers from persons located within their borders would have to “opt out” of the scheme within a specified period of time.

No tax scheme is included in the Barton Bill. Presumably the taxation scheme would be addressed in later-filed companion legislation. The Barton Bill’s treatment of intrastate Igambling is discussed below.

### C. The Reid Bill

In many ways, the Barton Bill borrowed from the earlier-drafted Reid Bill. Like the Barton Bill, the Reid Bill would only authorize Internet poker, and again, only poker played by two or more people playing against each other and not against a “house” or “bank.” The Commerce Department would supervise licensing, and the primary licensing authority would be delegated to established state and tribal licensing authorities. States that currently permit licensed poker play in “bricks and mortar” facilities – i.e., 15 specifically named states – would be deemed to permit federally licensed interstate Internet poker play from within their borders unless they “opted out” within a specified period of time. Licensed operators could take wagers from persons located in other states only if those states had specifically “opted in” to the federal scheme.

Under the Reid Bill, licensed operators would be required to pay an Internet poker activity fee equal to 16% of Internet poker receipts (i.e., poker commission fees and tournament fees, less prizes paid). Of that 16%, one-eighth (i.e., 2% of Internet poker receipts) would be the federal share used to administer the program, and the remainder would be allocated as follows: 70% would be distributed to the states and tribes in the proportion that the number of players in the applicable jurisdiction bears to the total number of players and 30% would be distributed to each state and tribe in the proportion that the amount of Internet poker receipts from customers in the applicable jurisdiction bears to the total amount of Internet poker receipts.

The Reid Bill’s treatment of intrastate Igambling is discussed below.

## III. THE BARTON AND REID BILLS, IN PARTICULAR, RESTRICT THE PREROGATIVE OF STATES TO REGULATE GAMBLING

The Barton and Reid Bills would create an unprecedented federal framework for legal gambling, dictating the licensing standards, terms and conditions to be met by Igambling operators and their vendors. Either Bill, if enacted, would usurp the historic prerogative of states to regulate legal gambling within their borders. Apart from (and notwithstanding) provisions allowing states to “opt-out” (or refuse to “opt-in,” as the case may be under the Reid Bill), the Bills would limit the Igambling that states could conduct themselves (e.g., through their lotteries) or authorize others to conduct.

Each Bill provides that an Internet system that does not process “bets or wagers” would not be an “Internet Gambling Facility,” and thus would not be covered under the Bill. In addition, each Bill excepts from the term “bet or wager” the following:

#### **Intrastate Lottery Transactions.** A bet or wager that is ...

(I) a chance or opportunity to win a lottery or other prize (which opportunity to win is predominantly subject to chance) authorized by a State or Indian tribe; and

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<sup>4</sup> The UIGEA explicitly excepts from “unlawful Internet gambling” Internet gambling conducted as follows: (i) the bets or wagers are placed and received exclusively within a single State; (ii) the bets or wagers and the method by which they are placed and received is expressly authorized by and placed in accordance with the laws of such State; (iii) the State law or regulations include (a) age and location verification requirements reasonably designed to block access to minors and persons located out of the State; and (b) appropriate data security standards to prevent unauthorized access; and (iv) the bets or wagers do not violate any provision of: (a) the Interstate Horseracing Act of 1978 (15 U.S.C. § 3001 et seq.); (b) the Professional and Amateur Sports Protection Act (28 U.S.C. § 3701 et seq.); (c) the Gambling Devices Transportation Act (15 U.S.C. § 1171 et seq.); or (d) the Indian Gaming Regulatory Act (25 U.S.C. § 2701 et seq.). A similar and analogous exception is provided with respect to wagers sent and received within the Indian lands of a single tribe or between the Indian lands of two or more tribes to the extent intertribal gaming is authorized by the Indian Gaming Regulatory Act (the “IGRA”).

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## Michelle Carinci

### Lottery Industry Leader

**PGRI Introduction:** The U.S. Dept of Justice has finally given the guidance that states have been begging for. Its clarification that the Federal Wire Act of 1961 applies only to sports betting and not to other forms of i-gaming effectively means that U.S. states do have the right to implement all forms of i-gaming other than sports betting; and that states do have the right to authorize their lotteries to sell lottery products over the internet. This is very good news indeed for states and their lotteries. Unfortunately, a lack of understanding is causing some to raise questions which may interfere with the rapid implementation of i-gaming initiatives. Speed to market is of the essence.

Michelle Carinci began her career in the lottery industry with the Western Canada Lottery Corporation when she was 22 years old. Ms. Carinci was the CEO of the Atlantic Lottery Corporation (ALC) in Canada for ten years, is a frequent speaker at PGRI conferences, is a moderator and speaker at countless World Lottery Association (WLA), European Lottery (ELA) and North American conferences and seminars, and has as much experience with managing the integration of internet distribution with existing channels as anyone. Under the leadership of Ms. Carinci, ALC was a pioneer in the development of new gaming opportunities, internet distribution of existing and new products, and the preservation of a healthy and mutually supportive relationship between lottery operator and the land-based retailers. ALC's internet offering which allows Atlantic Canadians to purchase lottery tickets in a secure, geographically and age controlled online environment, is an example of this forward thinking.

Michelle Carinci is, along with Dianne Thompson of the Camelot Group and an international working group, the architect of the World lottery Association's Responsible Gaming (RG) program. Preservation of the lotteries' reputation for the highest standards of RG is an integral part of any sustainable i-gaming initiative.

#### Engaging Land-Based Retailer Support for Internet Sales

**Paul Jason, Public Gaming:** *It is understandable that land-based retailers be concerned about the impact of the internet on their businesses. Yet, there are many lottery operators who, like ALC, have distributed their products over the internet for many years. How did internet distribution impact your land-based channels?*

**Michelle Carinci:** We are all naturally concerned about a future that is unknown and uncertain. So the first thing we might do is try to remove some of that uncertainty. Internet distribution has been highly disruptive to many industries. Fortunately, that has not been the case with lotteries.

What is also fortunate for our USA colleagues is that there are three lotteries today in North America – Atlantic Lottery, the British Columbia Lottery and Loto-Quebec – that have several years of experience and can provide the facts related to the impact of Internet gaming. There are also regulated lotteries in Europe that have deep experience and learning to share, Finland, Austria and Sweden for example. The trailblazers in regulated internet gaming were also the trailblazers for responsible gaming.

I would encourage the stakeholders related to lotteries in the USA to look north and

across the pond to ensure they are making informed fact-based decisions as they move into the future. Myth busting will be important. Some key facts are: players today are playing games and gambling on the internet in an unregulated and unprotected world and the money is not going to good causes. Regulated internet lottery and gaming is a channel that allows for very strong responsible gaming initiatives enabling players to make informed choices about their gaming practices. Another important fact is that retailers will not be impacted in a negative way.

There are a number of reasons why internet distribution actually supports and complements the traditional lottery - retailer business model. But first, the simple answer to your question is that the impact of the internet on land-based retailer sales has been

positive or neutral in the lotteries that I am familiar with. Lotteries all around the world have been selling traditional lottery products over the internet for many years and there is no evidence of a sustainable negative impact on sales at retail. Depending on the offering, the impact can be a positive one, helping to drive store traffic and sales of lottery products, and sales of other consumer products as a result of the increased consumer traffic. At ALC we did not have the benefit of quite as much historical hindsight when we started six years ago. But now the evidence is in. Integrating the Internet into the mix of lottery distribution channels does not hurt the retailers. And with a little creative thought and cross-promotional strategy, it actually helps the retailers with increased lottery sales and

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# REDS VERSUS GREENS

Common wisdom has always perceived a clear distinction between lottery players and casino players. Different player profiles, different buying motivations, etc. Lottery players buy the “hope and dream”. Casino players play to win money. Casino players “gamble” while Lottery Players play for fun. Different markets, different approaches to marketing, distribution, and game development. This has been a very convenient dichotomy, one that we are all quite comfortable with, but one that has now been obsoleted by the massive cultural embrace of online games.

The games that have captured the attention of millions of consumers – young and old and not just the “next gen” gamer – do not involve lottery jackpots, ‘hopes and dreams,’ or winning money. They involve fun and play and social interaction. Think Zynga, World of Warcraft, Angry Birds, and the countless mobile and internet applications being developed every day. They’re all about the playing experience with little prospect of winning anything tangible in the form of money or jackpots that will change anyone’s life. Modeling and classifying the player profile continues to be an important exercise in helping to guide our approach to marketing, distribution, and game development. The dichotomy, though, is no longer between lottery player and casino player. The dichotomy now is, wait for it ... between the REDS and the GREENS.

REDS want to win something, be it money or the ‘hope and dream’ of a jackpot. The focus is on the outcome more than the playing experience. GREENS want to enjoy an entertaining playing experience. The focus is on the fun of playing the game, with little focus on the outcome. Lottery operators have a tremendous opportunity to capture this GREEN market, to integrate into their games the entertaining extended-play experience that the world of gamers has migrated towards. Fortunately, we do not need to ignore the buyer motivations of the REDS in order to market to the GREENS. It isn’t the case that the REDS are rejecting games that includes an entertaining extended-play gaming experience. It’s just the case that GREENS are rejecting the focus on outcome and are demanding a more entertaining game-playing experience. Lottery operators can continue to market the ‘hope and dream’. But there is a huge opportunity to capture the explosion of GREENS into the marketplace by adding a more compelling component of fun, play, and entertainment to the games.

The popularity of non-money games has taken the world by storm. Imagine, though, the appeal of a game that would add the stimulus of an interesting outcome to the enjoyment of an extended-play gaming experience? That would be a uniquely appealing set of product attributes that Lottery can deliver like nobody else can. Lottery games have always had and will always have the vital value of selling the “hope and dream”. Our value proposition to lottery operators is simple: Add a big dose of extended-play entertainment value to the value of winning a prize, and capture the GREENS.

A recent survey of over 2,000 online players resulted in 71% claiming that they prefer frequent smaller wins and instant feedback over waiting for the outcome that might include a big prize. Industry veterans will point out that players say they want a higher frequency of smaller wins, but they vote with their wallets and big jackpots continue to drive sales. Maybe that’s because the options have always been games that do not provide an extended-play entertainment experience. The player choice has always been: game with minimal entertainment value and low jackpot versus game with minimal entertainment value and high jackpot. Obviously, they’ll wait to play the high-jackpot game. But the explosive popularity of non-money games clearly indicates that the consumer wants a third option; one that includes games with high entertainment value. Our simple proposition is that games that combine high-entertainment value along with the opportunity to win frequent and small prizes will be far more appealing to the consumer than either non-money games or outcome-focused games.

## What do the GREENS want?

**Simple and easy applications:** GREENS are used to game designs that are intuitive, easy to learn, and deliver quick feedback. Minimize entry barriers and optimize the play experience immediately.

**Online guidance and support:** GREENS are good at following online instructions so give it to them. The registration, first time deposit process, and initial play experience conveys the first and lasting impression, so make it fun and easy.

Deliver high player-engagement and long-term entertainment: Bonus rounds, Colorful 3-D Graphic animation, and frequent wins.

**Fresh and new content:** GREENS want fresh and new content. They want a variety of games to choose from. They want stimulating changes added to the games, extending the play experience further. You know how you keep jumping onto your favorite news website to see if something new has been added in the last half-hour? That is the kind of player engagement we want to create for the new online gamer. That’s what the GREENS live for!

For the last 5 years NeoGames has optimized and expanded its game offering to meet the taste of the soft gaming players who are the target audience for lotteries. Both the soft gaming players and the GREENS seek the same, games with high entertainment value and small wins while keeping the ‘thrill’ and maintaining the “hope and dream” state of mind. NeoGames is the leading provider of such games on the internet today, running on its cutting edge NeoSphere Platform. In addition, NeoGames is known for its Operational and Consulting Services enabling its customers to benefit from the vast experience the company has in soft gaming.

## In Conclusion

We all want to be GREENS and we all want to win over as many GREENS as possible. Everyone enjoys a more entertaining playing experience. And it’s now easier than ever to deliver just that to your lottery-playing customer. Simply call NeoGames! ♦

## About Neo Games

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## Frank Fahrenkopf

President and Chief Executive Officer,  
American Gaming Association (AGA)

**PGRI Introduction:** Frank Fahrenkopf is the national advocate for the commercial casino industry and is responsible for positioning the association to address regulatory, political and educational issues affecting the industry. A lawyer by profession, Fahrenkopf gained national prominence during the 1980s when he served as chairman of the Republican Party for six of President Ronald Reagan's eight years in the White House (1983 to 1989). Prior to becoming the AGA's first chief executive on June 1, 1995, Fahrenkopf chaired the International Trade Practice Group, represented clients before Nevada gaming regulatory authorities, served as the first chairman of the American Bar Association (ABA) Committee on Gaming Law and was a founding trustee and president of the International Association of Gaming Attorneys, a worldwide organization of government gaming regulators and private attorneys acting on behalf of licensed gaming enterprises.

**Paul Jason, Public Gaming:** *What are some of the implications of the memorandum from the U.S. Department of Justice regarding the Federal Wire Act from your point of view?*

**Frank Fahrenkopf:** This opinion creates as much confusion as it does to clarify the issues in the internet gaming debate. First, we all need to realize that this is an opinion of the Department of Justice. This is not the law of the land as set down in a Supreme Court decision or in any other court decisions. And this opinion goes counter to four Departments of Justice that considered this matter prior. And it does not mean that the Department of Justice that comes after the Obama Department of Justice couldn't change positions on this issue. So it's very important to realize precisely what it is and what it isn't.

But it does make two things clear. First, the Wire Act only prohibits the transmission of communications relative to bets and wagers on sporting events or contests. And as you and I have discussed before, Paul, it's always been my position that that's all the Wire Act was ever intended to cover and that the Fifth Circuit MasterCard case had the correct reading of the Wire Act by con-

firmer as much. Secondly, this U.S. DoJ opinion makes clear that intra-state sales of lottery tickets online are legal so long as the lottery games do not involve sports wagering, even though the digital signal may cross state lines in order to be completed.

Now here is what the U.S. DoJ opinion does not make clear and where it gets confusing. Are lotteries and/or states now authorized to implement intra-state online poker, slots, and other casino type games? My answer to that is probably yes, that states can now take legislative action to authorize internet gaming on an intra-state basis, except for sports-betting. That is a fundamental recognition of the Tenth Amendment right of each state to decide whether or not they want to have gambling. If they want to have it, the states need to decide and legislate the types of gambling they choose to authorize, and how it's going to be regulated, taxed, et cetera. There arises another important question. Can two or more states that legalize online gambling link their lotteries or other state approved online gaming together? Can states form agreements to collaborate on the implementation of the internet games? Such collaborations would constitute interstate commerce, so are states allowed to do

that? This is an important question because internet poker in particular depends upon a level of scale and liquidity that many states would not be able to achieve on their own. We know that states can negotiate interstate compacts. However, Congress does have the power to disapprove them. Historically, over the last couple of hundred years, there have been many, many state compacts that have been approved. Some multi-state compacts have been ignored, Congress just didn't take action to approve or disapprove. And in some cases Congress did not approve the compact. Congress does have the power under Article 1, Section 10 of the Constitution to approve or disapprove of state compacts. Then there is also the question of whether a state can enter into a compact with an offshore jurisdiction, like Alderney or the UK.

*And the reason that is relevant is that these offshore i-poker operators would offer an instant pool of players and liquidity. So, do states have the right to enter into international compacts?*

**F. Fahrenkopf:** Exactly. Multi-jurisdictional compacts like this result in inter-state or even inter-national commerce. The U.S.

DoJ opinion does not address these questions. I think that congressional approval would probably be needed for some of these.

