SUREBET GAMING SYSTEMS PTY LIMITED

SUBMISSION

TO

THE PRODUCTIVITY COMMISSION INQUIRY

INTO

AUSTRALIA'S GAMBLING INDUSTRIES

14 October 1999

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1. EXECUTIVE SUMMARY

Internet is changing the way we conduct business and spend our leisure time and money. Through the global access offered by the Internet, all businesses, including the gambling business, are disappearing. It is a foregone conclusion that this change cannot be reversed and will continue to accelerate for years to come.

This requires new developments in regulatory technology, and urgently, as the Internet as a communications channel is advancing far faster than developments in control and monitoring systems. The standard of current development in regulatory technology for the Internet is lagging, as evidenced by the US Internet Tax Freedom Act, 1998, as well by the current bans in the US on Internet gambling.

The concurrent growth in consumer participation in Internet use, and the global character of gambling operators, is now providing evidence of high growth.

The special requirements and sensitivities of current club and casino operations have led to the evolution over many years of sophisticated regulatory controls over those facilities and the entities involved in offering and managing services. The same standards should be mandatory for Internet gambling. A perceived lack of regulatory technology should not lead to the liberalisation of Internet gambling, since this will lead to a significant increase in the social cost associated with the industry and could also lead to adverse impacts on existing legislation.

The need to protect problem gamblers and allow for reduction of the negative costs associated with gambling suggests urgent attention should be applied to harm minimisation programs prior to the full scale licensing of Internet gambling.

Another important issue giving rise to the need for a suitable regulatory system is the threat of erosion of the tax base. The growth in gambling has also led to the dependence of states on gambling taxes as a major source of revenue.

Through the development of an Internet communications infrastructure technology, Surebet Gaming Systems Pty Limited is at the forefront of industry in responding to the multi-faceted needs of the many stakeholders in the Internet gambling industry. Surebet believes that Australia has an opportunity now to take the lead in socially responsible, and fiscally secure development of the Internet gambling industry.

Surebet is committed to developing in Australia an innovative regulatory technology whereby

- Players access a game that is regulated and assured safe;
- Players and operators have trust in the system;
- Government control authorities have the ability to
  - monitor games without knowledge of the operator or player;
  - disable game play at any time;
  - read turnover and other statistics online.

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3. INTRODUCTION

Surebet Gaming Systems Pty Limited (Surebet) makes this submission to the Productivity Commission Inquiry into Australia's Gaming Industries for the following purposes

- to contribute to the Inquiry and to the public debate;
- to explore some of the key issues concerning stakeholders to the review process;
- to examine the current state of security and regulatory technology available;
- to make disclosure concerning the leading edge Internet infrastructure technology being developed specifically to address the issues raised by the Productivity Commission and gambling industry stakeholders.

Surebet is currently developing a demonstration system for use in regulating Internet gambling services in Australia and internationally.

4. SUREBET GAMING SYSTEMS PTY LIMITED

Surebet Gaming Systems Pty Limited is an Australian owned company and was established in 1999. It has headquarters in Sydney, Australia.

In response to the un-resolved requirement for a technology based solution to monitoring and regulation of the worldwide emerging Internet gambling industry Surebet was incorporated to commercialise a practical, innovative and robust solution to the requirements of the operators, regulators and the playing public.

Technology has been developed to the stage where a full demonstration system is now being implemented. Surebet has filed for patent coverage of its innovative technology, and is committed to further developing its systems in Australia.

Surebet executives possess both extensive technology background and commercial experience in security, communications networking and the design and manufacture of gambling equipment for Australian and international markets.

5. INTERNET - CHANGING THE BUSINESS CONTEXT

Globalisation is the term used to describe the profound and rapid impact that events in one part of the world have on the social, political and economic institutions and lives of countries elsewhere in the world.

Globalisation is now a fact of life. Over recent decades there has been a progressive reduction in government imposed barriers to trade, with the spectacular result that international trade has grown more than twice as fast as worldwide GDP.

