

**ATTORNEY GENERAL OF THE STATE OF NEW YORK  
INTERNET BUREAU**

**IN THE MATTER OF  
  
PAYPAL, INC.**

**ASSURANCE OF DISCONTINUANCE**

Pursuant to the provisions of Executive Law § 63(12) and General Business Law Article 22-A, ELIOT SPITZER, Attorney General of the State of New York, caused an inquiry to be made into certain business practices of PayPal, Inc., regarding online gambling activities carried on by third parties. As a result of such inquiry, the Attorney General finds:

**ATTORNEY GENERAL'S FINDINGS**

**A. Online Gambling: Background**

1. It is estimated that in 2002, Americans will gamble more than \$4 billion over the Internet, the vast majority of it through credit cards. While all gambling has social costs, online gambling can have uniquely pernicious effects. For instance, it is generally considered more addictive than offline gambling, because gambling addicts can wager in the comfort of their own homes, without actual money or chips in hand – thus masking psychologically the destructive effects of their behavior. One recent report published by the American Psychological Association concluded that “[t]he availability of Internet gambling may draw individuals who seek out isolated and anonymous contexts for their gambling behaviors.” See Study: Internet Gambling Stakes are High, CNN.com/Health, March 17, 2002.

2. Moreover, there is no effective way to prevent minors from gambling, whether with their own or with their parents' credit cards.

3. Additionally, and perhaps most destructively, online gamblers can -- and often do -- gamble on credit. In turn, compulsive gamblers' credit card losses are limited not to what they possess in hand, but rather to their entire line of credit, potentially on several different credit cards, amounting to tens -- even hundreds -- of thousands of dollars, and incurring high interest charges.

**B. PayPal's Activities: Background**

4. PayPal is a Delaware corporation, with its principal place of business at 303 Bryant Street, Mountain View, California. It also maintains offices at 11128 John Galt Boulevard, Omaha, Nebraska.

5. PayPal operates an Internet payment system that provides a means by which businesses and individuals can send and receive online payments. Its payment system employs the existing financial infrastructure of bank accounts and credit cards, but permits individuals and businesses (particularly small businesses) to send and receive online payments using only PayPal as the intermediary.

6. PayPal's system permits relatively widespread access in several respects. For instance, sellers that have not opened, or could not open, a merchant banking account may open accounts through PayPal, by which they may receive consumers' payments (placed through the Visa and MasterCard associations). This is possible because the PayPal system effectively provides such merchants with access to PayPal's own merchant banks, which are in turn members of the Visa and/or MasterCard bank card associations. Alternatively, PayPal sellers can accept consumers' funds

directly from consumer bank accounts, thus bypassing the need for the consumer to write bank checks, and for the seller to accept and deposit those checks. Finally, PayPal sellers and buyers can transact business solely by accessing existing balances of funds held by the buyer.

7. PayPal's revenues derive largely from fees that it charges its business accounts. Over the year running from March 31, 2001 through March 31, 2002, these fees generally ranged from two to four percent per transaction, depending on a number of factors regarding each merchant's size, business activities, and the method of payment.

8. As of June 30, 2002, PayPal had approximately 17.8 million member accounts (reflecting accounts held both by merchant and individual consumers), approximately 1.1 million of which list a New York address.

**C. PayPal's Provision of Services to Online Gambling Merchants**

9. Since fall 2000, PayPal has processed payments for certain online gambling-related merchants, including online casinos and betting operations. In its prospectus filed with the SEC on June 28, 2002, PayPal, in enumerating potential risk factors to its business, confirmed (p. 15): "Some online casinos use our product to accept and make payments. If these casinos are operating illegally, we may be subject to civil or criminal prosecution for numerous laws, including but not limited to money laundering laws." PayPal's 10-Q statement, filed with the SEC on May 15, 2002, similarly stated (p. 34): "Some online casinos use our product to accept and make payments. If these casinos are operating illegally, which is uncertain, we may be subject to civil or criminal prosecution." See also PayPal's S-1 Registration Statement filed with the SEC and dated September 28, 2001, at p. 10 (offering similar statements).