Another confusing point: How does this ruling impact the pari-mutuel industry? Also as we've discussed before, online wagering is going on now in this country and has been for some time in the pari-mutuel industry. Now we have to ask, is horseracing a 'sports activity'? I think it is if you read the entire opinion by the Justice Department. In fact, they use the reference to horseracing and bookies and so forth as the justification of why the Wire Act was passed in the first place. Now, it's the position of the pari-mutuel industry that the Interstate Horseracing Act exempts them from the Wire Act. The Justice Department has never accepted that interpretation. It has taken the position that they're in violation of the Wire Act, but they've never prosecuted anybody. This U.S. DoJ opinion is quiet on that. It doesn't clarify it one bit.

*And what about Native American gaming?*

**F. Farhenkopf:** The U.S. DoJ is quiet on that as well. If New York, for example, amends its statutes to allow for online poker, does that give the Indian tribes in New York the right to offer online poker? And would online poker or other casino type games fall within the Indian Gaming Regulatory Act? I'm not sure I know the answer. If it does, would those tribes have to renegotiate their compacts with those states if they want to get involved in this? Can the tribes say, well, look, we're not going to just stick with tribal gaming, we'll establish a commercial operation and pay taxes and be subject to state regulation. Can they do that? And are the tribes limited to taking online bets from people who are on the reservation? Or could they take a bet from players physically located outside of sovereign land but within the borders of the contiguous state? And if so, are Tribes subject to state taxes and regulations?

*Let's circle back to offshore operators. How does the ruling affect them?*

**F. Farhenkopf:** First, it's clear that UIGEA is still going to apply if sports betting is involved. It also will probably apply if the operator was not licensed in the state where they were taking bets. If the state law however is silent or if the offshore company gets licensed in the state, then UIGEA probably would not apply.

Where are we going to be if states all over the country implement different regulatory and taxation structures, whether through the use of their lotteries or land-based casinos or some other system? And what about Native American tribes and the pari-mutuel industry? We need to have minimum standards for consumer protection, for underage gamblers and for those who can't gamble responsibly. It seems to me that a patchwork quilt of regulations all over the country is not the best system. I believe that there should be a federal legislation that gives states the rights to continue to have control over regulation and taxation. We just need a national framework that establishes some minimum standards for consumer protection, underage gambling, responsible gaming, and also strengthens UIGEA and clarifies it so that law enforcement and financial institutions know clearly what they can and cannot do. Remember, we are all served well by having an effective UIGEA to enforce the laws against illegal offshore operators. The best estimates are there are 2000 illegal i-gaming websites. In the i-poker space, they will probably be marketing themselves as having more

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# The mighty mite of the gaming site:

## Lotteries and retailers should expect more from their site controllers.

by Dave Rolince, Sr. Product Manager, Systems Division, SPIELO International



As lotteries step up the level of sophistication in their gaming programs, the demands placed on the local site controller are also increasing significantly. What was once a passive “middleman” between the VLT and remote central system can now provide interactive, multipurpose features to enhance a gaming program’s stability and success.

In distributed VLT gaming environments, the site controller is a small but critically important device located at each gaming retailer site. The site controller continuously monitors the operational status of VLTs and transmits vital game play data to the lottery central system located at lottery operational headquarters. It does all this remotely, because operational headquarters could be located hundreds of miles away from a given retailer site.

Initially, the main purposes of a site controller were to:

- Provide secure communication between VLTs and the central system
- Validate cash-out tickets printed from VLTs
- Monitor and capture VLT events and meters, and transmit this information to the central system
- Access reports on sales, invoice data and VLT events
- Perform control functions such as enabling and disabling VLTs

However, lotteries are raising the bar. A site controller must take on additional functions as a local host that requires real-time, two-way interaction with the central system. It also must be physically robust to withstand use in a bar environment (for instance, it should be spill resistant and not have a keyboard). As well, it should be tightly integrated with the central system to achieve the expected level of performance. You can’t simply put any off-the-shelf PC in place and expect it to perform to the standards and complex demands of today’s gaming operations.

So what are these new site controller functionalities, and how can they enhance a gaming program?

Site controllers’ newest capabilities can be grouped into two categories:

- Retailer Point of Service (POS) and
- Value-Added Applications

### Retailer Point of Service (POS)

Since income from gaming is often a significant share of retailers’ business, retail operators are playing a larger role in the gaming operation and seeking richer data about their part of the process. They’re asking for analyses, such as profiles and trends of VLT revenue and game play, to better manage their businesses. The site controller can offer access to business intelligence reports that might be available from the central system over a channel such as a lottery web portal.

As a retailer POS terminal, the site controller can also be used to cross-sell lottery products, such as quick pick tickets, Keno, and PowerBall. And for advertising purposes, an external LCD driven from the POS terminal can display the latest draw, or the current status of the multi-level progressive game operating on the VLTs in the next room.

As player cards gain popularity in VLT environments, the site controller POS terminal can be used for player registration, ID verification, and the addition of credit to a player’s eWallet account.

The site controller also offers a convenient conduit for communication between the retailer and the central system in the form of email, text messaging, and access to a dedicated, lottery-managed internet portal offering web-based services.

### Value-Added Applications

In parallel with expanded retailer POS functions, site controllers in a distributed wide-area gaming network need to host a broad range of new and value-added applications, which had traditionally been hosted on the central system.

As more lotteries adopt the Gaming Standards Association (GSA) standards in their distributed gaming networks, the site controller becomes an ideal candidate to take on the role of local host to the VLTs at the retail sites. This way, the site controller would support the Game to System (G2S) protocol in the local network, as well as the rich set of classes and new functionalities offered by the protocol.

Multi-player games are gaining popularity in lottery jurisdictions as a way to generate increased player excitement and entertainment. These games include progressive, tournament and community formats where players vie for wide-area and local jackpots. For local outcome games, the game controller function must be based at the gaming site. For wide-area participation, these local controllers must be able to communicate amongst each other. In this case, the site controller hosts the game controller function.

A wireless retailer site offers lower infrastructure costs and flexibility to reposition gaming equipment anywhere at the site at any time. This added convenience also requires strong security policies to guard against unauthorized access and hacking. To maintain a high level of security, site controllers in a wireless retailer site must be able to provide wireless access, data encryption, and port authentication.

As a diagnostic center, site controllers can continually monitor the operational health of all gaming assets on-site. Proactive diagnostic applications monitor device attributes such as CPU temperature, critical voltage levels, and data storage capacity. Such information can enable the early detection of imminent failures in devices, and can quickly alert field service technicians to help minimize downtime.

### A Greater Role

The range of functionality expected from today’s site controllers reflects lotteries’ needs to improve the player experience and maximize the gaming operation’s efficiency. From its humble beginnings, the role of the site controller has evolved into an interactive, multi-purpose, high-performance extension of the central system – clearly a mighty mite. ♦

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# US GOVERNMENT MOVES OUT OF THE STATES' WAY. STATE LEGISLATURES NEED NO LONGER FEAR AN OVERBROAD INTERPRETATION OF THE WIRE ACT.

by Bradley P. Vallerius, JD

As far back as the 1990s, the US Justice Department has insisted that federal law prohibits wagering of any kind on the internet, a view that has deterred lawmakers in the 50 states who might otherwise seek to raise tax revenue through internet gambling. Recently, however, the Justice Department has circulated a Memorandum Opinion indicating it would like to get out of the way.

## What is the Memorandum Opinion?

The Memorandum Opinion is signed by Virginia A. Seitz, Assistant Attorney General for the Justice Department's Office of Legal Counsel. Her Opinion is directed to the Justice Department's Criminal Division, which had requested clarification of two critical questions of law related to proposals by the States of Illinois and New York to sell lottery products over the internet.

In framing its questions, the Criminal Division had referred to the Justice Department's traditional view that the federal Wire Act of 1961 prohibits all gambling on the internet. The Criminal Division noted that this view conflicts with provisions of the Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA) which explicitly exempt intrastate wagering from its scope.

The problem, as perceived by the Criminal Division, was that the

Illinois and New York plans entail sending data across state lines, even though their lottery products would be available only to in-state customers. This was a problem because if data crosses state lines, then the federal government's power over interstate commerce is invoked, which means that the prohibitory provisions of the Wire Act would apply and consequently make Illinois and New York's plans illegal.

The Criminal Division, therefore, sought the opinion of the Attorney General's Legal Counsel to clarify this apparent tension between the Wire Act and UIGEA. Specifically, the Criminal Division asked whether New York and Illinois:

1. Could legally use a processor located outside the state to process their transactions; and
2. Could legally route data across state lines?

## A Surprising Conclusion

Legal Counsel's Opinion answers affirmatively that Illinois and New York may legally use out-of-state processors and may route data across state lines. Legal Counsel reaches this conclusion by disagreeing with the traditional Justice Department interpretation of the Wire Act.

According to Legal Counsel, the proper interpretation of the Wire Act is that:

*Interstate transmissions of wire communications that do not relate to a "sporting event or contest" fall outside the reach of the Wire Act.*

Legal Counsel's conclusion is based on a thorough statutory analysis of the Wire Act which takes into account the explicit language of the statute as well as its legislative history in order to determine the true intent of Congress in 1961.

*"In sum, the text of the Wire Act and the relevant legislative materials support our conclusion that the Act's prohibitions relate solely to sports-related gambling activities in interstate and foreign commerce," according to the Opinion.*

Legal Counsel further notes that it is not necessary to reconcile the Wire Act with UIGEA because the Wire Act does not apply to Illinois and New York's plans since their plans do not entail wagering on sports. Hence Illinois and New York may legally sell lottery products on the internet.

## Legal and Political Implications

There are substantial implications and there will be resounding effects throughout the states. Above all, the Opinion indicates how Justice Department officials will act in the future. Originating from the Attorney General's Legal Counsel, the Opinion should be regarded as a high-level authority commanding other divisions of the Justice Department how to conduct their affairs from this point forward. In this regard, it should be noted that the Attorney General's Office of Legislative Affairs has already forwarded the Opinion to Senators Harry Reid and Jon Kyl in a letter dated 23 December 2011.

Senators Reid and Kyl had written a letter to Attorney General Eric Holder in July 2011, criticizing the Justice Department for an apparent lack of consistent and aggressive enforcement of federal internet gambling policy. More importantly, the Senators requested that the Attorney General either "reiterate the Department's longstanding position that federal law prohibits gambling on the inter-

net.”... or ... “consult with Congress before finalizing a new position that would open the floodgates to internet gambling.”

As for potential effects in the states, if the Wire Act applies only to sports wagering, then each state has the power to license and regulate poker, gaming, lotteries, bingo, and virtually any other sort of gambling that is not related to sports, and the Justice Department should be expected not to interfere.

A surge of momentum is already being experienced this week (4 January 2012) in New Jersey, where media reports indicate Governor Chris Christie could be prepared to sign a bill that would be offered by the legislature, even though he refused to sign a similar bill that arrived on his desk less than one year ago.

### Interstate Regulation

One significant implication of Legal Counsel’s new interpretation is that the Wire Act does not apply to non-sports interstate wagering.

Thus far policy proposals in the states have dared to envision only wagering on an intrastate basis, but eventually they will desire to link their markets for poker and other games that require heavy liquidity.

If the Wire Act does not prohibit interstate wagers, then there may be no other federal statute which prevents states from linking their markets. Presumably state legislatures would have liked federal rules indicating how they should proceed with linking their markets, but if they perceive that there are presently no federal prohibitions against interstate wagering then they could potentially seek to negotiate agreements among themselves—especially if they lack confidence in Congress’s ability to legislate on these issues.

But it is still important to remember that just because wagering activity is not prohibited by the Wire Act does not mean the activity is legal in the states. The typical format of gambling laws in the states is to prohibit all gambling except that which is licensed by the state government. Hence state governments will remain hostile to operators from other states and countries in the absence of some sort of licensing agreements.

Also, the importance of UIGEA should not be underestimated. Although UIGEA explicitly exempts intrastate gambling from the scope of its financial transaction prohibitions, it does not explicitly exempt interstate gambling, and such an exemption should not be implied even where states have negotiated an agreement to connect their markets.

An exemption for wagering between regulating states probably cannot be implied because UIGEA explicitly gives such an exemption to Indian tribes that choose to combine their markets (see 31 U.S.C. § 5362(10)(C)(i)) but does not explicitly give such an exemption to states (see 31 U.S.C. § 5362(10)(B)(i)). Hence the most plausible interpretation is that Congress intended that tribes should enjoy this exemption but the states should not. UIGEA’s banking regulations, therefore, could prevent transactions for wagering even between two states which have properly legalized internet gambling.

### Pre-UIGEA Violations

Another significant implication is that if the Wire Act applies only to sports wagering, then many foreign companies who served American customers prior to UIGEA’s enactment may never have violated federal law.

The likes of PartyGaming and 888.com, as well as several other companies licensed outside the US actively seek to return to the US market by way of software and services partnerships with American operators, but the potential for findings of past transgressions

poses uncertain risks when it comes to suitability determinations for licensing purposes.

If the Wire Act is not applicable, then these risks are significantly reduced. However, it remains to be seen whether regulating states will choose to hold such companies accountable for past violations of state laws.

### Fighting the Black Market

Given that unlicensed operating remains a violation of state law even if it does not violate the Wire Act, Legal Counsel’s new interpretation does not weaken UIGEA’s ability to combat foreign operators.

As Ronald Weich, Assistant Attorney General for the Office of Legislative Affairs wrote in his letter to Senators Reid and Kyl:

*[Legal Counsel]’s conclusion will not undermine the Department’s efforts to prosecute organized criminal networks. The significant majority of our current and past prosecutions concerning internet gambling involve cases where the activity is part of a larger criminal scheme. [Legal Counsel]’s conclusion will not undermine our ability to use other powerful tools, such as federal statutes prohibiting organized crime, racketeering and money laundering, to prosecute that type of criminal conduct. Furthermore, in states that ban various forms of gambling – including internet poker – the Department will be able to investigate and prosecute those gambling businesses under [UIGEA] and other sections of the criminal code.*

### Conclusion

Overall, we think the Justice Department’s new interpretation of the Wire Act is a very reasonable and welcome turn of events that is long overdue. It finally restores to the states their sovereign right to make and enforce their own gambling laws without having to fear a long and expensive legal battle with the Justice Department.

And ultimately we agree with Assistant Attorney General Weich, who concludes his letter to Senators Reid and Kyl by stating:

*“Of course, if Congress wishes to give the federal government greater enforcement authority over non-sports-related Internet gambling, it could do so by amending the Wire Act.”*

GBGC believes that the main beneficiaries to begin with will be the state lotteries and the software suppliers to those lotteries such as Lottomatica GTECH, Scisplay (Scientific Games and Playtech joint venture), and Intralot. Various European state lotteries have proven that the lottery model works particularly well for Internet because:

- the player has an audit trail of his selections;
- the lottery notifies him when the player wins;
- there is no worry about the potential loss of a paper ticket.

Lotteries, however, are wary of upsetting their established retail sales network, through which retailers earn commission from sales of lottery tickets. Internet sales are often perceived as a threat to the retail sales. In the immediate aftermath of the interpretation being published some lotteries were cautious about what it would mean for their games.

For example:

- Tim Poulin, acting Director of the Maine State Lottery, stated: “I think it’s fair to say that we have no immediate plans here at the Lottery to offer any Internet-based lottery sales.”
- In Florida a spokeswoman for Governor Scott said the governor is “undecided on the issue of internet ticket sales.” ♦

ins and implement store-redemption promotions, the internet is used to drive store traffic and support the retailers' business objectives.

*To what extent do you need to get the consensus of the entire membership to promote a political position? It must be more do-able when the position is one that everyone can easily agree on, like the preservation of a states' prerogative to regulate and tax gaming within its borders.*

**G. Medenica:** It can be very difficult. As you point out, the issue of the federalization of internet gaming is one that everyone can agree on and in fact did galvanize us to take action. NASPL did take a position, articulated that position in a letter to members of U.S. Congress, and attempted to convey our concerns to all public policy stakeholders. The member vote on this was almost all in favor, with a few abstentions and nobody voting against it. And that is because everyone opposes the federalization of i-gaming; even though we may have very different reasons for opposing it. Some people are opposed to internet gaming altogether. They do not want the federal government to legalize internet poker or any kind of internet gaming because they prefer that i-gaming be prohibited everywhere, and especially in their own state. Others oppose the federalization of i-gaming for practically the opposite reason. They want the regulatory and taxation framework to be controlled by the state so that it benefits the in-state constituents instead of the federal government and private commercial interests. And I'm sure there are variations on those two basic positions. It is interesting, though, because it certainly is uniting some strange bedfellows with disparate points of view but coming together with the common objective of opposing the federalization of internet gaming.