The Internet will accelerate this trend, and will have wider impact on every aspect and institution of social, political and economic life.

The extent to which society has embraced the Net continues to expand. The recently released US Department of Commerce study, "The emerging digital economy II" included estimates for growth over the year from May 1998 to May 1999. The reported estimates included

- an increase in the number of world wide web users of 55 %;
- an increase in the number of Internet hosts of 46 %;

- an increase in the number of web servers by 128 %;
- an increase in the number of web addresses of 137 %.

And, since other countries are starting from a smaller base, use outside the US is increasing faster than in the US.

Now over 171 million people across the planet have access to the Internet, and of these 57% were located in North America.

The data on e-commerce in the US reveals that Internet based transactions in 1998 was less than 1 % of all retail transactions, but growing faster than even the most optimistic projections. Business to business Internet use is about 4-5 times the magnitude.

The Internet is highly visible and is transforming all commerce.

The Internet is also changing our perceptions of space and time. Access is available to anyone, from anywhere and at anytime.

Distance is no longer a limitation to doing business either. The impact of telecommunications infrastructure development has made the Internet cost and time efficient. Soon the transaction boundary will be the world wide web.

Not just for consumers, but for businesses too. The use of the Internet for management of the value chain is now possible over global digital networks.

And markets are also changing. We are moving closer to perfect knowledge for consumers on price. It is becoming more difficult to price discriminate, that is, to charge some customers more and others less for the same product. Speed of fulfillment is one component of a product that can allow differential pricing.

In increasingly efficient markets, it becomes more important to market to individual customers. So the emphasis on relationship is the new business imperative. Companies must find ways to "product bundle". A current example is Internet access with free computers. Products will be redefined in terms of a total experience.

The Internet also offers unprecedented opportunities for reducing the cost of production, sales, and distribution of products. First copy costs of digital products are high, but the marginal cost of production is typically ten cents. Such products are ideal for sale and distribution over the Internet.

Smart distribution is used in business, for example Internet is used for stock replenishment in manufacturing plants for bulk raw materials, in vending machines and soon you will be able to buy refrigerators in Australia so equipped.

The impacts on business processes are major, and the Internet has become a fundamental enabling communication technology in our modern society.

6. CHALLENGES FOR GOVERNMENT

Deregulation around the world has progressed and continues to drive increasing levels of competition, in

- supply of infrastructure for telecommunications, power and transportation;
- financial markets;
- international trade;
- exposure of excess capacity in global industry, leading to extensive cross border rationalisations.

We have also witnessed increasing rates of technical innovation.

However, in the free wheeling world of the Internet Governments have some new concerns. One of these is the potential to erode Government tax bases. With the move world wide away from direct income tax, any threat to the ability of Governments to collect indirect taxes applicable to Internet transactions (such as sales tax, GST, VAT, etc) is being taken very seriously.

The current general consensus among business tax professionals is that the existing tax rules can accommodate e-commerce transactions and therefore the compliance challenges will be resolved and planning opportunities will be pursued during the normal course of business.

While tax authorities also tend to agree that existing tax rules can be applied to e-commerce, they are not yet convinced that they have identified all of the potential chinks in their armour, and have not yet quantified the related potential loss of tax revenue.

With a 1999 Forrester Research study estimating that that US Internet sales will grow from US$51 billion in 1998 to over US$551 billion in 2001, Internet sales will reach 7.2% of the US GDP.

Concerns of tax authorities include

- lack of any user control over the location of the activity;
- no means of identifying the users;
- reduced use of information reporting and with-holding institutions (dis-intermediation);
- development of electronic payment systems.

The OECD has identified many issues related to tax administration and compliance, consumption taxes, income tax treaties and transfer pricing.

Several particular areas of concern for tax administrators include

- the effective elimination of national borders;
- inconsistent treatment of cross-border transactions by taxing jurisdictions and payments being subject to quixotic taxation;
- tax rules should provide certainty and prevent double taxation.

