



# WHY SENATORS KYL AND REID ARE WRONG ABOUT STATE- AUTHORIZED INTRASTATE INTERNET GAMBLING

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## I. Introduction

In their July 14, 2011 letter to Attorney General Eric Holder, Senators Jon Kyl and Harry Reid noted with alarm that certain state lotteries had indicated that they intended to move forward with plans to offer lottery products on the Internet on an intrastate basis. Regarding such Internet gambling, where the player purchasing the lottery

product and the lottery server accepting the purchase are located in the same state, they wrote:

[W]e have heard that at a major conference in May, several officials from various state lotteries boasted that they have obtained the Department of Justice's effective consent by writing letters of their plans that stated that if no objection was received they would proceed with their Internet gambling plans — and no objection has been received despite many months or years.

In light of the lotteries' intention to proceed, the Senators urged the Department of Justice ("DoJ") to "reiterate the [DoJ's] longstanding position that federal law prohibits gambling over the Internet, including intra-state gambling (e.g., lotteries)." The Senators reminded the DoJ that the basis for the DoJ's position "has been that all forms of Internet gambling are illegal — including intra-state Internet gambling, because activity over the Internet inherently crosses state lines, implicating federal anti-gambling laws such as the Wire Act."<sup>1</sup>

While Senators Kyl and Reid accurately described the DoJ's position regarding intrastate Internet gambling promoted during prior administrations, they were wrong to urge the DoJ to adhere to it — especially with respect to non-sports intrastate gambling conducted in accordance with the intrastate Internet gambling safe harbor contained in the Unlawful Internet Gambling Enforcement Act of 2006 (the "UIGEA").<sup>2</sup> This is because the DoJ's historic position — although not entirely without support — is unlikely to prevail when tested in court.

Contrary to the view historically espoused by the DoJ, intrastate Internet gambling should not be found to violate federal law, where the wager (i) does not relate to a sporting event (subject to certain exceptions for pari-mutuel wagering on certain events), (ii) is made and accepted in the same state, (iii) is authorized by that state's law, and (iv) complies with the intrastate gambling exception to unlawful Internet gambling contained in the UIGEA. (Such gambling is hereinafter referred to as "State-Authorized Intrastate Internet Gambling").

## II. The Federal Laws Usually Cited by the DoJ are either Inapplicable or are Intended to Assist State's Enforcement Efforts, Not Thwart Their Policy Decisions

The primary laws cited by the DoJ in support of its past position regarding intrastate Internet gambling are the Wire Act, the Travel Act of 1961 (the "Travel Act")<sup>3</sup> and the Illegal Gambling Business Act of 1970 (the "IGBA").<sup>4</sup> For there to be a violation of the Travel Act, there must be an underlying violation of state or federal law, and a violation of the IGBA requires an underlying violation of state or local law. Thus, the IGBA does not apply to State-Authorized Intrastate Internet Gambling, and the Travel Act would apply only if the gambling activity were to violate a different federal law — i.e., the Wire Act.

However, State Authorized Intrastate Internet Gambling would not violate the Wire Act. The only federal appeals court to examine the applicability of the Wire Act to non-sports gambling held that the Wire Act applies only to wagering on sporting events.<sup>5</sup> (The U.S. District Court for the District of Utah held otherwise, but this lower court decision has precedential value only in Utah.<sup>6</sup>)

Even if the Wire Act were applicable to non-sports gambling, however, it would be contrary to the purpose of the Wire Act for it to be used to prohibit State-Authorized Intrastate Internet Gambling. To make such gambling illegal merely because the wagering transmis-

1) The "Wire Act" refers to the Wire Wager Act of 1961, at 18 U.S.C. § 1084. 2) 31 U.S.C. § 5361 et seq. 3) 18 U.S.C. § 1952. 4) 18 U.S.C. § 1955. 5) In re MasterCard Int'l Inc., 313 F.3d 257, 262 (5th Cir. 2002). 6) United States v. Lombardo, 639 F.Supp.2d 1271 (D. Utah December 13, 2007).

sions, although sent and received in the same state, might be routed outside it (because they were carried on the Internet), would be contrary to the purpose of the Wire Act. As stated by the U.S. District Court for the Northern District of West Virginia, in a case decided in the year after the Wire Act was enacted:

The purpose of [the Wire Act] is to assist the various States ... in the enforcement of their laws pertaining to gambling, bookmaking, and like offenses and to aid in the oppression of organized gambling activities by prohibiting the use of ... wire communication facilities which are or will be used for the transmission of certain gambling information in interstate ... commerce ...<sup>7</sup>

More clearly, the Court stated: “[T]he objective of the [Wire] Act is not to assist in enforcing the laws of the States through which the electrical impulses traversing the telephone wires pass, but the laws of the State where the communication is received.”<sup>8</sup>

Thus, it would defy common sense if the DoJ were to apply the Wire Act to prohibit wire transmissions between points in the same state, where such transmissions constituted wagers authorized by that state’s laws. Use of the Wire Act to prohibit such intrastate gambling authorized by a state would actually thwart that state’s laws, directly contrary to the Wire Act’s stated purpose.