*It seems like this issue has elevated the role of NASPL, mainly because the need was so pressing for NASPL to take a stand.*

**G. Medenica:** I think it has brought everyone together and revealed the more impactful role that NASPL can play. NASPL is a tremendous resource and it has been a learning experience to see how those resources can be applied. There were, for instance, strategic meetings a couple years ago in which we explored the ways in which NASPL can serve a more active role in public policy issues. There were some who thought that NASPL ought to

become a very aggressive lobbying organization, promoting an agenda consistent with lotteries and the good causes they benefit. There were lots of arguments for and against. On a very practical level we realized we could never compete with real lobbyists because we just don't have the money. Further, NASPL does have an obligation to each of its members to stay consistent with each lottery's state-specific policies and political positions. So there are limitations to what NASPL can do.

There are two fantastic things about the efforts to inform policy-makers about the implications of federalization of i-gaming. First, it has caused us to realize that our association can make a real difference - not that we were the decisive factor. The battle is not necessarily over for that matter. But we are contributing to the dialogue in a material way and that is very rewarding. Two, it has shown us that we are capable of overcoming our differences, honing in on the common ground to all of our causes, and then formulating and implementing an action plan. We can now really see that working together can produce results that we would not be able to accomplish on our own. The strength of lotteries will always lie in its local and grassroots level support. It is the connection with the consumers that reside in our own in-state market that drives the business and is the source of whatever influence we may have. But it has been very rewarding for all the directors to see the impact that their industry association can have in translating those local interests onto the national stage. Of course, the effort to stop federalization of i-gaming began with past NASPL president Ed Trees, continued with immediate past president Jeff Anderson, and will continue after my term ends in September. And it all is really a tribute to the willingness and ability of the entire membership to work through our differences and build a coalition that takes action to defend the interests of our good causes and all lottery stakeholders. Credit is also due to the vendor community for all of their tremendous efforts to lobby and exert influence at the federal level. Everyone has come together to defend the prerogative of states to determine regulatory and taxation policy in all sectors of gaming, gambling, and lottery, and to prevent the federal government from acting in ways that would damage the state lotteries. It's been rather a unique alignment of the sun and the stars, allowing us to take this unified position

that is fairly unusual in the history of NASPL.

*It is thrilling to see how meaningful our industry association can be, how a membership that works together can make a real difference. What else is on the NASPL agenda for 2012?*

**G. Medenica:** I think one of the most important roles that NASPL has is to facilitate communication. That applies not just to hot issues like i-gaming. NASPL serves as a great vehicle to disseminate information, to foster a dialogue about troubling issues, and to promote a best practices approach to improving our businesses. For instance, we all know we need to accelerate the rate of adoption of new technologies and progressive business practices. NASPL can help us all to learn from the experience of our peers so that we might replicate success and minimize mistakes. NASPL has always done a great job at bringing us all together, enabling us to talk among ourselves. However, i-gaming was an issue where we agreed that it wasn't enough that we talk with each other, we needed to reach out and get an important message out to everyone who has a stake in protecting the interests of states and their lotteries. While we don't have the apparatus for high-level lobbying, we have a level of grassroots support and in-state support that may be just as powerful. But only if we are all fully engaged in the business of getting this message across to the people that count. We have found, frankly, that there is a lack of knowledge and understanding about issues like federalization of i-gaming and other regulatory matters. Instead of thinking about it as "lobbying," we should just think of it as effective communication, making sure all constituents are fully informed.

*So we are achieving some measure of success at getting our message out beyond the confines of the lottery industry and onto the agendas of policy-makers. How can we get this message into the general mass media?*

**G. Medenica:** That again is a fortuitous aspect of the i-gaming issue. The nature of its being national and of widespread interest and importance to everyone, has perhaps freed us up to address it on a policy level. Many state lotteries are really not at liberty to speak out on state-specific issues of public policy. That responsibility typically lies with the elected officials and others in state government. But the regulation on internet gaming is an issue of such singular importance, and affects

all states in somewhat similar fashion, that somebody had to take a stand in defense of states' interests. And that somebody clearly had to be us. Lotteries are the states' connection to the gaming industry and so lottery directors should be expected to contribute to the policy process in matters of such importance. The general media has taken an interest in the federalization of i-gaming because it is a national issue affecting everyone. And on a practical level, we're not really impinging on the turf of our in-state policy-makers.

*Education has always been a vital component to the NASPL mission and service to its members.*

**G. Medenica:** The participation at the professional development seminars has never been higher. And we are working hard to build on the tremendous success of 2011 to create an even more exciting professional education program for 2012.

*What kinds of things are you doing to improve upon those past successes?*

**G. Medenica:** The committee structure of NASPL has been redesigned. There were about a dozen committees and then maybe eight or ten subcommittees. It was not clear how all these groups should work together to accomplish the association's goals, one of which, for the subcommittees, is to set the agendas for the professional development seminars. We've decided to rename the subcommittees the "Professional Development Steering Groups". Functional business areas like accounting, audit, distribution, video operations, IT, legal, PR, sales and marketing, security, operate in ways that are not always similar to other businesses. Experience in oth-

er industries and higher education is not adequate to prepare our top managers to operate in the lottery business. So we provide special lottery-specific training. NASPL is the perfect institution to consolidate the brain-trust existent within our leadership, and translate that into professional development seminars for the benefit of all our members. The ability to harness the experience and intelligence of the leadership of this industry and apply that to develop the next generation of leaders is a core attribute of NASPL. And, really, what could be more important than that?

We're also consolidating the main NASPL Committees to be more relevant and significant. For example, we used to have separate committees for awards, seminar break-out sessions, and conference site selection. All those things relate to the conference, so we grouped them together to create a Conference Committee which will now deal with all of the issues.

*Any new committees, new areas of focus?*

**G. Medenica:** We are placing a renewed emphasis on the product development committee. The next step after cross-sell was to differentiate the two super-jackpot games. That is happening with the \$2 Powerball change. Now the next step is to create a new national game, also called a 'premium game' because it might be a \$5 ticket. That committee has been led by Arch Gleason and Margaret DeFrancisco who have done a tremendous amount of work. We are very fortunate to have those two industry veterans and leaders on that project. At the same time, there is a WLA group, consisting of Camelot, FDJ (the French Lottery), and MUSL that's been working on a world game. And so you have these different multi-jurisdictional and even international game de-

velopment efforts. I would like to see NASPL take a little stronger role in helping that process along so that it's not viewed as necessarily a MUSL project or game or a MegaMillions project or game. NASPL is the one truly all-inclusive and national organization that could perform that role of coordinating the efforts of the different lotteries, consortiums and associations. I've asked Margaret DeFrancisco to chair that committee and she thankfully accepted. That's another example of a NASPL role that I'd like to see expanded through the redesign of the committee structure.

And the government relations committee has had a huge amount of visibility this year, hopefully to positive effect! NASPL will continue to work hard to influence the political process when it serves the interests of its members.

*It sounds like you have a few things on your agenda for NASPL this year.*

**G. Medenica:** It has been an evolutionary process. NASPL has always evolved with the marketplace and with the issues of the day, just as any vibrant organization must do. Fortunately, NASPL has a history of being supported by an enlightened membership that is focused on protecting the interests of lottery stakeholders, and pushing for progress as times and circumstances change.

Last year, for example, a change that has broadened our base of support is to create a more affordable associate membership to bring in the smaller vendor community. Delivering value to a broader base of constituents, and engaging their active participation and financial support, makes NASPL a stronger organization. ♦

*Michelle Carinci* ...continued from page 22

store traffic.

*How did you engage the support of your retailers in the beginning?*

**M. Carinci:** Back then, our first order of action was to be certain that age verification and geo-location functions were extremely reliable. The reputation of the lottery depends on that, which makes it mission-critical. The technology has been in place for over a decade now, is used by many lotteries all over the world, and is proven to be reliable. Our second order of action was to make sure our retailers are engaged and motivated to support our ef-

forts to sell products over the internet. Along with reputation and brand value, the land-based retail network is lotteries' most valuable asset. We were not going to do anything to hurt that relationship. But we are also not going to let a lack of understanding impede progress and increased funding for our beneficiaries. It turns out that there is no conflict between the two because the internet can drive sales and profits for both the lottery and the retailer. It is true that a thoughtful plan is needed to communicate and convince the retailers of the commitment to that partnership and to protect the earnings of lottery retailers.

*What did you do to make sure that the sales and profits of your retailers stayed on a positive trend-line?*

**M. Carinci:** It is important to make a couple of key points first to create some context for those considering offering lotteries and gaming on the internet.

The majority of current players are not looking to replace their lottery experience at retail by moving to the internet. Internet players are typically looking for a different social and gaming experience than what the

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to generate a huge amount of publicity, especially in smaller markets where everything we do is newsworthy.

Getting the customers to come out to see us builds incredible good will with our retailers. Now the retailers want to know when we are coming so they can pitch in with their own promotional campaigns and join in the fun. We're creating the buzz around our products so that's good for us. But we're also creating buzz around the retailers' location and that is great for them. In fact, none of them have ever seen anything like it. Now they are all eager to make sure that our POS's are up and running. Of course, our sales rep's know that won't last without their constant attention. We won't necessarily maintain the high that happened at the time of promotion, but we do feel that there is a permanent increase in the level of commitment and attention that lottery enjoys at the retail level.

We increased our Scratcher facings in some locations from eight facings to 16 in the St. Louis and Kansas City area. We had one chain go from eight facings to 16 facing on both sides of the state which increased sales for that chain by \$3.2 million or 21% from the same four quarters the previous year.

*You're doing this in spite of, or perhaps because of, a 25% reduction in advertising costs.*

**M. Scheve Reardon:** We knew we could not sit in our offices and just orchestrate advertising and sales promotions to get the results we need. Not just because our ad budget was cut, but because we have to get out from behind our desks and get out and sell tickets. This isn't a forty hour a week job. It is a calling, really, an exciting privilege to get out there and engage the public to remind the folks about all the good that the Missouri Lottery has done for 25 years for elementary, secondary, and higher education. And how much fun it is to play games that create millionaires. It reenergizes our customers, it reenergizes our staff, it stimulates those lapsed players and it brings in an amazing amount of new players as well.

The legislature gave us our number, \$267 million, in the beginning of May. At the time, we were just trying to reach the finish line of fiscal 2011, working like crazy to hit our number of \$259 million. To have our number increased and our budget cut

at the same time could have been a morale buster. But our team rallied around our new mission, we put our heads together and decided that this will be done and now it's just a matter of doing it. We were energized, we enjoyed some early small successes which inspired us to share our confidence and excitement with our players and retailers. And now I feel like we are all a mutual reinforcement society. To date, we are 8% over last year sales, 6% above our YTD target, positioned extremely well to take full advantage of the 'More, Bigger, Better' \$2 Powerball launch, and have a good pipeline of exciting products and crazy promotions to carry us to the finish line.

*Your legislature explored the possibility of privatizing the lottery, or executing a form of private management agreement (PMA). Whatever became of those discussions?*

**M. Scheve Reardon:** Many states are challenged by fiscal crises and are exploring ways to extract more value from the assets under their control. The Missouri legislature looked into the possibility of restructuring a long list of state-owned assets. The Lottery was just one of many on that list, and just one topic in a series of hearings. It was a brief conversation. We provided information as asked, as did one of our vendors. Nothing has been pursued. I can't say what will happen in the future, only that no other hearings have been held and no action has taken place.

*Were you invited to express an opinion when the MO legislature was exploring management structure options, or the possibility of outsourcing a larger portion of the management of the lottery?*

**M. Scheve Reardon:** Part of my job description as executive director is to research and explore trends that are happening throughout the nation and see how they affect or could affect the Missouri Lottery. Understanding the issues and how they affect an important asset that belongs to the state of Missouri is part of my job description. It is my responsibility to share whatever knowledge and insight may have been gleaned by my experience as executive director of the Lottery, and the study that I do to understand the gaming and lottery industry, and to be without political or personal agenda as to the recommendations I render.

I did testify, though the hearing was brief. Of course, my primary duty as a public servant is to optimize the performance of the state's Lottery.

*Do you think that the twelve years you served in the state legislature has influenced and perhaps informed the way you approach the job of leading the state lottery?*

**M. Scheve Reardon:** Yes, definitely. I feel that I can relate to their concerns better for having served in that position. It can be hard to fully appreciate the kinds of pressure, and irreconcilable differences, and all varieties of challenges that legislators must deal with on a daily basis. As a result of my service in the legislature, I appreciate and respect what they do, I try to anticipate how our actions will affect them so that I can manage the Lottery in ways that are consistent with our legislative agenda, and ways that avoid undermining that agenda. And I try to translate the concerns of our legislature into terms that are understood by our team here at the Lottery.

*As in helping your team to not be frustrated by the demands of the legislature, to not misinterpret those demands as being obstructionist.*

**M. Scheve Reardon:** Right. Just remember that their job is to answer to a myriad of different constituents. So give them the information they need, the tools they need, to garner the support of those constituents, or in perhaps defuse the opposition of some interest groups. I hope that my years in the legislature help me to know how to frame the issues and answers in ways that help the legislators communicate effectively with their constituents.

*On the other hand, I find it interesting that you have a rather aggressive entrepreneurial approach towards managing this business.*

**M. Scheve Reardon:** Of course. It's never that legislators don't want results. They just don't want problems. So it is our job to give them results, and to do that without creating any problems.

*Simple as that.*

**M. Scheve Reardon:** The state lottery is a business. It operates in the same arena as other giant consumer products companies,

and competes with those companies for a share of the discretionary dollar. We need to approach our business with the same level of bold aggressiveness as they do. We can make a list of 20 excuses as to why we can't do what private commercial companies do and why we can't accomplish our goals. Or we can take away those excuses, try to think outside of the box, try to think about how those for-profit entities position their product, how they market their product, how they service and build relationships with their channel partners, how they deal with budget cutbacks. Do you think Jack Welch, or whatever corporate CEO you think of as a hard-driver, would have said "since we're cutting your ad' budget, we don't think it would be fair to ask you to increase your sales"? We all have our challenges. The Missouri Lottery operates within a political system, but our legislature wants us to operate like a business to achieve our goals. And so we do.

*Like other lotteries, the Missouri Lottery has sponsorship agreements with numerous different sports franchises. But it seems like the Missouri Lottery does more with their sponsorship relationships.*

**M. Scheve Reardon:** That's a really good question. I'm born and raised in Missouri, and a passionate sports junkie. Perhaps that is why I have enjoyed rolling my sleeves up and getting more involved in the process of working with our sports franchises to create new ways to add value to the collaboration. We had these sponsorship agreements when I joined the Lottery two years ago. But I have enjoyed digging into the whole business to see how we can take everything to another level. For instance, it costs nothing, and benefits both the Lottery and the sports franchise, and creates a newsworthy promo event, to recognize people in the community whose service or actions deserve to be honored. Our beneficiary is Education. So we now have a program to recognize a teacher, a hero in the classroom, every month. We create media events that loop in great teams like the Royals and the Cardinals, leverage the passion that sports fans have to bring attention to Education, and tie that in to the fun and excitement of our games. In college sports, the Missouri Valley Conference is a huge event. That's all about a

great four day weekend in March of basketball playoffs. The tournament is called Arch Madness after the St. Louis Arch. People come from all different states. We make sure the Lottery is a big part of the celebration and the whole PR machinery. The Lottery supports Education and so these teams and the institutions are happy to work with us, to help us promote the Lottery. And the Lottery is fun and exciting so it actually helps to promote them, our sponsors and their events, as much as it helps us. There is so much that can be done to integrate lottery into the fabric of popular culture and people love it when we make the effort to do that. The main thing is that the Lottery has huge intrinsic value as a promotional tool. Our product is all about fun and excitement and so it is a welcome addition to anyone's PR and marketing strategies. We think of retailers, sports franchises, our customers, our beneficiaries, and every citizen in the state of Missouri as our partners. Lottery can be the catalyst that brings us all together. The ways in which we can all help each other are limited only by our imagination.