The Australian Taxation Office, in their submission to the OECD recently, provided several important recommendations

- the overriding principle is that there should be broad neutrality between the treatment of businesses engaged in traditional physical commerce and those engaged in electronic commerce;
- tax return forms should be amended to require businesses trading on the Internet to provide contact information such as the uniform resource locators (URLs) and email addresses together with limited information indicating Internet trading;
- webshops should be licensed;
- ATO should negotiate with providers of software used for electronic transactions to incorporate message digests, electronic date stamp or other available technology to ensure the integrity of transactional records;
- ATO should negotiate with major international credit card and electronic payment system providers to seek international agreement to allow revenue authorities to obtain access to credit card transaction details held by credit card companies outside of the jurisdiction of the domestic revenue authority.

Meanwhile the US National Tax Association has commenced a project called the Communications and Electronic Commerce Tax Project in 1997. They have developed a one-rate per state tax proposal, and will be now studying income tax and the minimum physical presence required for income tax nexus.

In October 1998 President Clinton signed the Internet Tax Freedom Act (IFTA) into law. The IFTA imposes a moratorium ending after three years on

- taxes on Internet access, unless such tax was generally imposed and actually enforced prior to October 1998;
- multiple or discriminatory taxes on electronic commerce.

The statute requires that all Commission recommendations shall be tax and technology neutral and shall apply to all forms of remote commerce. The state anticipates that a regulatory and robust tax regime will be introduced at the end of the moratorium period. That regime will be an operative Internet infrastructure, based on technological innovation.

An area allied to tax collection is the gaming industry, where the Internet is already making major inroads.

7. MARKET OPPORTUNITY

In the US, where Internet gambling is banned, Internet gambling doubled between 1997 and 1998.

- Gross revenues reached an est. US$651 million in 1998

- Expected to exceed US$2 billion by 2001;
- In 1997 there were 6.9 million potential Internet gamblers, and Internet gambling revenues of US$300 million;
- By 1998 there were an estimated 14.5 million gamblers, and Internet gambling revenues of US$651 million..

The 1998 Commission concluded the same as the first 1976 Commission report on gambling in general that since gambling is inevitable, and it cannot be satisfactorily regulated, its continuing illegal status should continue.

As well as the Internet itself. The gambling industry has been growing rapidly around the world over the last twenty years. Australia leads the world in this entertainment business.

So much so, that now on average every adult in Australia bets more than $1,100 per annum.

The Internet will change the way adults around the world participate in all forms of gambling.

But the established casino and club gambling industry is already heavily regulated. This provides the legitimate basis for strongly arguing that the same standards of regulation should be applied to Internet gambling, otherwise an erosion in the overall level of regulation could result.

This provides a significant opportunity for regulatory innovation in the Internet gambling market.

Already the need for adequate regulation is evident with the operation of over 150 Internet gaming and wagering sites worldwide, operating mostly in unregulated jurisdictions.

8. INDUSTRY REGULATION

Current regulation is typified by the controls applied to poker machines (or slot machines). These are hard wired back to government centres for

- security monitoring;
- tax collection (consolidated revenue in real time).

Current governments increasingly find themselves dependent on gaming for their revenue base. For example, the State of NSW obtains 10% of its budget from gaming. Any erosion of this would create fiscal problems.

There are many stakeholders in the gaming industry, government, community organisations, players, operators, and suppliers

- Players require the game to be regulated and assured safe;
- Players and operators must have trust in the system;
- Government control authorities must have the ability to
    - monitor games without knowledge of the operator or player;
    - disable game play at any time;
    - read turnover and other statistics online.

Responding to this market need, Surebet Gaming Systems has developed patented intellectual property (actually a protocol patent) that provides an Internet infrastructure for multi-party Internet transactions.

This facilitates government control and tax collection in real time, as well as providing for player control - something currently not achievable.