10. Through a variety of internal investigative procedures, PayPal generally has been able to identify online gambling merchants operating through its payment system. Because such merchants often pose greater financial and legal risks than do other merchants, PayPal has investigated the holders of such accounts and (among other things) their respective financial condition, web sites, company and industry types, and their licenses to operate in home jurisdictions. Pursuant to these procedures, PayPal has identified approximately 260 members, with approximately 525 separate accounts, that are online gaming-related service providers, and online gaming merchants. A list of these merchants (not necessarily exhaustive) is attached as Tab A to this Assurance of Discontinuance (“Assurance”).

11. Furthermore, as to specific transactions, PayPal’s payment system often is able to identify payments to online gambling merchants as the transactions occur. At the time such payments are made, if the payments are funded by credit card or debit card, PayPal provides information to its card processor so the processor will identify such transactions to the Visa and MasterCard systems as online gambling. Credit card issuing banks may then block such transactions from their own lending operations, as many such banks have done.<sup>1</sup>

12. Through targeted marketing efforts, PayPal has on occasion sought to establish and/or reinforce its business relationships with online casinos. In doing so, it has reached out to such entities in

---

<sup>1</sup> In response to, inter alia, concerns and lawsuits regarding extensions of credit for potentially or assertedly illegal activities that occur across their credit systems, Visa and MasterCard have enacted computerized coding systems that inform their respective issuing banks when they are processing transactions identified by merchants as online gambling. Under these coding systems, when a cardholder bets online, the credit card issuing bank is simultaneously informed, by computer code, that the transaction is occurring. Issuing banks then have the option to decline any and all such coded transactions. In order to avoid playing a role in such online gambling transactions, thousands of issuing banks therefore have blocked all transactions coded to indicate online gambling.

an effort to solidify its ties to such businesses and throughout the online gaming industry.

13. Based upon discussions with the Attorney General's Office, and as further set forth herein, PayPal now agrees to cease processing transactions involving payments by New York PayPal members to merchants that PayPal has identified or identifies in the future as online gambling merchants. PayPal further represents that it has ceased submitting to the MasterCard system transactions identified as online gambling transactions. Such cessation was initiated based on independent agreements reached between PayPal and MasterCard.

**D. The Status of Online Gambling under New York Law**

14. Betting and gambling are illegal in New York. N.Y. Gen. Oblig. Law § 5-401 states that "[a]ll wagers, bets or stakes, made to depend upon any race, or upon any gaming by lot or chance, or upon any lot, chance, casualty, or unknown or contingent event whatever, shall be unlawful." N.Y. Gen. Oblig. Law § 5-411 further renders "void" all contracts based on such wagers, bets, or stakes.

15. The New York Constitution, art. I § 9 states, "no . . . bookmaking, or any other kind of gambling [with certain exceptions pertaining to lotteries and horseracing] shall hereafter be authorized or allowed within this state."

16. Further, in July 2001, the Second Circuit held in United States v. Cohen, 260 F.3d 68 (2d Cir. 2001), that 18 U.S.C. § 1084 -- which prohibits the use of wire communications to take bets or wagers, or transmit information that assists the placement of bets or wagers on sports contests -- was applicable to a foreign offshore sports betting operation used by persons located in New York State.

17. Similarly, in The People of the State of New York v. World Interactive Gaming Corp.,

185 Misc. 2d 852 (Sup. Ct. N.Y. Co. 1999), the New York Supreme Court, applying N.Y. Penal Law § 225 (prohibiting promotion of gambling) held that the State of New York could properly enjoin a gaming enterprise, legally licensed in another jurisdiction yet having a presence in New York, from providing gambling to Internet users in New York. The Court also recognized the “deep-rooted policy of the state against unauthorized gambling.”

18. In recognition of the above-stated New York law and policy against unauthorized gambling, in voluntary cooperation with the Attorney General, and as further set forth herein, PayPal is now willing to enter into this Assurance without admitting to the Attorney General's findings or to any violation of law. In turn, the Attorney General is willing to accept this Assurance pursuant to Executive Law § 63(15) in lieu of commencing a statutory proceeding based on the activities described in ¶¶ 10 through 12 herein.