*And the excitement would be in overdrive for the World Series Champions St Louis Cardinals.*

**M. Scheve Reardon:** Of course. The state of Missouri is one big full of Cardinal fans. Cardinals fan club. So we'll use that affiliation to engage everyone in the Lottery, to bring everyone together, the retailer, the sports fan, the lottery player, the lottery sales rep', the education community, to celebrate the Lottery mission and its service to the community and the great games we have for everyone to enjoy.

*Extracting every ounce of value out of every asset seems to be your path towards making your numbers.*

**M. Scheve Reardon:** Another example of stretching the advertising dollar is to use every consumer touch-point to promote the product. We wrapped vans with lottery promotional banners to create moving billboards. Though that is tricky because people follow us or come up to us when we park to get free samples. We advertise the lottery on all in-store terminals which costs us little to do yet promotes the lottery at the most critical time, the point of purchase.

They're great visuals, colorful and with our logo and current themes. And ITVM's don't just provide another POS. They too do double-duty as giant in-store displays.

*The mission of lottery is to support Good Causes. In the case of the MO Lottery, that is Public Education. There seems to be a little confusion over how, or even whether, to integrate the public service mission into the marketing message. You seem to do it organically, like it is a part of all your messaging but only as a supporting actor to the main message of great products and community and other things.*

**M. Scheve Reardon:** I come from a very strong fundraising background. It may sound corny, but you and everyone in the organization has to be 100% committed to the cause, to really believe in it with all your heart. It makes all the difference. The business of lottery is to sell tickets and so in a way our business might seem to be one step removed from the mission of fund-raising. But why would we ignore the incredibly exciting mission that our business supports? Again, it is a tool to bring everyone together and so it would be a terrible waste to not use it. You are alluding to the fact that lottery players don't buy tickets because the profits go to support Good Causes. So the media message of "buy lottery products because the profits go to support Education or Good Causes" is not effective. But our public service mission is a key component to a broader media and promotional message that focuses on fun and exciting products, coming together as a community, rallying around our common interests like sports, celebrating all of that and celebrating the fact that it's all for a Good Cause. Of course it's not the dominant buying motive for the lottery player. But like icing on a cake, it should be a part of all media messaging because it does make a really big difference to the overall relationship that lottery has with the community, the sports franchises, the lottery staff and sales rep's, the retailers, and everyone involved in making it all resonate for the player. There is nothing more inspiring, there is no better sales pitch, than a genuine heart-felt belief in what you are doing. That's why belief in the mission of Lottery is such an integral part of everything we do at the Missouri lottery. Plus, it just makes everything more fun! ♦

bringing more retail opportunities and gaming solutions for lottery and this includes on-line and social media. Whether its payment processing, winner redemption, secure transaction logging or game design our engineers are chomping at the bit. Having said that, we're keeping them busy as it is!

*What is involved in enabling the conversion of electronic payment processing devices into lottery terminals?*

**D. Cage:** Over the course of the last three years we have aggregated the payments side of the transaction and can now provide the lottery a single point of access to a massive footprint of POS devices. On the ATM side, we contracted with the nation's leading ATM manufacturers, the owner groups, and the processors to make that a reality. To enable other kinds of POS devices Linq3 has forged some fantastic partnerships that we believe will help shape a new landscape for distribution. We have recently partnered with VeriFone to enable fuel pumps and taxis for lottery (with in-lane solutions to come).

The lottery can scale these programs efficiently and quickly due to this single point of integration that provides transactions, reporting, web support, redemption and a number of other service related functions.

*The Linq3 solution isn't just about increasing the number of POS. It's also about enhancing the player experience by exposing them to additional information services that can sell lottery products. The screen can display all different kinds of messages, for both the lottery and the retailer?*

**D. Cage:** Yes, our screens provide a convergence of media, advertising and purchasing capabilities. A great example is taxi screens in New York City. A taxi passenger is sitting in front of a screen as a captive audience with full media and transaction capacity. This is the ultimate in driving an impulse buy to lottery and we're excited about the potential performance on this platform.

Our focus is on delivering an optimal consumer experience that appeals to the players and drives revenues, integrates the retailers into the value chain so that they understand how it aligns with their own business objectives. We are focused on achieving this with the entire process meeting the highest standards of integrity and security.

Enhancing the player experience and evolving the business from being transac-

tion-driven to being relationship-driven is another benefit. The exchange of information is the first step towards building the kind of interactivity that we all know is the key to creating the kind of dynamic relationship that keeps the consumer engaged.

*Can you give some detail about the player benefits?*

**D. Cage:** For the player it will include a variety of benefits including auto redemption for winnings under \$600, a web interface to view play history, results of lottery transactions, options to opt-in to receive text alerts of jackpot levels, a 24/7 call center support to name a few. We're not only increasing the number of POS, our goal is to use our technology to create a great player experience. Our screens have the ability to give the player a menu of options, answer questions, and offer promotions and bonus plays.

*Even more than most business models, this would seem to be a technology-driven solution.*

**D. Cage:** It's true, our technology and the security built into it is paramount. Talking about marketing and distribution benefits really doesn't matter if the transactions are not at the highest level of performance and security. That is essentially what we have spent the last three years building. We employ top tier PCI-DSS security, the highest level of data security for debit/credit processing. We have SAS 70 data centers, powering transactions speeds that are comparable to wagering on current gaming systems. We also use third party testing prior to going live, which ensures objectivity and integrity to the whole process. So, as much as we have talked about the marketing aspects of the Linq3 solution, at its core, we are a secure transaction-processing provider.

*As an organization, how does this focus play out?*

**D. Cage:** Security is the first thing we think about when investing in infrastructure, hiring and even strategizing product development. Linq3 hires the highest level of talent for engineering these secure transactions, partner connectivity and data management. And although the technology is incredibly sophisticated on the back end, the implementation of it from the operator point of view is straightforward.

The process of providing a highly secure solution from the start involves extensive real-time field-testing, and an ongoing process of collaboration with the lotteries to

evolve our technology and products to deliver maximum value.

*In locations participating in the fuel pump lottery program is there a concern that retailers might have about losing store traffic. One of the benefits of lottery is that it causes the consumer to come into the store and proceed to buy other stuff in addition to lottery.*

**D. Cage:** Our solution has the potential to actually increase store traffic. For example, 70% of fueling customers never go into the C-store. The flexibility to include additional media to drive the customer into the store could in fact, increase store traffic. The same messaging that is promoting lottery on the screen at the pump also promotes product tie-ins that the customer redeems in the store. Just as we are creating a whole new class of customer for the lottery, we are also creating a new class of customer for the retailer. Keep in mind too, we just offer the draw games. Instants and any bonus-play, Megaplier, or PowerPlay options need to be purchased inside the store. So really, we're capturing a new set of customers for the benefit of both the lottery operator and the retailer.

*Can you tell us more about responsible play?*

**D. Cage:** The responsible play features we take very seriously. We provide daily play limits set by the lottery, which are a unique feature we're proud of. We also have various age control features that are based on the terminal type and location. Our on-line support also is a platform for additional responsible play resources.

*It is easy to see that the market is huge and your solution is scalable. But how easy is it for the operator to get started on a smaller scale before they commit to a big implementation?*

**D. Cage:** It's easy, and we actually recommend starting on a small scale. Every jurisdiction, and every market is different with unique objectives. Some jurisdictions want us to focus on both current lottery and new retailers while others want us to do the opposite and focus on only non-lottery retailers. As the Linq3 solution is integrated into the lottery's operation, we can scale up as it makes sense for the operator.

The way in which we source locations is an ongoing collaborative process with the lotteries. First, we talk with the lotteries about the

different options, the different ways to segment retailer profiles and consumer groups, and then clarify the types of retailers the lottery would like to access first. We then get a list of addresses, stores, and location types from our processing and terminal partners. Included in that data set is the detail needed to analyze the market, the competition, the proximity to other lottery retailers. The lottery then decides what locations to approve, how the recruitment will be executed, and whatever other details of implementation need to be determined. Linq3 essentially functions as a conduit that connects the lottery to this entirely new network of ATM's, alternate POS, retailers, and payment processors. It all intersects at Linq3's payment center that processes these secure transactions.

*Michelle Carinci* ...continued from page 33

lottery offers at retail. This will vary somewhat from between markets, but draw games represent a very small percentage of the internet gaming pie, one or two percent, on the other hand those offering sports betting will see double-digit percentages and once interactive social games like multi-player bingo are added to the portfolio there is significant activity. Lottery games offered at retail today will not be noticeably cannibalized. The sales will be incremental.

My second point is that mature lotteries around the globe have experienced a slow but steady decrease in their core player base over the past years. One of the reasons is lifestyle changes that changed the frequency of retail visits. The internet offers the lottery the opportunity to acquire those lapsed players and drive retail sales at the same time.

At ALC it was decided to introduce existing lottery products first, the same products that are sold at retail. The more interactive and social new game styles that have more appeal to the internet gamer, was part of the second phase of the plan. To engage the support and cooperation of our retailers from the beginning was very important to sustaining the existing strong relationships. The goal was to target lapsed players, preserve the earnings of the retailers, and gain insights into this new world of digital. Maximizing the impact on sales was not the short-term goal, how we sell was always more important than how much we sell. So our strategy was not to target players who were already engaged in playing at retail. In fact, it was the opposite. We

*How do the additional supply chain partners, like the ATM owners and payment processors, get paid?*

**D. Cage:** Linq3 manages payment to all supply chain partners. These include the terminal owner, processor, payments networks, and merchant. Linq3 captures the current retail commission per jurisdiction.

Describe the actual transaction from the player/consumer perspective.

It's an easy, fun, secure new way to purchase lottery for people who usually don't! The user experience differs slightly depending on the location and terminal type but I'll take you through a basic example. After the player selects lottery, they are presented with a simple screen offering 5, 10, 20 quick pick Mega Millions or 3, 5, 10 quick pick Powerball tickets. Before confirmation of pur-

chase the player is prompted to enter their mobile number to receive a text link of their purchase (entering number is not required). The player confirms purchase and collects a receipt with their printed lottery plays. The entire transaction is quick and designed to be straightforward and easy to use for players.

There has never been anything quite like this as a tool to grow the retail footprint. As traditional and on-line opportunities evolve (including Linq3 products), very few will offer the explosive expansion for accessing an impulse purchase the way that an active POS location does. We believe that the ability to turn this immense network of POS into lottery touch points, the ability to attract entirely new consumer groups, and the speed and efficiency at which it can be implemented, is revolutionary. ♦

knew there was a group of consumers that was more active on the internet, not playing at retail, and that many were lapsed lottery players. That is who we targeted.

The goal of increasing sales to lapsed or otherwise inactive consumers groups was also the solution to avoid cannibalizing the retailer business. No big media campaign. It was all online advertising with no mass media. I would interject to say that this would be a more conservative approach than most operators would want to do today. With the benefit of seeing what works and what doesn't, it would be easy to accelerate the entire process, and actually deliver more benefits faster to your retailer constituents. But this is what we did six years ago. Retail sales were tracked and surveys were conducted. The majority of play at the outset was from lapsed players and sales were incremental.

*I can see how that approach would minimize cannibalization of retailer sales. But how does it drive lottery sales and store traffic in a positive way?*

**M. Carinci:** We used a "web-cash" or "e-cash" tool. In order to play on the internet, the player is required to buy this web-cash for the first transaction at the retail store. The retailer is paid their normal 5% commission on that sale. Then, once the player is registered and in the system, they have the option of depositing funds directly from their account to the lottery or to return to the store to buy web-cash. The players do not have to return to the retailers if they do not want to. What's interesting is that

as of last spring, several years later, over 40% of the players go back to retail to buy web-cash. So the retailer is still benefiting from the purchase of the web-cash and the internet play. I would expect that at least some of the players who are attracted by way of online banner advertising, and directed to go to the retail store to buy web-cash, in many cases are consumers who were not already going into the store. We were surprised at the percentage of online players that chose to return to the retailer to buy web-cash. The web-cash system was driving new consumers into the store and moreover, these players who come in to buy web-cash often ended up making impulse purchases of other consumer products, or an Instant scratcher or some other lottery product while they were there.

The main thing is, our studies indicated that the majority of the players who bought online were not previously buying at retail. Retailers did not lose lottery sales, and they did gain new customers.

Training, education and communication with retailers is critical to success. Helping them to understand the benefits with facts and how to take full advantage of the increased selling opportunities is important to sustain that healthy partnership which has been the lottery's bread and butter for years. Too, web-cash is only a tool, and is not a necessary component for an effective retailer engagement program. Many operators do not use e-cash and the results speak

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# European Austerity Measures to Hit Gambling Spend in 2012.

## GBGC 2012 Turnover and Gross Gaming Yield Forecast for UK, Greece, Italy, Ireland, Spain, and France

Gambling spend in key European markets will decrease in 2012 due to austerity measures.

### UK

- The gambling industry Gross Gaming Yield (GGY) growth to grow by only 0.5% in 2011 with growth picking up in 2012
- GBGC's 2011 estimate show that casinos and lotteries performed well, while horseracing is expected to end 2011 in sharp decline, with further loss of market share in 2012.
- The land based bingo industry will decline by 3% in 2011 and 4.5% in 2012.

### Greece

- The Greek gambling industry is estimated to shrink by an incredible 17% in 2011.
- With introduction of Video Lottery Terminals (VLTs) in 2012, the gambling market will grow by more than 12% but would have shrunk by 2.5% without VLTs.
- By the end of 2012 land based casino's revenue is forecast to shrink by more than a quarter

### Spain

- Spanish GGY estimated to decrease by 3.3% in 2011, due to decline in household income, unemployment and the smoking ban.
- Worst performers in 2011 are land based casinos and bingo halls
- 2012 launch of the Spanish online gambling market, however the whole of the gambling industry will decline by 1.6%

### Italy

- The growth estimate for the Italian gambling market for 2011 is an unprecedented 24.5%, boosted mainly by slots, VLTs, lotto and lotteries.
- In 2012 however, growth will slow down markedly to around 5%, again on the strength of gaming machines and the pickup of sports betting.
- Online cash based poker and casino gaming estimated to grow in 2011 but 2012 will be a difficult year.
- Italian horse racing in terminal decline

### France

- French gambling industry GGY estimated to grow by a healthy 6.7% in 2011, thanks to online poker, lotteries and horseracing. GGY growth will slow to 2.3% in 2012, mainly fuelled by lottery and land based sports betting
- Online sports betting has disappointed and will continue to do so unless the online tax system is changed

### Ireland

- Irish gambling market GGY is estimated to shrink by 4.5% in 2011. All gambling segments will decline compared to 2010 with horseracing and gaming machines GGY performing the worst
- Aggregate gambling GGY will decline a further 1.6% but lottery and sports betting are forecast to have turned the corner in 2012.

*Sports betting turnover is forecast to grow in Italy, Greece, Spain, Italy, France and Ireland due to the Euro 2012 football tournament in Poland and Ukraine in the summer of 2012. However, the profitability of bookmakers in each country is dependent on how the national team performs. More the national team wins, the higher the pay-out to players, as most people tend to back their own national team.*

If households and operators in Europe thought they had a difficult year in 2011, then they will find no respite in what will be an even more trying 2012, especially in the UK, Greece, Ireland and Spain, where governments had to undertake difficult austerity measures. In 2012, Italy and France will also join them.