The benefits of the system include

- secure transactions between casino and player that are monitored by the casino control authority;
- ability of the government to verify winnings in real time;
- no ability for the casino to interfere with game play, which is currently not the case;
- Ability of the casino control authority to shutdown players or casinos should irregular activity be detected;
- Ability for the casino control authority to validate any winnings by players and to ensure that correct financial transactions take place.

This product will give Australia the opportunity to remain at the forefront of gaming technology worldwide.

Surebet is currently in the development-for-demonstration phase over the next 9 months.

Consultation with major stakeholders, including government, gaming industry, financial institutions and the community is in progress to ensure that this is a world class development.

9. THE COMMISSION'S ISSUES

The Commission has sought to understand several key issues, including:

1. Will the Internet change the nature of gambling in society?

Opportunities for people to participate in gambling will now be anywhere, anytime and by almost everyone. The current high growth of connectivity, and the increasing use by consumers of the Internet for many e-commerce transactions, is providing the context for increased access to gambling.

2. What are the player demographic patterns?

The current demographics of Internet users differ from those of gamblers, however the profile Internet users is extending, and it is inevitable that the overlap with gambling will continue to extend

3. What are the possible restrictions to players?

Current Internet systems provide for a player registration process, that includes confirmation of personal details, including a PIN or personal information. Exclusion based on geographic, or other parameters is possible but not often exercised.

4. What levels of security can be provided?

High levels of security are required to deal with issues generic to e-commerce, including payment systems, protection from hackers on the public Internet system, operator's staff, system continuity and integrity of payout from operators.

A regulatory system should provide regulators with ability to monitor transactions, audit in real time operator integrity, as well as being able to detect interference with the system. An ability to detect money laundering and gather information relating to the probity of operators and players is an essential part of any Internet gambling system.

Other issues that must be addressed include privacy of personal information.

5. What is the ultimate level of safeguard?

Internet gambling systems should be regulated and accredited, in the interests of the public. A regulatory regime can and should address this. However, there is always the possibility for users to access unregulated Internet sites, but they would do so at risk. Where a practical system for regulation of Internet gambling is adopted by the responsible major gambling jurisdictions, it is likely that the unregulated sites will be pushed to the fringe.

6. REGULATORY ENVIRONMENT

Gaming is currently regulated at the state level in most jurisdictions, and this is the case in Australia.

However, with the borderless access possibilities that are provided by the Internet, there is an opportunity for a national regulatory approach. Apart from operating standards and safeguards, the collection of taxes at the state level will need to be addressed. A model that remains flexible to meet the various jurisdictional stakeholder issues is recommended.

7. BENEFIT COST DEBATE

There is a continuing debate concerning the benefits and costs of the gambling industry for society. Whilst the methodologies may differ, all parties agree that there are central themes and issues to the benefit cost evaluation, including

- contribution to GDP and overall economic activity;
- cost of social support facilities;
- difficulty in forecasting long term effects of current trends;
- effects on crime rate;
- effects on retail;
- employment effects;
- leisure and entertainment benefits of gambling;
- non-uniform effects across geographic regions;
- non-uniform effects across the socio-demographic range;
- problem gaming;
- taxation and income redistribution effects;
- tourism industry effects;

8. HARM MINIMISATION

One conclusion that can be drawn from the benefit cost debate is that through the minimisation of the social costs, the large benefit can potentially provide for a net positive social benefit.

Surebet offers regulators opportunities to monitor

- player identity;
- amounts played;
- time played;
- other playing patterns including game types;
- earnings made;
- trends in game play, including indications of addictive behaviour, or other departures from previous norms;

Apart from access restrictions, including limits to funds bet, players may also register voluntary restrictions, to provide a safeguard to exceeding norms on the "spur of the moment".

Very sensitive personal information and profiles must be gathered and stored in a secure data-base for these systems to work, and it highly desirable that these be held independently from a commercial operator.