### III. The UIGEA Excepts Intrastate Internet Gambling from “Unlawful Internet Gambling”

The UIGEA makes clear that Congress intended that State-Authorized Intrastate Internet Gambling (other than on most sporting events) not be unlawful under federal law. In the UIGEA, Congress explicitly excepted Internet gambling from “unlawful Internet gambling,” where:

- (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;<sup>9</sup>
  - (b) the Professional and Amateur Sports Protection Act;<sup>10</sup>
  - (c) the Gambling Devices Transportation Act;<sup>11</sup> or
  - (d) the Indian Gaming Regulatory Act.<sup>12, 13</sup>

Whether the electronic packets constituting the bets or wagers may be routed out of the state before returning does not affect whether the gambling is excepted from “unlawful Internet gambling.” The UIGEA states: “The intermediate routing of electronic data shall not determine the location or locations in which a bet or wager is initiated, received, or otherwise made.”<sup>14</sup>

Although the UIGEA does not amend any previously-existing federal (or state) gambling law<sup>15</sup> (the UIGEA merely facilitates enforce-

ment of otherwise unlawful conduct), the above intrastate exception to “unlawful Internet gambling” demonstrates that Congress did not intend that such intrastate Internet gambling would be prohibited. Moreover, previously-existing federal laws do not prohibit non-sports intrastate Internet gambling which has been authorized by the state in which it occurs. The Wire Act, as aforesaid, applies only to wagering on sporting events, and the other federal laws historically cited by the DoJ in support of its argument that intrastate Internet gambling is unlawful – i.e., the Travel Act and IGBA – require a separate local, state or federal law violation, and there would be no such violation where the intrastate Internet gambling were authorized by applicable state law (given the above-demonstrated inapplicability of the Wire Act).

While the statute clearly excepts State-Authorized Intrastate Internet Gambling from prohibition, regardless whether the bettors are wagering from their home computers, the UIGEA Conference Report strangely suggests otherwise. That report discusses the UIGEA’s intrastate gambling exception stating:

The Internet gambling provisions [of the UIGEA] do not interfere with intrastate laws. New section 5362(10)(B) creates a safe harbor from the term “unlawful Internet gambling” for authorized intrastate transactions, if the state law has adequate security measures to prevent participation by minors and persons located out of the state. The safe harbor would leave intact the current interstate gambling prohibitions such as the Wire Act, federal prohibitions on lotteries, and the Gambling Ship Act so that casino and lottery games could not be placed on websites and individuals could not access these games from their homes or businesses. The safe harbor is intended to recognize current law which allows states jurisdiction over wholly intrastate activity, where bets or wagers, or information assisting in bets or wagers, do not cross lines. This would, for example, allow retail lottery terminals to interact with a processing center within a state, and linking of terminals between separate casinos within a state if authorized by the state.<sup>16</sup>

Thus, the Conference Report suggests that the UIGEA’s intrastate Internet gambling exception is meant only to create a safe harbor for intrastate Internet gambling where the wagering occurs from retailer terminals and not from home computers, and where the bets or wagers do not cross state lines. This is inconsistent with the plain language of the UIGEA’s intrastate Internet gambling exception, and if upheld as a correct interpretation would make the exception almost meaningless. The UIGEA’s intrastate Internet gambling exception is an exception to the term “unlawful Internet gambling.” If the exception were intended to relate only to gambling that does not involve the Internet, as the Conference Report suggests, then the exception would be redundant, since, by definition, “unlawful Internet gambling” must “involve[ ] the use, at least in part, of the Internet.”<sup>17</sup> In addition, to claim that the exception “is intended to recognize current law which allows states jurisdiction over wholly intrastate activity, where bets or wagers, or information assisting in bets or wagers, do not cross lines,” would read out of the statute entirely the language of 31 U.S.C. § 5362(10)(E), which makes the intermediate routing of electronic data irrelevant as long as the bet or wager begins and ends in the same state.