In a previous analysis conducted by GBGC on how the "great recession" of 2007-2009 affected the gambling spend of punters, GBGC's research showed that the gambling industry is not immune to the contraction of the economy.

GBGC has been for the last 12 months tracking the economic performance of the various countries in the Eurozone where austerity budgets were passed so to analyse how austerity measures that have been, or are about to be undertaken in key European countries such as the UK, Greece, Spain, Ireland, Italy and France affect the Gaming Gross Yield (GGY- player spend minus pay-out) of gambling operators.

The more severe public expenditure cuts and tax rises were undertaken by Greece and Ireland, the two countries that required a bail out by the European Union (EU) and the International Monetary Fund (IMF).

Italy and Spain had to implement their own austerity measures to avoid the fate of the Greeks and the Irish, while at the same time avoid doing irreparable damage to the economy of the Eurozone and the survival of the common currency. Even a country like France, a country not long ago considered one of the safest economies on Earth, was put under duress by the financial markets and had to pass a small package of austerity measures to safeguard its treasured triple A rating.

While UK, Greece, Spain and Ireland passed a 2011 under the banner of austerity, the bulk of public expenditure cutbacks and tax rises in Italy and France will commence in 2012.

GBGC's 2012 gambling turnover and GGY forecasts of Greece, Ireland, Spain, Italy and France have been re-drafted due to the effects of austerity measures on household incomes in these countries. We estimate that discretionary income in the aforementioned countries will continue to worsen and households and consumers will come under unprecedented duress in the coming year.

#### UK - Turnover and GGY (€ m) 2011e-2012f

	Sports Betting		Horse Racing		Casino		EGM*		Lottery		Others (Bingo)		Total GGY
	Handle	GGY	Handle	GGY	GGY	GGY	Sales	GGY					
2011 Est.	25002	3625	10231	1299	699	3292	5825	2840	1242	373			12128
2012 Frct.	26377	3825	9617	1221	751	3381	6203	3021	1186	356			12555
Var. %	5.5	5.5	-6.0	-6.0	7.5	2.7	6.5	6.4	-4.5	-4.5			3.5

\*Electronic Gaming Machines  
Source: GBGC

The austerity measures undertaken by the government of the United Kingdom (UK) are the most severe since the end of the Second World War. The austerity measures with cost an average British household around £1000 in 2012, following the £900 in 2011. According to the Institute of Fiscal Studies, real disposable household income will decrease by 1.1% in the 2012, following the 3% decline in 2011. Real mean earnings growth (which take into consideration inflation) will diminish by 1.3% in 2012, following the -4.3% of 2011. This is the largest fall in British living standards since records began in mid-50s.

The UK gambling industry GGY is estimated to grow by around 0.5% in 2011 compared to 2010. Casino gaming is expected to have an excellent 2011, producing revenue growth of 9%. Lottery products also performed very well in 2011, with an estimated GGY growth of 6.5%. The National Lottery has been particularly aggressive in pushing sales throughout the year, as it is responsible to provide funds for the infrastructure projects of the London 2012 Olympic and Paralympic Games.

2011 was a bad year for betting activities; sports betting GGY is estimated to decline by 5% and horse racing GGY by a steeper 8.7%. Bingo gaming is also estimated to produce poor results, ending the year with -3%.

GBGC forecast the UK gambling industry GGY to grow by 3.5%. Like in 2011, the main boost to GGY growth will derive from Lottery products (+6.4%) and casinos gaming (+7.5%). Land based casinos, particularly in London, are expected to provide a

sustainable growth next year as they depend on high rollers, and high rollers are marginally affected by the general loss of disposable income. Casinos will also benefit from the high tourist traffic into London attracted by the Olympic Games.

Sports betting will also pick up activity in 2012. In an economic environment where income was increasing instead of falling, the growth rate of sports betting GGY would have surged by around 7% to 8% because of the Euro 2012 tournament in Poland and Ukraine, but under the current economic conditions sports betting handle and GGY are forecasted to grow by a more modest 5.5%. But if England does perform well and advances far in the tournament, UK bookmakers will produce a lower GGY will due to high pay-outs.

The UK horseracing handle and GGY is estimated to again decline in 2012 compared to 2011, but at a slower rate of -6%, as the industry continues to lose market share to other gambling activities, especially sports betting and fixed-odds betting terminals installed inside betting shops.

Land based Bingo operators, particularly outside the South East of England, will find 2012 another challenging year as their customer base is particularly vulnerable to the deterioration of disposable income due to austerity measures. Bingo's revenue loss is expected to slightly accelerate in the coming year (-4.5%) compared to 2011.

#### Greece - Turnover and GGY (€ m) 2011e-2012f

	Sports Betting		Horse Racing		Casino GGY	EGM*	Lottery		Total GGY
	Handle	GGY	Handle	GGY			Sales	GGY	
2011 Est.	1545	277	191	38	437	0	2742	705	1457
2012 Frct.	1579	283	168	34	399	220	2741	704	1640
Variance %	2.2	2.2	-12.0	-12.0	-8.6	n/a	-0.04	-0.04	12.5

\*Electronic Gaming Machines  
Source: GBGC

The Greek government issued the most draconian austerity measures in the Eurozone. By some estimates Greek austerity measures in 2011 make up a cut of more than 13% of take home household income. This dramatic situation is also accompanied by an unemployment rate of 18.4%.

GBGC's 2011 estimates for the whole Greek gambling industry are a testament to this state of affairs. Combined GGY for 2011 is estimated to come out at €1,14bn, a drop of 17.1% compared to 2010. Not one of the Greek gambling segments was spared from the general revenue downfall, but sports betting GGY, with -21%, and land based casinos, with -17%, are the hardest hit.

GBGC's forecast for 2012 sees the Greek combined gambling market GGY increase by 13% compared to 2011. GGY growth is boosted by the introduction of 35,000 Video Lottery Terminals (VLTs) next year, that will be exclusively operated by the partially state owned monopolist OPAP. VLT's will add around €20m into the gambling market. Without the introduction of VLTs, aggregate Greek GGY would have shrunk by 2.5%.

GBGC's forecasts show a slight growth of around 2% of sports betting GGY due to the Euro 2012 tournament in the summer, where the Greek national team is participating. Greek land based casinos will face another difficult year, growth declining for the fifth year in a row.

## Spain Turnover and GGY (€ m) 2011e-2012f

	Sports Betting		Horse Racing		Casino		EGM*		Lottery		Others (Bingo)		Total
	Handle	GGY	Handle	GGY	GGY	GGY	Sales	GGY					GGY
2011 Est.	507	221	18	6	315	3351	11256	4333	2032	752			8978
2012 Frct.	533	232	17	6	331	3301	11031	4247	1930	714			8830
Var. %	5.0	5.0	-3.0	-3.0	5.0	-1.5	-2.0	-2.0	-5.0	-5.0			-1.6

\*Electronic Gaming Machines

Source: GBGC

The austerity measures took away around €1,100 from Spanish households in 2011, which is equivalent to 4.8% of the take home household income. Spanish unemployment rate is also over 21%, the highest in Europe, and rising. The new Conservative government elected in November of this year will undoubtedly pursue further austerity measures in 2012 to reduce public deficit considering that it has foregone the policy of partially privatising the lottery operator LAE and other state assets to pay down the national debt.

GBGC's 2011 GGY estimate for the comprehensive Spanish gambling market is €8,97bn, 3.3% less than the previous year. 2011 will be the third consecutive year that the Spanish gambling market has decreased compared to the previous year.

Apart from the challenging economic conditions, the gambling market in Spain was debilitated by the total smoking ban that came into force at the start of the year. The smoking ban had a severe negative impact on land based operators such as slot halls, bingo halls and casinos.

The revenue estimate for land based casinos for 2011 is expected to decrease by around 17%, while bingo operators are expected to lose around 24% compared to 2010.

For 2012, GBGC expects the entire Spanish market GGY to lose another 1.6% compared to 2011, mainly due to the -2% of lotteries and -5% of the land based bingo halls. The loss of revenue of the two gambling segments is mainly the result of shrinking gaming spend being channelled to the newly legalized online gambling market.

The opening of the online gambling market in January will help increase cumulative casino gaming by 5%, but land based casinos are expected to face another very difficult year. However, restrictions imposed on online gambling, such as €500, deposit limits for poker, roulette and blackjack players (which are the most popular games) will limit the growth potential of the market, as high rollers are for many operators detrimental in the creation of GGY

## Italy - Turnover and GGY (€ m) 2011e-2012f

	Sports Betting		Horse Racing		Casino		EGM*		Lottery		Others (Bingo)		Total
	Handle	GGY	Handle	GGY	GGY	GGY	Sales	GGY					GGY
2011 Est.	4046	930	1383	415	896	8816	21909	8490	2307	646			20193
2012 Frct.	4248	977	1217	365	862	10138	21362	8278	2215	620			21240
Var. %	5.0	5.0	-12.0	-12.0	-3.8	15.0	-2.5	-2.5	-4.0	-4.0			5.2

\*Electronic Gaming Machines

Source: GBGC

2011 will be the fourth consecutive year that household disposable income in Italy has been decreasing. In the last four years, households have lost 7% of their purchasing power. Austerity measures that will start to be implemented between 2012 and 2014 will cost average Italian households at least €3,300 by the end of 2014.

GBGC estimates that for 2011 the whole of the Italian gambling

industry will grow by 24%, on the back of the extraordinary growth of gaming machines, VLTs in particular, and the very strong growth of lotto and lottery products.

Sport and horserace betting had a particularly poor year, as did land based casinos, although the introduction of internet cash based poker and casino gaming helped increase aggregate casino gaming revenue by around 7%.

GBGC expects 2012 to be a year where the growth rate of the gambling market will slow down markedly. The average growth of the Italian gambling industry in the last five years has been 12%.

The forecast for GGY growth of the industry for 2012 is around 5%. A slowdown of the market will put many operators that have recently entered the Italian market, enticed by the recently legalised online cash poker and casino games and the stellar growth of the VLT market, under increasing pressure as profitability will decrease. The high expectations of the cash based online poker and casino gaming to boost online gambling GGY have yet not been satisfied, as the newly permitted games cannibalised online tournament poker, which is much more profitable for online operators.

As in 2011, growth will be fuelled by VLTs, including the 6,600 licenses assigned in the November 2011 tender, which will be installed as the year progresses. Out of the 56,697 licenses issued in 2010, more than 20,000 have yet to enter the market, and will certainly do so by the end of the second quarter of next year.

The Italian sports betting sector will produce growth of 5% compared to 2011, helped by the Euro 2012 football championship in Poland and Ukraine in the summer. The introduction of betting exchanges will also contribute to growth, but the impact of betting exchanges will be limited until Italian players become more familiar with the product.

## France - Turnover and GGY (€ m) 2011e-2012f

	Sports Betting		Horse Racing		Casino	Lottery		Total
	Handle	GGY	Handle	GGY	GGY	Sales	GGY	GGY
2011 Estimate	1239	229	10465	2302	2927	9551	3581	9040
2012 Forecast	1291	232	10675	2242	3044	9953	3732	9251
Variance %	4.2	1.4	2.0	-2.6	4.0	4.2	4.2	2.3

\*Electronic Gaming Machines

Source: GBGC

The 2012 French austerity measures are not as austere as those that will be implemented in the other Eurozone countries and as such, their impact on household spending will be rather limited.

GBGC estimates that the French gambling market will grow by around 6.7% in 2011, dragged by the good performance of online poker, which helped casino gaming GGY rise by 20%. Horse race betting and lotteries, both big segments of the French gambling market, are expected to produce a GGY growth of 1.2% and 1.3% respectively.

For 2012, GBGC forecasts the French gambling market to grow again by 2.3%. The main drivers of 2012 growth will be sports betting, online casino gaming and lotteries.

The contribution of online sports betting will be minimal due to the tax system (which GBGC highlighted in the September 2010 edition of its Interactive Gambling Report). The current 7.5% tax on handle is equivalent to 50% tax on profits and operators are unable to offer punters competitive betting products, thus losing customers to unlicensed betting websites. Even the regulator ARJEL, despite its best of efforts, admits that French players continue to use offshore betting websites.

## Ireland - Turnover and GGY (€ m) 2011e-2012f

	Sports Betting		Horse Racing		EGM*	Lottery		Others (Bingo)		Total
	Handle	GGY	Handle	GGY	GGY	Sales	GGY	GGY		
2011 Est.	633	87	3029	407	116	782	357	61	18	987
2012 Frct.	671	93	2877	387	111	798	365	55	16	971
Var. %	6.0	6.0	-5.0	-5.0	-5.0	2.0	2.0	-10.0	-10.0	-1.6

\*Electronic Gaming Machines  
Source: GBGC

Ireland, as a country that required a bailout, implemented one of the most punitive austerity measures in the Eurozone. The measures adopted in the last two years have wiped off 8.5% take home household income. Other measures to take effect in the coming year will cost an average Irish household an additional €1,800.

GBGC estimates the Irish gambling market to decrease by 4.5% in 2011. The fall of gambling revenue will not spare any segment, but horserace wagering and land based bingo, with a GGY decline of -7% and -5% respectively, will take the brunt of the decline.

2012 will be another year with declining revenue for operators working in the Irish market; however, the rate of decline will slow. GBGC forecasts the Irish gambling market to decrease by 1.6% in 2012 compared to 2011, with lottery sales and sports betting bucking the downward trend and producing growth of 2% and 6% respectively.

### Summary

2012 will be a tough year for gambling operators not only in the jurisdictions analysed, but in the whole of the European Union. Next year could be the year that the Eurozone crisis stabilises, but it could just as easily deteriorate, which would trigger further austerity measures that would cut even more into household income and consumer confidence that would require adjustments to our forecasts.

In the coming year policy-makers will undoubtedly shape the gambling market by the fiscal and regulatory decisions that will directly affect the gambling industry, and indirectly through the income of customers. However, operators, be it land based or online, will unquestionably improve their chances by adapting their strategies for the incoming tough environment by attracting new customers with clever marketing strategies and innovative products, and more importantly, not losing the acquired ones.

GBGC also estimates that the gambling industry will undergo through significant consolidation and the privatisation process of state controlled gambling operators will enter a crucial phase. ♦

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*GBGC has established itself as the most credible specialist international gambling consultancy in the world. The company has work with or supplied information to over 400 clients the majority of whom are 'blue chip'. In addition to its consultancy GBGC has produced six reviews of the global gambling market that have been widely acknowledged to be the best available both in terms of both their detail and accuracy. The latest Global Gambling Report was published in April 2011 and extends to over 1,500 pages, covering more than 250 individual markets on every continent.*

Frank Fahrenkopf ...continued from page 27

players and more liquidity to appeal to U.S. players. That is why it's still necessary to consider federal legislation to establish some minimum standards that will strengthen and clarify the effectiveness of UIGEA tools to enforce the laws.

*I can see that states will always need the agency of the federal government to assist in the enforcement of state laws, especially as it applies to foreign operators. I agree that a UIGEA is a very serviceable tool to accomplish that and so therefore the federal application of UIGEA is needed. But why do we need the federal government to do anything other than assist in the implementation of state laws? State laws vary in the other areas of gambling, like casino gambling. Why do we need to have a federal government overlay on top of states?*

**F. Fahrenkopf:** Because brick and mortar gambling establishments, pari-mutuels and state lotteries are all operated within the physical boundaries of the state. There is no inter-state component to the operation of a casino. Where the activity is strictly intra-state, the federal government has no interest. But when you have a situation where a state might want to do something inter-state, as would likely be pursued with i-gaming, then I think it's important to have some minimum standards.