9. CURRENT TECHNOLOGY

Traditionally, government authorities have been seeking to regulate gaming in all it's forms, to protect players and to ensure taxes are paid on profits. However, these arrangements do not allow a regulatory authority to regulate the game play on the internet.

Although the regulatory authority oversee the use of gaming devices used by gaming operators, it is unable to control the content of the messages between the gaming operator and the players. This allows the gaming operator to control the information flow to the player from the gaming device, and have the capability to tamper with that information. Such an arrangement, because of its lack of direct control, allows unscrupulous operators

to cheat both players, by skimming winnings, and the relevant government, by avoiding tax. The problem is exaggerated with the gaming operators reside outside the control authority's state or national jurisdiction.

10. SUREBET TECHNOLOGY

The accepted requirements for a regulatory system for Internet gambling includes that

- Players require the game to be regulated and assured safe;
- Players and operators must have trust in the system;
- Government control authority must have the ability to
  - monitor games without knowledge of the operator or player
  - disable game play at any time either at the player end or the operator end;
  - read turnover and other statistics online.

SureBet is designed for real and virtual casino configurations, providing a complete gaming infrastructure for operators.

Surebet technology is based upon a number of current technologies, including private and public key cryptographic algorithms, network protocols, database and distributed processing technologies. Through an Internet communications system design that Surebet Gaming Systems has filed a patent for, a multi-party Internet gambling system provides the following functionality

- secure system initialisation;
- registration of new players;
- player logon process;
- game play processing;

- player logoff processing;
- casino auditing;
- player auditing.

In an independent technical review of the Surebet technology just completed by Unisearch Limited, it was concluded that Surebet "has incorporated security features which are essential components of success of such a system over the public Internet". Unisearch Limited is the commercial company of the University of New South Wales specialising in expert advice, problem solving, research and development, training and technology commercialisation.

Surebet technology provides comprehensive functionality for operators, and regulatory authorities, including

- audits;
- money trail recording;
- security of transactions;
- protection of game play outcomes, including winnings, for players;
- active harm minimisation programs.

Major benefits of the Surebet system include that

- Players game play is regulated and assured safe;
- Casino control authority has ability to monitor games without knowledge of operator or player;
- Casino control authority has ability to disable game play at either the player end or the operator end;
- Players and operators have trust in the system;
- Casino control authority has ability to read turnover and other meters online.

11. RECOMMENDATIONS

Internet gambling is inevitable and will be increasingly accessible in our society.

Surebet has several recommendations for the Productivity Commission including the following

1. The high regulatory standards applicable in the established gambling industry, evolved because of legitimate need, provides the justification for not accepting lower standards for Internet gambling. Liberalisation of standards in order to facilitate the conduct of Internet gambling in Australia would result in increased social cost and potentially lead to a dramatic reduction in existing levels of gaming regulation.

2. The commonly held view on the state of available technology, that the presently adopted security and monitoring systems for Internet gambling activity are not adequate to support Internet gaming, should be rejected on the basis of evidence of recent innovation.

3. Innovative regulatory system technology should be evaluated and trialled as one activity in a program to develop adequate regulatory standards for Internet gambling.

4. A draft national regulatory model has merit and should be further considered as a basis for regulation of Internet gambling in Australia.

5. Developments in technology that allow active management of access to Internet gambling and well as development of harm minimisation programs should be a priority. Recent developments in Internet infrastructure technology should be evaluated for application.

6. Australian companies, at the forefront of innovation in the gambling industry, should be encouraged to accelerate the development and deployment of suitable regulatory technologies. These firms should be actively encouraged to work with key government and community organisations, as well as potential operators, in order to secure advantages for Australia in the competitive international gambling industry.

7. A moratorium should be placed on any new internet gaming licences until sufficient evaluation of applicable technologies are conducted. Further licences could result in an inability to guarantee any regulation of gambling as has been evidenced in recent attempts to control pornography on the internet.