### **AGREEMENT**

IT IS HEREBY UNDERSTOOD AND AGREED by and between the parties that:

19. This Assurance shall be binding on and apply to PayPal, whether acting now or hereafter in its own capacity or through any of its officers, directors, servants, agents, employees, assignees, or any individual, subsidiary, division, or other entity through which PayPal may now or hereafter act, as well as any successors in interest.

20. Effective no later than September 1, 2002, PayPal shall cease processing any payments for online gambling merchants, where such payments involve PayPal's New York members, other than payments for gaming transactions that are expressly authorized under New York law. This cessation

shall apply to all merchants identified at Tab A, and to any merchants further identified, in the future, by the procedures described in ¶¶ 10 through 12 herein.

21. Further, effective no later than September 1, 2002, PayPal shall institute procedures to block automatically, and not to submit to the credit card systems, any credit card or debit card funded payments by PayPal's New York members that, under Visa or MasterCard rules, should be coded to indicate they are both (1) gambling or betting transactions and (2) e-commerce transactions, unless such payments are for transactions expressly authorized by New York law.

22. Further, effective no later than September 1, 2002, PayPal shall, upon determining (e.g., through its merchant investigation procedures) that a member's website reflects or represents conduct that violates any state or federal law, report such member and website to an appropriate law enforcement authority. For instance, should PayPal determine that a member advertises for sale on its website controlled substances without a doctor's prescription (or words to similar effect), PayPal shall report such member to the appropriate state attorney general's office, or to the appropriate federal agency if such member is not based in the United States, and/or to such other law enforcement or regulatory offices PayPal believes appropriate.

23. PayPal shall pay the sum of \$200,000 to the New York State Department of Law as and for disgorgement of profits related to online gambling, penalties and costs of investigation. This payment shall be made by check or certified check, and be delivered to the Attorney General within ten days of the execution of this Assurance.

24. Within forty-five days of the execution of this Assurance, PayPal shall file with the Attorney General an affidavit, completed by an officer of PayPal knowledgeable of PayPal's business

practices, describing PayPal's compliance with all the terms of this Assurance, and supplying copies of all relevant documentation.

25. Nothing contained in this Assurance shall be construed to limit or affect the rights of any persons or entities who are not parties to this agreement with respect to any of the matters contained herein.

26. The acceptance of this Assurance by the Attorney General of the State of New York shall not be deemed or construed as an approval by the Attorney General of any of PayPal's activities or practices, past or present, and PayPal will not make any representations to the contrary.

27. The Attorney General makes no finding herein regarding any aspect of PayPal's system not specifically referenced in ¶¶ 6 through 12 herein.

28. Such agreement or forbearance on the part of the Attorney General as described in ¶ 18 herein, to avoid commencing a statutory proceeding, is conditioned upon PayPal's compliance with the conditions herein, and upon the truthfulness of PayPal's statements herein and during the course of the Attorney General's investigation.

29. Except as provided herein, no party to this Assurance relinquishes or waives any legal rights or arguments with respect to this Assurance, its subject matter or enforcement, and the entry into this Assurance shall not be deemed to be a waiver of any legal right or argument. Further, the aforementioned payment shall in no way foreclose and/or prohibit the Attorney General from taking further action against PayPal for non-compliance with this Assurance.

30. In the event of any violation of this Assurance, the Attorney General may commence an action or proceeding, under Executive Law § 63(12), in which evidence of a violation of this Assurance



shall constitute *prima facie* evidence of a violation of the applicable law.

WHEREFORE, the following signatures are affixed hereto this 16th day of August, 2002.

PayPal, Inc.

ELIOT SPITZER  
Attorney General of the  
State of New York  
120 Broadway  
New York, New York 10271-0332  
(212) 416-8433

By:

---

By:

---

Kenneth M. Dreifach  
Assistant Attorney General in Charge  
Internet Bureau

---

Daniel L. Feldman  
Assistant Deputy Attorney General

---

Brian Stettin  
Assistant Attorney General