*Would you agree that the role of the federal government should be contained. For instance, the federal government should not be involved in the determination of licensing. The states are perfectly capable of deciding the terms and conditions for all licensing within the borders of their state.*

**F. Fahrenkopf:** Agreed. I am not recommending that the federal government should actually do the licensing. I do envision that there are issues that require the involvement of the federal government. There is the question of Native American tribes, for instance. The sovereign rights of Tribes will likely conflict with the rule of state laws and that will require federal involvement to sort those issues out, and to possibly be involved in licensing procedures. But whenever and wherever possible, I would propose that the federal governing body of the Department of Commerce or Treasury would delegate the licensing, regulatory, and taxing authorities to the states and that those functions would not be performed at the federal level. States will almost certainly need to enter into inter-state compacts to collaborate on certain kinds of internet gaming initiatives. That will require the approval of the federal government. These are practical matters that do not need to be seen as impeding on states' rights. And as regards to taxation, the only federal taxation should be the income tax applied to the winnings. That, of course, is to be expected because the federal government taxes all income, including lottery and casino winnings.

I believe in the Tenth Amendment rights of states to control intra-state activity. And that applies to gambling. There are, though, some fundamentally inter-state aspects to internet gaming. It is these inter-state issues that clearly require a federal government presence and involvement. ♦

**PGRI Introduction:** One of the most significant industry developments of the past year is the “Private Management Agreement” (PMA) executed between the Illinois Lottery and the Northstar Lottery Group (Northstar). Although the private management model exists internationally, the Illinois Lottery/Northstar agreement is the first Lottery PMA in the United States. As the results of Northstar initiatives unfold, other states are taking a careful look at the strong start of this first-of-its-kind private management model.

Northstar is committed to helping the Illinois Lottery double its business in five years and generate a billion additional dollars to good causes. That is growth at an annualized rate of approximately 15% per year for five years. In the following article, GTECH Corporation, as the 80% owner of Northstar, provides an overview of one of the innovative same store sales growth initiatives currently underway in Illinois.

The principal stakeholders in this mission include:

- The State of Illinois, which owns the Illinois Lottery.
- The Illinois Lottery, under the leadership of Superinten-

dent Michael Jones, which exercises oversight of all lottery business.

- Northstar Lottery Group, a fully integrated and privately held consortium of best-in-class commercial lottery operators. GTECH at 80% and Scientific Games at 20% owners.
- GTECH Corporation is the leading gaming technology and solutions provider to government lotteries, with over 100 lottery clients worldwide.
- Lottomatica Group, the operator of the largest lottery in the world, the Italian Lottery, and the owner of GTECH Corporation.

The growth strategy profiled in this article is retailer-based, where performance impacts results in the most direct way. Lottery sales are driven by the relationship between the operator, the retailer, and the consumer. It is the local retailer who connects the lottery to the consumer. Today, the retailer is the player user interface, the consumer touch-point, and the nexus of interaction between the consumer and lottery. So let's look at how Northstar is attempting to transform the consumer experience where it matters most – at the retail level.

## SAME STORE SALES: ENHANCE DISPLAYS → GROW EARNINGS

Lottery operators are charged every day with sustaining same store sales momentum and increasing profits to good causes. For most operators, increasing lottery sales and profits requires superior retail execution of all marketing and promotion strategies with a strong emphasis on engaging new customers while re-engaging “light” and “lapsed” customers.

As with any mature industry, finding new ways to attract players within the existing sales channel requires innovative thinking. Retailers fall into routines with their suppliers that can limit growth opportunities. Our job is to reignite retailer excitement and commitment to the traffic-building lottery category.

Northstar Lottery Group (Northstar) has been aggressively investigating successful retail strategies around the world in many different industries. As an example, Italian lottery operator, Lottomatica, developed innovative retail merchandising programs in Italy that have generated substantial revenue increases, showing the power of an innovative approach in driving same store lottery sales growth. Our Italian colleagues implemented an aggressive brand transformation program for the Gratta e Vinci

(scratch ticket) category. The branding program touches consumers at all levels, but most importantly enhanced their experience at retail. This disciplined approach to improved product display was a key factor in driving Gratta e Vinci sales from €2 billion in 2003 to more than

According to a December 2011 Consumer Behavior report provided by OCR International, a leader in global market research, “Recent changes in purchase behavior driven by the current recession have forced retailers to react in innovative ways in order to capture impulse buys, including removing barriers between the purchase decision and purchase completion point.”

€ billion in 2008, representing a 4,500% increase. And, of course, once the retail lottery partner began to generate increased lottery revenues from both instant and draw-based games, the retailers' attitudes toward promoting the lottery significantly improved.

## SUPERIOR RETAIL EXECUTION

The scale of such same store sales growth suggests the value of going back to basics: significantly improving instant and online product placement and visibility; promoting in-store and local winner awareness, and reinforcing the whole purpose of the lottery as an important contributor to the local community and good causes. In other words, to create a clear path from curb to counter for lottery purchases while emphasizing the 'why' of the lottery.

## ILLINOIS BRAND TRANSFORMATION PROJECT EDGE PILOT

December 2011 Consumer Behavior report provided by OCR International.

On October 26th, based on Lottomatica Italian Lottery learnings, Northstar in collaboration with Illinois Lottery Superintendent, Michael Jones, launched a retail store transformation project called EDGE (Enhance Display, Grow Earnings), targeted at re-merchandising 25% of the entire retail network of 1,875 high-potential lottery retailers. A team of dedicated retail specialists working hand-in-hand with an outside supplier was deployed on a full-time basis until project completion.

"With the current recession forcing people to re-evaluate their needs and wants and to budget more effectively at home, there has been an increase in what are termed 'surgical' or 'mission' shoppers, or those who are entering a retail outlet with a predetermined list or very narrowly defined set of items to purchase. Consequently, retailers relying on impulse purchase sales are being forced to re-evaluate their strategies and improve how they draw people into stores, keep them browsing, and spur impulse buys."

December 2011 Consumer Behavior report provided by OCR International.

"The lottery encourages Northstar's innovative thinking and the testing of new retail paradigms and is committed to increasing lottery profits through broadening the player base. We'll soon have an accurate picture of the effect of EDGE on both retailers and consumers. Every effective brand transformation begins at the interface between the potential buyer and the licensed seller: it all begins on the street." Michael Jones, Superintendent, Illinois Lottery.



- 1 Use dual stackable dispensers.
- 2 Waterfall tickets with flush mount grip clips, push pins, or binder clips.
- 3 Double face all Cash For Life price points.
- 4 Add on-counter merchandiser.

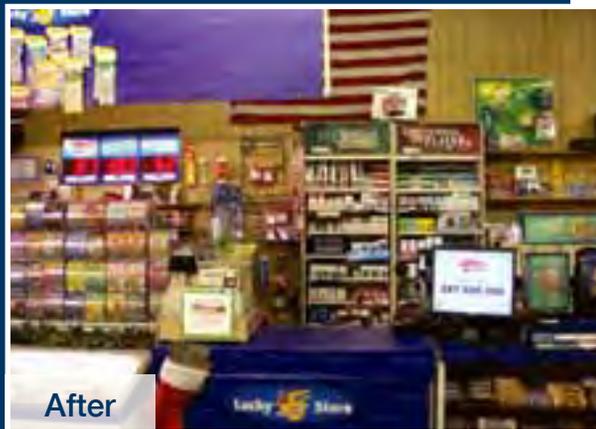
## ENHANCE DISPLAY

### INSTANT PRODUCT PLACEMENT

Since the instant game is primarily an impulsive purchase, Northstar is testing the effect of having the entire portfolio of products highly visible at the point of sale. Working with retailers, the Northstar retail specialist teams added on-counter dispensers, increased ticket facings when possible, and used other creative methods to



Before



After



After

make sure the retailer is carrying and showcasing all the Lottery's top-selling games in an effective manner.

### ONLINE PRODUCT VISIBILITY

With draw-based games offering almost twice the profit opportunity per ticket sold to good causes, the reset teams set out to improve the visible presence of draw games by creating a lottery destination area, complete with updated jackpot signage, drawing days and times, play slips, relevant lottery promotions and messaging, in a highly visible location near the point of purchase. Draw-based game merchandising, because of the permanent nature of the products, can be more difficult to communicate than instant game displays. Teams exercised originality and creativity in achieving greater draw-based game consumer exposure.

### WINNER AWARENESS

Reset teams also took every opportunity to showcase local winner awareness. Product visibility transformations included dedicated lottery-branded areas for posting winning tickets and "lucky lottery store" signage.



### LOTTERY BENEFICIARY MESSAGING

Store reset messaging reinforces the core of what the lottery is all about, namely, generating revenue for good causes. In Illinois, Northstar installed digital advertising (ES Multimedia) signage capable of reinforcing this crucial message right at the counter in a compelling, flexible delivery system. To make sure shoppers reach the lottery destination area, lottery-branded materials lead consumers from the store's entrance area to the register or counter zone.

### GROW EARNINGS

#### CREATING A MORE ALIGNED RETAILER/LOTTERY RELATIONSHIP

##### Creating a More Aligned Retailer/Lottery Relationship

A product visibility reset should be the starting point of a new management relationship with retailers. To ensure an effective interaction, it is important to communicate success among fellow retailers to spark interest in program participation. It is equally important for our teams to remain flexible in the approach to each

retailer – not every solution works in all stores – and to provide a level of attention that takes the retailer/lottery dynamic from a service relationship to more of a consulting partnership. The key message to the retailer is that the program does more than support lottery: it improves the overall image of the store, while increasing lottery profits, foot traffic, and potentially, core business growth in all available products in every participating location.

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“Every day, I remind myself and our team that retailers are the most important asset we have in the lottery business. Their success is our success. Tickets are sold in their shops. EDGE is focused on strengthening our business relationships and trust with each retailer in a way that improves our brand image, attracts new players and ultimately grows both their profits and our contributions to the Common School Fund and Capital Projects.”

Connie Lavery O’Connor,  
Northstar Lottery Group CEO.

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## STORE RESET MECHANICS

As a trained merchandiser enters any retailer, they need to ask themselves: “What is the consumer experience in this store?” They then should assess what changes can be effected that will result in a direct increase in sales. Are instant tickets easily visible to players? Are current jackpots communicated? Is the POS up to date and visible? Can you see information about winners? Is self-service equipment near entry/exit? Are the bins full? Is the lottery beneficiary message showing where the money is going?

When one fully understands the quality of consumer experience desired for all potential customers, the reset process can begin.

## PROGRAM ASSESSMENT

The objectives of the Illinois pilot program were to grow sales and profits by ensuring every prospective consumer could see the lottery portfolio, online and instant, when they walk into the store. The experience of the Italian lottery operations suggested that enhanced display would grow sales for all lottery products. As of this writing, the 149 stores that have been re-merchandised, with five weeks of sales since the re-merchandising, have demonstrated a 17% increase in instant sales.

We will continue to measure performance on a week-by-week basis, with currently more than 1,200 locations re-merchandised. The decision to expand beyond the 1,875 pilot locations (high-performing and high-potential retail locations) will be based upon the results we achieve in increased sales, increased profits to good causes, and, most importantly, an increase in converting store foot traffic into consistent lottery players. ♦

## PROJECT EDGE PILOT EXECUTION STEPS

- > Selection of Participating Retailers:  
Resets began with high-potential retailers, with plans to extend the program.
- > Project Team:  
A 14-member EDGE-dedicated team conducted nearly 2,000 resets in approximately two months.
- > Tools and Training:  
Training materials showing the “perfect store” were created and shared with reps, knowing that this ideal may be impossible to achieve in some locations.
- > Overcoming Concerns:  
Before and after photos and sales figures are communicated to reluctant retailers. The EDGE team has achieved an 86% success rate in acquiring retailers to the program.
- > Single Visit Execution:  
The reset team is in and out of the retail location in a single visit, minimizing disruption of business.
- > Tracking and Reporting:  
A major effort is being made to track pre- and post-performance, both in the instant as well as the draw-based side. Preliminary data on 149 resets with five weeks or more of sales shows a 17% increase. We continue to measure instant and online performance and are also attempting to measure any impact on the core business.

(II) [carried out pursuant to the UIGEA Intrastate Igaming Exception].<sup>5</sup>

Thus, each Bill would exclude from its scope intrastate Igaming conducted by state lotteries only if the outcome of the games depended predominantly on chance. Games whose outcome depended predominantly on skill (or in which skill and chance played an equal role) would not be excluded from the federal scheme, and a federal license would be required to conduct them. However, state lotteries would be ineligible for licensing under either Bill until at least two years after the first license had been issued, and then only if allowed by the Secretary of Commerce.<sup>6</sup> (Even then, poker would be the only game that could be licensed.) Thus, for at least that two-year period, state lotteries would be prohibited from offering skill games, and thereafter, the offering of such games would require a federal license (if allowed by the Secretary of Commerce). Moreover, if the Barton Bill were enacted, state lotteries could not include poker among their games even if applicable state statutes or case law had determined poker to be a game of chance in their respective state. This is because the Congressional findings contained in the Barton Bill declare poker to be a game determined predominantly by skill, and this finding would presumably take precedence over state law determinations.<sup>7</sup>

It is acknowledged that each Bill provides: “No provision of this [Bill] shall be construed to have any effect on the rights, privileges, or obligations of a State or tribal lottery as may be provided under other applicable Federal, State or tribal law.”<sup>8</sup> However, the more specific language discussed above conflicts with this general language, and under the usual rules of statutory construction, the more specific language would be deemed to govern. In addition, a court interpreting the Bills could be of the opinion – incorrectly, in this author’s opinion – that state lotteries did not have the right to conduct intrastate Igaming prior to the Bill’s enactment, and that, therefore, the language addressing the conduct of intrastate Igaming actually expands the rights of state lotteries. In either case, the ability of states to decide what type of games could be offered online via their state lotteries would be restricted.

Not only would intrastate Igaming by state lotteries be restricted under the Barton and Reid Bills, other (non-lottery) intrastate Igaming would be limited as well. The Barton and Reid Bills each also except from the term “bet or wager” the following:

**Certain Intrastate Transactions.** Placing, receiving, or otherwise transmitting a bet or wager ...

(I) [pursuant to the UIGEA’s Intrastate Igaming Exception]; and

(II) authorized under a license that was issued by a regulatory body of a State or Indian tribe on or before the date of the enactment of this Act.<sup>9</sup>

The implicit result of this exception is that intrastate Igaming (other than that conducted by state or tribal lotteries) would be prohibited absent a license under the federal Bill unless such intrastate Igaming had been authorized pursuant to a state or tribal license on or before the date the Bill was enacted. In other words, if such intrastate Igaming had not been “grandfathered in,” it could not be conducted outside of the federal scheme, and since the federal scheme would only allow Igaming on poker games, all other forms of intrastate Igaming not conducted by a state or tribal lottery would be prohibited. This would preclude (absent a license under the federal law) the intrastate Internet poker contemplated by bills introduced in California by State Senators Rod Wright<sup>10</sup> and Lou Correa,<sup>11</sup> (except to the extent “grandfathered in”), and it would preclude entirely (except to the extent “grandfathered in”) the intrastate Igaming contemplated by the New Jersey intrastate Igaming bills introduced by State Senator Ray Lesniak (to the extent they contemplate games other than poker – e.g., black jack and slot games).<sup>12</sup>

In summary, if enacted, the Barton and Reid Bills would limit the effect of the DoJ’s December 23rd opinion and dictate to the states what forms of intrastate Igaming could be conducted within their borders. Each Bill would prohibit state lotteries from offering games of skill, and would allow non-lottery intrastate Igaming only if it had been “grandfathered in” (unless the non-lottery intrastate Igaming was licensed under the federal scheme, but even then, only gambling on poker could be offered). Although not as heavy-handed, the Campbell Bill – like the Barton and Reid Bills – would require state lotteries and other Igaming businesses seeking to offer common games across state lines to submit to a federal licensing and taxation scheme, inconsistent with Congress’ long-standing position that the states should have the power to regulate for themselves the gambling activities being conducted within their borders.