In any event, the confusing UIGEA Conference Report is not rele-

7) *Yaquina v. United States*, 204 F.Supp. 276, 279 (N.D. W.Va. 1962) (quoting from Attorney General Robert F. Kennedy’s letter to the branches of Congress dated April 6, 1961). 8) *Id.* (emphasis added). 9) 15 U.S.C. § 3001 et seq. 10) 28 U.S.C. § 178, 11) 15 U.S.C. § 3001 et seq. 12) 25 U.S.C. § 2701 et seq. 13) 31 U.S.C. § 5362(10)(B). 14) 31 U.S.C. § 5362(10)(B). 15) 31 U.S.C. § 5361(b). 16) 152 Cong. Rec. H8026-04, p.8; 2006 WL 2796951 (Cong.Rec.) (emphasis added). 17) 31 U.S.C. § 5362(10)(A). 18) *Bedroc Limited, LLC v. United States*, 541 U.S. 176, 124 S.Ct. 1587, 1595 fn. 8 (2004) (citations omitted). 19) Lottery ticket subscriptions – essentially lottery play purchased in advance for a period of time six-months or longer in duration – are sold over the Internet (to persons located in the state) by the state lotteries in Illinois, Minnesota, New Hampshire, New York, North Dakota and Virginia. 20) Indeed, such activity arguably is not “interstate commerce” within Congress’ plenary power under Article I, Section 8, Clause 3 of the United States Constitution (the “Commerce Clause”). A discussion of Congress’ power under the Commerce Clause is outside the scope of this article. 21) Similar letters include those sent, in 2001, to the United States Virgin Islands Casino Control Commission, and in 2002, to the Nevada Gaming Commission. 22) 18 U.S.C. § 2. 23) Some state lotteries, however, have proceeded to sell their products via the Internet – albeit in a limited fashion. Lottery subscriptions – essentially lottery tickets for a period of time six-months or longer in duration – are sold online (to persons located in the state) by the state lotteries in Illinois, Minnesota, New Hampshire, New York, North Dakota and Virginia.

vant to the interpretation of the UIGEA's intrastate Internet gambling exception, because the language of the UIGEA's intrastate Internet gambling exception is clear and unambiguous. It is one of the fundamental rules of statutory construction that "resort to legislative history [is permitted] only when necessary to interpret ambiguous statutory text . . . Where a law is plain and unambiguous, whether it be expressed in general or limited terms, the legislature should be intended to mean what they have plainly expressed, and consequently no room is left for construction."<sup>18</sup>

#### IV. To find that Federal Laws Prohibited State-Authorized Intrastate Internet Gambling would wrongly imply that existing Intrastate Gambling Activity was Also Illegal

Finally, if one were to accept the argument of Senators Reid and Kyl in their July 14 letter – that intrastate Internet gambling is unlawful, "because activity over the Internet inherently crosses state lines" – then businesses in Nevada and lotteries in states that utilize interstate communications networks to facilitate gambling that is otherwise intrastate would be subject to possible prosecution by the DoJ. By way of example, many state lotteries utilize satellite communication technology to transmit bets and wagers from retailer locations in the state to the lottery data center located in the same state. Such communications inherently cross state – and national – boundaries, before returning to the same state. More significant, at least six state lotteries allow persons within their states to purchase lottery ticket subscriptions over the Internet, an activity legally indistinguishable from purchasing individual lottery game-play online.<sup>19</sup> Congress could not have intended that such activity be prohibited, when authorized by the law of the state in which it occurs, merely because an interstate communication facility was utilized to carry the wagering transmissions between points within the same state.<sup>20</sup> Were this otherwise, it would require state lotteries and other licensed intrastate gambling businesses to use "closed-loop" communication networks whereby all wagering transactions were transmitted not via the most efficient path available, but rather via a path that never traveled across the state's boundaries. Such a restriction would serve no policy purpose whatsoever, and would needlessly restrict the ability of states to conduct lawful gambling within their boundaries.

