



California Lottery

Headquarters

600 North Tenth Street

Sacramento, CA 95814

www.calottery.com

December 10, 2007

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
Docket No. R-1298

Re: Prohibition on Funding of Unlawful Internet Gambling
Docket Number: R-1298

Dear Ms. Johnson:

Thank you for allowing me this opportunity to comment on regulations that the Secretary of the Treasury and the Board of Governors of the Federal Reserve System (Agencies) have proposed to implement the Unlawful Internet Gambling Enforcement Act of 2006 (Act), *31 USCS §§ 5361 et seq.*

As Director of the California State Lottery, I am particularly interested in protecting the right of Californians to determine what types of gaming they wish to allow in their state without being impeded by unnecessary restrictions on financial transactions. In passing the Act, Congress made it clear that its intent was not to usurp the power of California's citizens to regulate gaming in their state. Rather, the Act specifically requires that its provisions not be construed as "altering, limiting, or extending any Federal or State law or Tribal-State compact prohibiting, permitting, or regulating gambling within the United States." *31 USCS § 5361 (b).*

The Act prohibits gambling businesses from accepting online payment for unlawful internet gaming and requires financial transaction providers, as defined, to identify and block prohibited financial transactions. It is not meant to impede lawful purchases of state lottery products. On the contrary, the Act specifically *excepts* from the definition of "unlawful internet gambling" those transactions that are made exclusively within a single state, are expressly authorized by state statute, and

include specified age and location verification restrictions and security measures. 31 USCS § 5362 (10)(B). The exception appears tailor-made for state lotteries, and evidences Congress' intent that state lotteries be free from the blocking requirements that may be imposed upon other gambling interests.

Unfortunately, financial institutions have reacted to the Act by rejecting any transactions characterized as gambling without regard to the fact that state lottery transactions are specifically exempt from the Act. This over-reaction by financial institutions reflects the ambiguity in the Act that the Agencies are tasked with clarifying through regulation.

Despite Congress' intent to except state-run lotteries and other lawful gaming interests from the restrictions imposed by the Act, the proposed regulations would allow financial transaction providers to implement their own policies for identification and blocking, which the Agencies acknowledge may include procedures allowing for blocking of *all* online gambling transactions, lawful or not. In the supplemental materials published with the proposed regulations, the Agencies express the opinion that the Act does not provide them with the authority to require financial transaction providers to process lawful online gambling transactions.

The Act *expressly* provides the Agencies with that authority. It requires that the regulations contain provisions to "*ensure* that transactions in connection with any activity excluded from the definition of unlawful internet gambling in subparagraph (B), (C), or (D)(i) of section 5362 (10) (31 USCS § 5362(10)) are not blocked or otherwise prevented or prohibited by the prescribed regulations." Congress charged the Agencies with the responsibility to protect those conducting lawful gambling activities from overblocking. With all due respect, proposing that no action be taken to prevent it is contrary to the express language of the Act and is an abdication of the responsibility given to the Agencies by Congress.

In requiring that the regulations *ensure* lawful transactions are not blocked, I believe the Act mandates the Agencies to take affirmative action to prevent it. To that end, I propose that the regulations be revised to provide financial transaction providers with a safe harbor, and eliminate liability for financial transactions to which state-sponsored lotteries are a party. This could be tracked via merchant code or by other means, perhaps using methodology that might have been used to identify and block such transactions. I believe providing this "safe harbor" for financial service providers would go a long way toward encouraging these businesses not to block legitimate state lottery transactions. We would be happy to work with those providers to develop an identification system that is practical, cost-effective, and as simple as establishing a different transaction code for lottery transactions.

Jennifer J. Johnson
December 10, 2007
Page 3

Unnecessarily allowing elimination of a lawful source of revenue would be detrimental not only to the financial service providers, but also to the deserving beneficiaries of the many state lotteries throughout the United States. In California, our beneficiary is public education. We ask that you not sit by and allow a potential revenue source to disappear when you can take action to prevent it as the Act intended.

The California State Lottery would be happy to work with the Agencies and financial service providers to develop mechanisms to eliminate the potential for overblocking under the Act. Please let me know how we can assist you in your efforts. I can be reached at (916) 323-0403.

Very truly yours,



Joan M. Borucki
Director

cc: Kate Killeen
Acting Chief Counsel