#### IV. THE HISTORIC PREROGATIVE OF STATES TO REGULATE GAMBLING WITHIN THEIR BORDERS

Unsurprisingly, state lotteries and governors have written letters to federal legislators opposing the creation of a federal scheme to regulate and oversee Igaming.<sup>13</sup> They have noted in their opposition that regulating Igaming at the federal level would usurp what has historically been the prerogative of states to regulate gambling occurring within their borders. Also, on July 1, 2011, the North American Association of State and Provincial Lotteries (“NASPL”) passed a resolution “oppos[ing] federal legislation that would encroach on the traditional state prerogative to regulate gaming within each state’s borders.”<sup>15</sup> The resolution states:

Bills such as this would federalize the Internet as a gaming portal, and create a costly and duplicative federal gaming-licensing regime, and moreover, they would impair the ability of states to represent the sensibility of their citizens, which states are uniquely qualified to do

5) Barton Bill, Title I, § 101(2)(B)(iii); Reid Bill Title I, § 102(2)(B)(iii). 6) Barton Bill, Title I, § 104(f)(3); Reid Bill Title I, § 104(f)(3). 7) Barton Bill, Section 2 (“Findings”), paragraph (5). 8) Barton Bill, Title I, § 112(c)(2); Reid Bill Title I, § 115(b)(2). 9) Barton Bill, Title I, § 101(2)(B)(ii); Reid Bill Title I, § 102(2)(B)(ii). 10) California Senate Bill SB 45. 11) California Senate Bill SB 40. 12) New Jersey Senate Bill S. 490, which passed both houses of New Jersey’s legislature, before being vetoed by Governor Chris Christie in early 2011, and S. 3019, introduced by Senator Lesniak in August, 2011. 13) As of the date of this Article, the Governors of Idaho, Maryland and New Hampshire, and the state lotteries in Iowa and Kentucky have written such letters. In addition, the Executive Director of the New Hampshire Lottery Commission, Charlie McIntyre, testified in favor of states’ prerogative to regulate gambling at hearings held by the House Energy and Commerce Committee, Subcommittee on Commerce, Manufacturing and Trade on November 18, 2011. 14) See, for example, letter from Martin O’Malley, Governor of Maryland, to Senator Patty Murray and Congressman Jeb Hensarling, dated October 20, 2011 (“Historically, states have had the right to make their own decisions about whether to offer gambling and how to regulate the industry. These proposals would strip states of those rights.”); and letter from John H. Lynch, Governor of New Hampshire, to Senator Harry Reid and Congressman John Boehner, dated December 13, 2011 (“[S]tates have traditionally had the right to make their own decisions about what type of lotteries and gaming to allow and how to regulate the industry. This legislation would usurp state rights to regulate this area.”) 15) NASPL Resolution, adopted July 1, 2011. 16) *Id.* 17) Testimony of Frank Fahrenkopf, President and CEO of the American Gaming Association, submitted to the U. S. House Committee on Energy and Commerce Subcommittee on Commerce, Manufacturing, and Trade Hearing entitled: “Internet Gaming: Regulating in an Online World,” November 18, 2011. 18) *Id.* 19) Article I, § 8, clause 3 of the United States Constitution – the so-called “Commerce Clause” – provides that “Congress shall have the

and which they accomplish, by regulating gaming within their borders to, among other reasons, raise revenue for worthy causes. We believe that the use, regulation, and ultimate beneficiaries of the Internet for gaming are best left to the legislative determination of each state.<sup>16</sup>

Proponents of regulation on a federal level, such as the American Gambling Association, believe that “federal guidelines [should be established] so there will be consistent regulations for online poker in all states. Without a federal overlay, [they argue,] there will be a patchwork quilt of rules and regulations that will prove confusing for customers and difficult for law enforcement to manage.”<sup>17</sup> These proponents also assert that the ability of states to determine whether online poker should be legalized within their jurisdictions – i.e., the ability of states to “opt out” – preserves states’ ability to decide for themselves matters relating to gambling within their borders.<sup>18</sup>

There is little doubt that Congress has the legal right under the Commerce Clause of the Constitution<sup>19</sup> to regulate gambling within state borders if it affects interstate commerce. As stated by the federal Court of Appeals for the Fifth Circuit in rejecting a 10th Amendment<sup>20</sup> challenge to the Illegal Gambling Business Act, a federal law that can apply to illegal gambling activity that is entirely intrastate:<sup>21</sup>

The power of Congress to legislate under the Commerce Clause of the Constitution “is not confined to the regulation of commerce among the states.” It also extends to intrastate activities which affect interstate commerce to such an extent “as to make regulation of them appropriate means to the attainment of a legitimate end . . .”<sup>22</sup> As Mr. Justice Jackson stated in *Wickard v. Filburn*,<sup>23</sup> even if [a person’s] activity be local and though it may not be regarded as commerce, it may still, whatever its nature, be reached by Congress if it exerts a substantial economic effect on interstate commerce and this irrespective of whether such effect is what might at some earlier time have been defined as ‘direct’ or ‘indirect.’<sup>24</sup>

The Court in that case determined that illegal gambling, “even if intrastate in character,” was rationally determined by Congress to be a type of activity that affects interstate commerce, and thus was properly subject to federal regulation pursuant to Congress’ Commerce Clause power.<sup>25</sup>

However, the Illegal Gambling Business Act was passed to assist states in combating illegal gambling, not to regulate lawful gambling occurring within their borders. Prudence and reason – as well as historic precedent – dictates that the regulation of legal gambling be left to state legislatures. As stated in the NASPL July 1, 2011 resolution, “states are uniquely qualified to [represent the sensibility of their citizens] . . .”<sup>26</sup> Moreover, unlike the federal government, state legislatures are accountable to the state electorate in respect of their decisions as to what types of gambling should be permitted within their respective borders.

Congress recognized this in 1978, when it passed the Interstate Horseracing Act. Declaring expressly that “the States should have the

primary responsibility for determining what forms of gambling may legally take place within their borders,”<sup>27</sup> Congress passed the IHA to “ensure states will continue to cooperate with one another in the acceptance of legal interstate wagers.”<sup>28</sup> As discussed in the September 2011 issue of this magazine,<sup>29</sup> such cooperation under the IHA has indeed occurred. Several states have passed legislation authorizing their membership in or participation with the cooperative interstate organization known as the “National Racing Compact,” which is an independent, interstate governmental entity, composed of pari-mutuel racing regulators from participating states, which has been authorized by the states and approved by the Federal Bureau of Investigation to receive criminal history information from the FBI. The Compact is empowered to set standards for individual licenses, accept applications and fingerprints, analyze criminal history information and issue a national license which will be recognized by all member states and other states that may elect to recognize the license.<sup>30</sup>

Congress recognized that the regulation of legal gaming should be left to the states again in 1994, when it passed the Interstate Wagering Amendment<sup>31</sup> to close a loophole in existing federal law which was being exploited by Pic-A-State Pa., Inc. (“Pic-A-State”). Pic-A-State was a Pennsylvania retail business with which customers placed orders for tickets in the state lotteries of other states. The Pic-A-State retailer would transmit the orders to purchasing agents in the other states via the Internet, and those agents would purchase the out-of-state lottery tickets on behalf of the customers. Pic-A-State avoided a federal law prohibiting the interstate transportation of lottery tickets by keeping the actual tickets within the state of origin and transmitting to the customer only a computer-generated “receipt.” Pennsylvania had tried to stop Pic-A-State’s business through the passage of a state law that prohibited the sale of any interest in another state’s lottery.<sup>32</sup> However, the state law was struck down in federal court on the grounds that it violated the dormant Commerce Clause.<sup>33</sup> Congress then intervened, passing the Interstate Wagering Amendment, and as a result, the lower court’s decision was reversed.<sup>34</sup> Pic-A-State then challenged the Interstate Wagering Amendment on the grounds that its passage exceeded Congress’ power under the Commerce Clause.

The Interstate Wagering Amendment expanded the scope of existing law prohibiting the interstate transportation of lottery tickets to also prohibit one engaged in the business of procuring for a person in one State . . . a ticket, chance, share, or interest in a lottery . . . conducted by another State (unless that business is permitted under an agreement between the States in question or appropriate authorities of those States), [from] knowingly transmit[ing] in interstate or foreign commerce information to be used for the purpose of procuring such a chance, share or interest.<sup>35</sup>

Recounting the purposes for which the Interstate Wagering Amendment was passed, the Third Circuit federal Court of Appeals stated: Senator [Arlen] Specter identified two other purposes for the Interstate Wagering Amendment. First, that the Amendment was necessary to

Power . . . To regulate commerce with foreign Nations, and among the several States, and with Indian Tribes.” 20) The Tenth Amendment to the United States Constitution provides: “The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.” 21) The Illegal Gambling Business Act, 18 U.S.C. 1955, makes it a federal crime for anyone to conduct, finance, manage, supervise, direct or own all or part of an “illegal gambling business,” defined, generally, as a gambling business (1) which is in violation of the law of the State in which it is conducted, (2) which involves five or more persons who conduct, finance, manage, supervise, direct or own all or part of the business, and (3) which has been or remains in substantially continuous operation for a period in excess of thirty days or has a gross revenue of \$2,000 in any single day.” 22) *United States v. Harris*, 460 F.2d 1041, 1047 (5th Cir. 1972), cert. den., 409 U.S. 877, 93 S.Ct. 128 (1972) (quoting from *United States v. Darby*, 312 U.S. 100, 118, 61 S.Ct. 451, 459 (1941)). 23) 317 U.S. 111, 125, 63 S.Ct. 83, 89 (1942). 24) *Harris*, at 1047. 25) *Harris*, at 1048. 26) See footnote 15, 27) 15 U.S.C. §3001(a). 28) 15 U.S.C. §3001 (a)(3). 29) See, Hichar, “A Model for Respecting States’ Rights in Regard to Internet Gambling – The Interstate Horseracing Act,” *Public Gaming Magazine*, September 2011. 30) See <http://racinglicense.com/info.html>, last accessed December 19, 2011 (emphasis added). 31) The Interstate Wagering Amendment amended 18 U.S.C. § 1301. 32) 72 Pa.Stat. Ann. § 3761-9(c) (1995). 33) *Pic-A-State Pa., Inc. v. Pennsylvania*, 1993 WL 325539 (M.D.Pa. 1993). The dormant Commerce Clause is a doctrine inferred by the Supreme Court from the Commerce Clause of the U.S. Constitution. It prohibits states from regulating in ways that unduly burden interstate commerce. According to the Supreme Court, the dormant Commerce Clause bars states from discriminating against interstate commerce and favoring in-state economic interests over out-of-state economic interests. *United Haulers Association v. Oneida-Herkimer Solid Waste Management Authority*, 127 S. Ct. 1786, 1793 (2007).

preserve “the right of a State to regulate lottery [sic] and gambling within its borders.” He stated, “Federal laws should continue to limit the proliferation of interstate gambling to preserve the sovereignty of States that do not permit certain forms of gambling.” Second, that businesses such as Pic-A-State’s would “undermine [the States’] ability to realize projected revenues.” Senator Joseph Biden echoed Senator Specter’s concerns, noting the interstate sale of interests in lottery tickets “hurts the operation of lotteries in smaller States.”<sup>36</sup>

The Court specifically rejected Pic-A-State’s claim that “the protection of the states’ ability to regulate gambling within their own borders is an impermissible purpose for federal lawmaking.”<sup>37</sup> The Court stated:

Congress rationally believed that the Interstate Wagering Amendment served the purpose of preserving state sovereignty in the regulation of lotteries. Senator Specter explained: the right of a State to regulate lottery [sic] and gambling within its borders must be preserved. Federal gambling laws have traditionally enabled the States to regulate in-State gambling. Federal laws should continue to limit the proliferation of interstate gambling to preserve the sovereignty of States that do not permit certain forms of gambling.

The Interstate Wagering Amendment furthered these goals by giving the states the sole right to regulate lottery sales within their borders. The states need not permit the sale of interests in out-of-state lottery tickets, but may do so by concluding an agreement for that purpose with other states. The Interstate Wagering Amendment thus allows the various states to gauge the economic effects of their own lotteries without out-of-state interference, to form their own judgments about the propriety of lotteries, and to regulate the types of state-sponsored gambling they wish to allow within their borders.<sup>38</sup>

Thus, in passing the Interstate Wagering Amendment, Congress expressly recognized the need to preserve the prerogative of states to regulate legal lotteries and gambling within their borders. Also, consistent with the policy espoused in the IHA, Congress recognized that if states wished to allow their citizens to purchase gambling products from other states, they “may do so by concluding an agreement for that purpose with other states.”<sup>39</sup>

In connection with the pending bills that would federalize the licensing and regulation of Igaming, state lotteries and governors are correct in pointing out that, historically, states have been allowed to decide for themselves what types of lotteries and gaming shall be permitted within their borders. The Campbell, Barton and Reid bills represent a marked departure from historic precedent by substituting federal regulation and decision-making with respect to lawful gambling for that of state legislatures and regulators.

## V. NONE OF THE PENDING BILLS ADEQUATELY PROTECT THE PREROGATIVE OF STATES TO REGULATE GAMBLING

From the discussion above, it is apparent that none of the Campbell, Barton or Reid Bills preserve the historic prerogative of states to regulate lawful gambling occurring within their borders. Each of the Bills would create a federal licensing framework, thus restricting states’ historic prerogative to determine their own regulatory requirements in respect of gambling conducted within their borders. Moreover, the Barton and Reid Bills would limit the types of Internet wagering games

states could authorize – even when conducted on an intrastate basis pursuant to the UIGEA Intrastate Igaming Exception.

Even the AGA, one of the most notable proponents of federal legislation with respect to Internet poker, should oppose the Barton and Reid Bills if it examined them in respect of the AGA’s own stated policies. In testimony submitted to the U.S. House Committee on Energy and Commerce, Subcommittee on Commerce, Manufacturing, and Trade, AGA President and CEO, Frank J. Fahrenkopf Jr. testified as follows:

[T]he AGA has a long-standing policy of putting any gaming legislative proposal through three tests: 1) The legislation must not create competitive advantages or disadvantages between and among legal commercial casinos, Native American casinos, state lotteries and pari-mutuel wagering operations; 2) No form of gaming that currently is legal shall be made illegal; and 3) The legislation must respect fundamental states’ rights in an appropriate manner. Any online poker legislation must pass these three tests to gain AGA support.<sup>40</sup>

Clearly, the Barton and Reid Bills disadvantage state lotteries. Indeed, they exclude them entirely from participation in Internet poker – whether on an interstate or intrastate basis. (State lotteries would be ineligible to receive licenses under either Bill.) Thus, the Barton and Reid Bills fail the AGA’s tests.