#### V. The DoJ should Remove the Cloud over Intrastate Internet Gambling

Notwithstanding the above legal analysis, the intimidating effect of the DoJ's historic contrary position cannot be denied. Letters such as those written in 2005 by United States Deputy Assistant Attorney General Laura H. Parsky to the Illinois Lottery have intimidated states from authorizing or conducting State-Authorized Intrastate Internet Gambling, even though the weight of legal authority indicates that the DoJ's position is unlikely to succeed when challenged in court. The Parsky letter, and those like it (all from prior administrations),<sup>21</sup> typically threaten with prosecution not only the state operator, but also its vendor – the latter under the federal "aiding and abetting" statute.<sup>22</sup> It is not surprising, then, that state lotteries and their vendors have been reluctant to proceed with State-Authorized Intrastate Internet Gambling.<sup>23</sup>

Thus, it seems that until the DoJ clarifies its position on State-Authorized Intrastate Internet Gambling, or is challenged in court on the issue and loses, states' further expansion of their lawful wagering games on the Internet will occur under a cloud – i.e., there will be at least some risk of federal law enforcement action. While



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# SSAE 16 REPLACING SAS 70 ADVANTAGE TO THE LOTTERY INDUSTRY

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## OVERVIEW

The AICPA's Statement on Standards for Attestation Engagements No. 16 (SSAE 16), Reporting on Controls at a Service Organization was issued in April 2010. As of June 15, 2011, the SSAE 16 effectively replaced the long standing SAS 70 as the U.S. standard for reporting on a service organization's internal controls. SSAE 16 is also referred to as Service Organization Control (SOC) Reporting 1. The focus of SSAE 16 is on controls at a service organization likely to be relevant to user entities' internal control over financial reporting. The SAS 70 has been used as the de facto standard for the Lottery industry for close to 20 years now. For service organizations that currently have a SAS 70 service examination ("SAS 70 audit") performed, changes will be required to effectively report under the new SSAE 16 standard.

## APPLICABILITY OF SSAE 16 TO THE LOTTERY INDUSTRY

If you are a company directly providing services to the various Organizations that run the Lottery programs or are a vendor associated with companies that provide the Lottery industry with services such as electronic funds transfer and as such have a direct or an indirect impact on the end customers' financial statements the SSAE 16 will be applicable to your company. Organizations that outsource their gaming and transaction processing systems to services providers require independent assurance that the provider has adequate controls in place so as not have an adverse impact over the controls related to and the accuracy of its financial statement. The SSAE 16 report is the perfect vehicle for Organizations to obtain that level of assurance and for services providers to provide that assurance to them.

## WHY THE CHANGE FROM SAS 70 TO SSAE 16

Globalization of business process outsourcing drove the need for a common global standard. SSAE 16 was issued to align with International Standards on Attestation Engagements (ISAE) 3402. There was also the need for increased emphasis on the service organization rather than the auditor. SAS 70 was more focused on the auditor rather than on the service organization. Companies reporting under SAS 70 had several misunderstandings in that SAS 70 was thought to be the implementation of best practices and that it was a certification. SSAE 16 clarifies these misunderstandings.

## TWO TYPES OF ENGAGEMENTS

SSAE 16 will continue to enable a service

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the lotteries in some states and in the District of Columbia have stated that they intend to move forward with plans to offer gambling products on the Internet on an intrastate basis notwithstanding the DoJ's historic position,<sup>24</sup> a DoJ clarification of its historic position – in line with the weight of the law – clearly is desired. As stated by United States Assistant Attorney General Michael Chertoff in his August 23, 2002 letter to the United States Virgin Islands Casino Control Commission:

As a general rule, the Department of Justice is limited by statute to providing legal advice within the federal government and the Criminal Division does not issue advisory opinions with respect to the legality of specific gambling operations. This allows the Department to defer the resolution of legal questions until it is confronted with a concrete situation requiring action in a judicial forum.

We may, however, provide general guidance as to relevant statutory provisions that are applicable to Internet gambling.

It is hoped that the DoJ will provide such general guidance now, and indicate that State-Authorized Intrastate Internet Gambling is not prohibited under federal law.

## VI. Conclusion

In these times of extremely challenging state financial circumstances, states should not be foreclosed from pursuing lawful means of generating revenues. The position espoused by Senators Reid and Kyl regarding intrastate Internet gambling is against the weight of legal authority and should not be adopted. The DoJ should make clear – pursuant to its ability to provide general guidance – that State-Authorized Intrastate Internet Gambling is not prohibited by federal law. ♦

<sup>24</sup> The District of Columbia passed the "Lottery Modernization Amendment Act of 2010," which was a part of the "Fiscal Year 2011 Supplemental Budget Support Act of 2010" (codified at D.C. Code § 3-1313). It authorizes the D.C. Lottery and Charitable Games Control Board to offer both games of skill and games of chance via the Internet. See: <http://www.dclottery.com/pdfs/igaming/iGaming%20FAQs%20Final.pdf> (last accessed October 8, 2011).