The AGA also asserts – as does the Poker Players Alliance – that a federal licensing overlay is necessary to prevent states from creating “a patchwork quilt of rules and regulations that will prove confusing for customers and difficult for law enforcement to manage.”<sup>41</sup> This is belied by the IHA, however, which provides a light federal framework and leaves entirely to the states the licensing and regulation of Igaming system operators. However, this does not mean that operators must comply with a “patchwork of rules and regulations.” As mentioned above, pursuant to the IHA, the states have cooperated, and many of them have entered into the “National Racing Compact” pursuant to which there is a standard national license for participants in horseracing with pari-mutuel wagering. Its very purpose achieves what proponents of a federal scheme seek – i.e., The purpose of National Racing Compact is

To establish uniform requirements for and issue licenses to participants in pari-mutuel racing to ensure that all participants who are licensed meet a uniform standard of honesty and integrity, and to reduce the regulatory burden on those participants in pari-mutuel racing who are indisputably welcome to race in every state and province by providing them with a single license recognized in all racing states and provinces.<sup>42</sup>

The National Racing Compact currently is recognized in 24 jurisdictions – 15 member states and 9 participating states,<sup>43</sup> and a national racing license now exists for several participants in the pari-mutuel racing industry (e.g., owners, jockeys and trainers). Although the National Racing Compact currently does not establish requirements or issue licenses to businesses that accept Internet wagers on horse races, a law enacted in Kentucky in March, “2011 contemplates the establishment pursuant to an additional state compact of “an interstate governmental entity of the member states, to coordinate the decision-making and actions of each member state racing commission ...”<sup>44</sup>

34) Pic-A-State, Pa., Inc. v. Pennsylvania, 42 F.3d 175 (3rd Cir. 1994). 35) Interstate Wagering Amendment of 1994, amending 18 U.S.C. § 1301. 36) Pic-A-State, Pa., Inc. v. Reno, 76 F.3d 1294, 1297-1298 (3rd Cir. 1996), cert den. 517 U.S. 1246, 116 S.Ct. 2504 (1996), quoting from 139 Cong.Rec. S15247 (emphasis added). 37) Id., at 1301. 38) Pic-A-State, at 1302, quoting from 139 Cong.Rec. S15247 (emphasis added). 39) Id. 40) Testimony of Frank J. Fahrenkopf, Jr., President and CEO of the AGA, submitted to the U.S. House Committee on Energy and Commerce, Subcommittee on Commerce, Manufacturing, and Trade, in connection with the November 18, 2011 hearing entitled “Internet Gaming: Regulation in an Online World.” 41) Id. and Interview with former U.S. Senator Alfonse D’Amato,

In this way, the IHA respects the prerogative of states to regulate gambling within their borders, and at the same time provides federal support. Moreover, state cooperation in respect of gambling is not limited to interstate pari-mutuel wagering pursuant to the IHA. States have shown that they can work together on other gambling licensing and regulatory issues – witness multi-state lottery games such as “Mega Millions” (involving the cooperation of 42 states, the District of Columbia and the U.S. Virgin Islands)<sup>45</sup> and “Powerball” (operated by the Multi-State Lottery Association, with membership including 31 states, the District of Columbia and the U.S. Virgin Islands).<sup>46</sup> In any event, different rules and regulations in different states – if that were to occur – would not be “confusing for customers and difficult for law enforcement to manage.” Internet bettors on horse races and their Igaming system operators deal with different regulations in different states today, without confusion, and state law enforcement agencies have proven able to enforce the laws and regulations of their states. Also, Igaming system operators are familiar with and can accommodate different rules and regulations existing in different jurisdictions. Many successful Igaming businesses operate in Europe today, meeting different requirements imposed by different jurisdictions. Igaming system operators are able to determine the location of their customers, and they are able to make available to bettors different games depending on the jurisdictions in which they are located. A system with different games being available in different states would be no different and no more confusing than it is today, with different gambling states permitting different mixes of gambling products within their borders.

Any federal Igaming legislation should not adopt an approach – as offered under the Barton and Reid Bills – where states are forced to choose between permitting no Internet gambling (other than pari-mutuel wagering on horse races) and permitting only those Internet games deemed appropriate by the Federal Government.

## V. CONCLUSION

As set forth above, historically it has been left to the prerogative of states to determine the types of gambling that shall be authorized within their borders. The Barton and Reid Bills are inconsistent with this historic precedent, and, indeed, would dictate to the states in regard to what Igaming they can allow on an intrastate basis. Moreover, they would create an uneven playing field, restricting the games state lotteries could offer and making them ineligible for federal Igaming licenses. The Barton and Reid Bill, and the Campbell Bill as well, would, for the first time, create federal regulation with respect to lawful gambling in the states. Congress has shown, through the IHA, that the prerogative of states to regulate gaming can be better protected, and that a federal law could be passed that would leave to the states entirely the ability to regulate the wagering occurring within their borders. Congress should consider this model when considering federal legislation authorizing Igaming. ♦

for themselves. BCLC, for instance, does not use web-cash and its retail network continues to be strong even while its internet sales are increasing. Retailers are key to the continuing success of lotteries, so gaining their active support is imperative. There are lots of different approaches to accomplishing that.

*Wouldn't the retailer still be concerned that internet distribution would redefine the lottery's relationship with the consumer in ways that might end up hurting them? Wouldn't they feel vulnerable for losing control of their customer?*

**M. Carinci:** I understand this concern and that is why communicating fact-based information based on the actual experience of others is so important while lotteries venture into new territory. First, nobody really has control over the customer. Consumers have choices and they expect to have options. All of us, lottery operator and retail store proprietor alike, need to be flexible and open-minded to deliver optimal value and convenience to the consumer. Second, retail continues to be very strong, and not just with the proverbial core player. While consumers are active on the internet, and it is clear that consumers will continue to shop at retail for a different experience. That is where cross promotion between channels can take advantage of both experiences. Third, internet sales remain a fraction of overall lottery retail product sales. Retail will continue to get the vast majority of draw games. Depending on the introduction and execution, the internet can be a tremendous tool to promote visits and sales at retail and retail can promote sales on the internet. There are lots of options!

*We have been focusing on integrating internet into the distribution of the existing traditional lottery products. Massively multi-player online games are taking the internet by storm. What implications does that have for lottery?*

**M. Carinci:** Over the past decade online poker and casino games have become mainstream, poker players have become front page news and lead stories. World of Warcraft has a massive following as do the social games such as Farmville and then there is Angry Birds! But think about this for a minute ... a very small percentage of consumers play poker and casino games online, and it is a very small percentage of consumers that will ever play traditional draw games online. Now add to that group the 10% to 14% of consumers that will never play any games at all, on or off line. That leaves somewhere in the neighborhood of 80% that will be looking for lottery and gaming related products that offer a fresh, new, different kind of entertaining experience. What have operators got in mind for them? And what about the players coming of age? We have begun to see the introduction of what I will call soft lottery games and social games on the internet using the unique attributes of the internet to create an entirely new gaming experience. This digital space includes opportunities that go way beyond the internet. This is a very exciting time in our industry with lots of opportunities to offer smart, responsible, and entertaining gaming experiences. Someone will have the strategic foresight to provide that experience. I hope it will be the regulated operators!

In the meantime, both the retailer and the lottery have the opportunity to benefit by creating an integrated approach to serving the consumer. Everyone wins. ♦

Chairman of the Poker Players Alliance, published in Public Gaming Magazine, January 2012. (“As a practical matter, we need a uniform regulatory framework that the federal agents and departments of law enforcement can implement. If states all have different rules and reg’s, it becomes difficult for all operators to comply with the patchwork of different laws, and so it becomes difficult for the federal law to enforce them.”) 42) See <http://racinglicense.com/info.html>, last accessed December 19, 2011. 43) See <http://racinglicense.com/accepted.html>, last accessed December 19, 2011. 44) KY S.B. 24, enacted March 16, 2011, Article III(B). 45) <http://www.megamillions.com/about/history.asp>, last accessed December 19, 2011. 46) [http://www.musl.com/musl\\_members.html](http://www.musl.com/musl_members.html), last accessed December 19, 2011.



# Joining Forces to Enhance the Lottery Model

By Philippe Vlaemminck, Partner, ALTIUS Law Firm

There is never a dull moment when it comes to the changes in regulations in the lotteries and gambling sector. In both the USA and in the EU, much has happened which will again influence the way forward and the future for Lotteries. In so many ways, the issues we face on both sides of the Atlantic are similar, even though they need to be understood within their own specific cultural and social environments.

In the EU, we have been talking for years about “subsidiarity” as the basic legal standard which states that every business sector needs to be regulated at the most appropriate level. For lotteries and gambling, that is the member-state level in the EU and the state level in the U.S. Today, facing the developments of new technologies, lotteries need to respond to those who challenge this basic principle, or risk losing their authority over regulation and taxation in their jurisdictions.

In the recent discussion regarding online gambling, this was expressed at the European Parliament as “active subsidiarity”. This is an important concept, referring to the ability to respond to the changing environment and reflecting the competence to do so. In practice, it means that states can grant Lotteries the right to use the internet (this being in line with the judgments of the Court of Justice of the EU which grant the right to states to respond to growing illegal activities on the internet). Various models have been implemented and often tested by the highest courts of the concerned states. In Belgium, the state introduced the license-plus model, granting only land-based licensees the right to use also the internet as an additional form of distribution. The Belgian Supreme Court considered that this was in line with EU law. In France, only the internet market was partially opened, while FDJ could keep its monopoly in the off-line market. The highest Administrative Court decided recently that this approach, and specifically the way FDJ operates as a lottery provider, was fully compatible with the jurisprudence of the European Court of Justice. The red line in these approaches is clear. The role of the state lottery is preserved, while the internet may only be used to offer lottery and gambling services to residents of the concerned jurisdiction. Respecting those two fundamental principles is of critical importance.

Opening up the market to operators of other states (as done by Malta and promoted by the remote gambling industry in various countries, like Denmark, with the argument that the trans-national scale and liquidity is necessary for an attractive offer) is totally unacceptable and violates the basic principles of state competence and authority over regulatory and taxation policy.

The most recent developments in the USA are fully in line with the approach in the EU. The opinion of the U.S. DOJ of September, 20, 2011 (albeit published on December 23) implicitly grants to states the right to authorize their lotteries to sell lottery tickets to adults over the internet with sales restricted to transactions initiated and received within the concerned state, regardless of whether the intermediate routing of electronic data passes through other states. This is a big victory for states and their lotteries and enhances their ability to market their products in an ever changing environment, and therefore to enhance their specific role to society.

Notwithstanding this excellent development, we can see again that others try to re-direct the meaning and intent of legal opinions and decisions.

Antigua’s lawyers contend that the DOJ opinion gives them leverage for requesting a favorable deal from the US authorities. Antigua has spent years pushing the WTO to deny the U.S. its right to regulate its markets for the protection of consumers and public order. Antigua even received support from the British remote gambling operators who decided to violate US federal laws and initiated in the EU a Trade Barriers action against the US. This procedure was never pursued, but is still pending. It is clear that the object and purpose of the DOJ opinion is being deliberately misinterpreted by the remote gambling people. The fact that the Wire Act only addresses sports betting does by no means diminish the right of the USA to invoke the public order exception to protect its citizens against cross-border gambling services offered without proper control in the state where the offer is made. Also, the European Court has in numerous cases recognized this fundamental right of the states by stating: “a Member State is entitled to take the view that “the mere fact that an operator such as Bwin lawfully offers gambling services via the internet in another Member State, in which it is established and where it is in principle already subject to statutory conditions and controls on the part of the competent authorities in that State, cannot be regarded as amounting to a sufficient assurance that national consumers will be protected against the risks of fraud and crime, in the light of the difficulties liable to be encountered in such a context by the authorities of the Member State of establishment in assessing the professional qualities and integrity of operators” (§69 Liga Portuguesa).

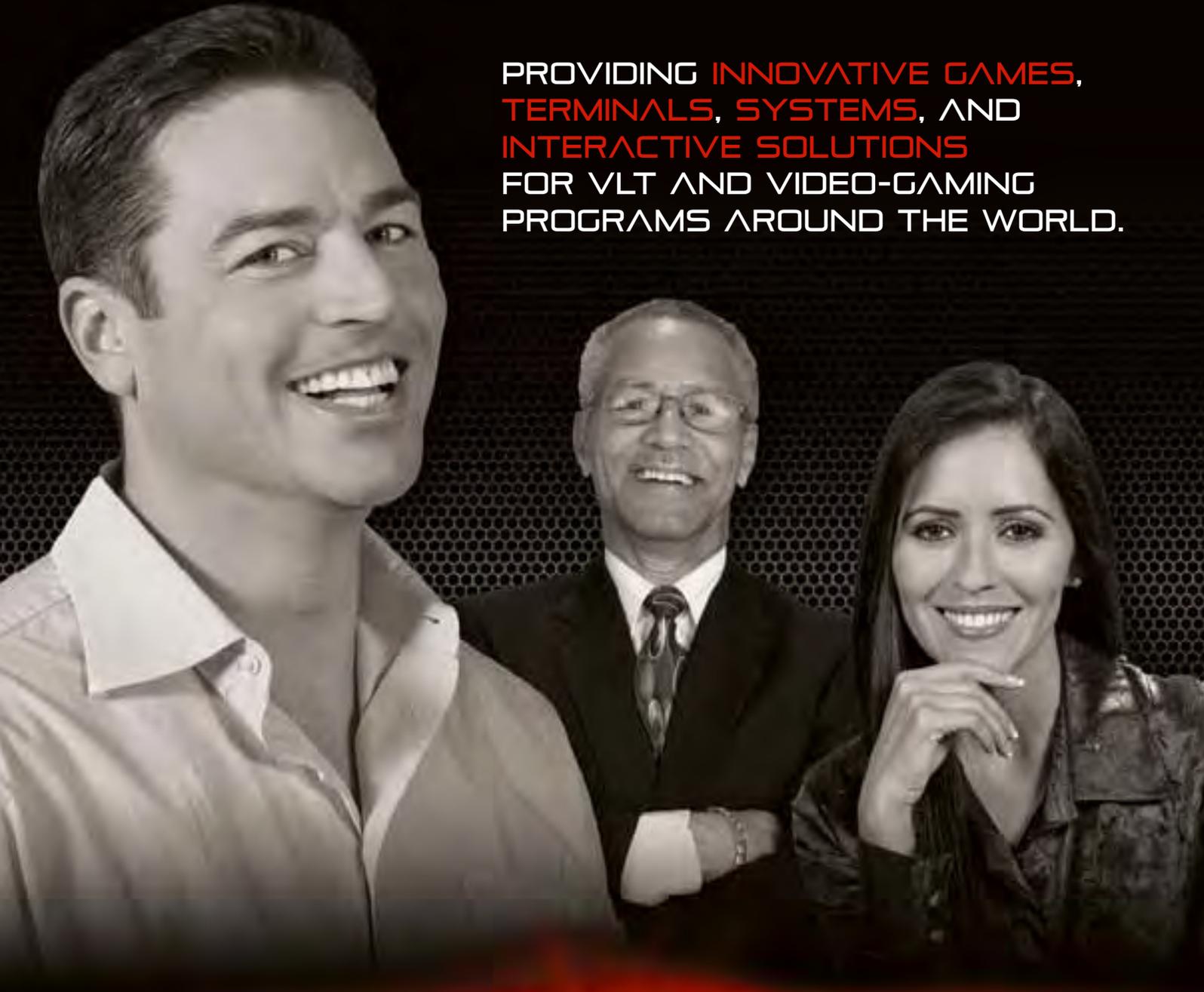
Another major new argument in support of the USA states’ rights to regulate their markets comes from another ruling of the Court of Justice of the EU. In a decision of the Court of 15 November 2011, it was decided that a tax system designed in such a way that offshore companies avoid taxation constitute an illegal state aid scheme contrary to EU law. This ruling will make Gibraltar less attractive for remote gambling operators who want to operate offshore and benefit from low taxation in addition to offshore gambling licensing (cases C-106/09P & C-107/09P EU Commission & Kingdom of Spain vs. Government of Gibraltar & UK).

The business and markets of gambling and lottery are becoming globalized. Technology is obsoleting legacy laws and regulations designed before the age of the internet. Thankfully, the European and U.S. courts are catching up, establishing the principles of protecting the consumer and recognizing the state interests in the lottery and gambling sector Today we see more legal rulings, and the tools to enforce them, emerging to enhance the role of state lotteries around the world. Lotteries have the right to use the Internet and States are entitled to protect their borders. Intermediate technology can be used as long as the integrity of state gambling is not undermined by off-shore based remote gambling operators. And on both sides of the Atlantic, governments and their lotteries are developing their businesses and the means to protect them in quite comparable ways.

By joining forces, by sharing information, ideas, and experiences, by working together to build effective public policy arguments and positions that advance the common cause of government lotteries, we will prevail. The Smart-Tech conference in New York has become a great venue for lottery leaders from both sides of the Atlantic to meet and forge the collaborative approach we need to protect the interests of government lotteries and their stakeholders. ♦

Philippe Vlaemminck is widely regarded as a leading player in the current debate on gaming and gambling in the EU, and has been involved in every gambling case before the CJEU and the EFTA court. He heads the EU Regulatory and Trade Practice at Altius Partnership. e-mail: philippe.vlaemminck@altius.com

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