

CALIFORNIA GAMBLING CONTROL COMMISSION

INITIAL STATEMENT OF REASONS

CGCC-GCA-2011-02-R

HEARING DATE: November 3, 2011

SUBJECT MATTER OF PROPOSED REGULATIONS: Minimum Internal Control Standards for Gambling Establishments – Phase III; Gambling Floor Operations and House Rules

SECTIONS AFFECTED: California Code of Regulations, Title 4, Division 18, Chapter 7: **Sections 12360, 12391 and 12392**

SPECIFIC PURPOSE OF REGULATORY PROPOSAL:

Introduction:

The California Gambling Control Commission (Commission) is the state agency charged with the administration and implementation of the California Gambling Control Act (Act).¹ The Commission is authorized to adopt regulations governing the operation of gambling establishments (cardrooms) in California.² Specifically, the Commission is mandated to adopt regulations on the subjects enumerated in Business and Professions Code section 19841.³ Regulations concerning the establishment of minimum policies and procedures by owner licensees to exercise effective control over their gambling affairs have been prepared in compliance with section 19840⁴ and subdivisions (h) and (o) of section 19841.⁵

Gambling is the quintessential cash business and internal controls are the primary procedures used to protect the integrity of cardroom funds and games. Internal controls are therefore a vitally important part of properly regulated gambling.

¹ Business and Professions Code, Division 8, Chapter 4, section 19800 et seq.

² Business and Professions Code section 19840.

³ All statutory references are to the Business and Professions Code, unless otherwise specified.

⁴ Section 19840 provides, in pertinent part, that “[t]o the extent appropriate, regulations of the Commission ... shall take into consideration the operational differences of large and small establishments.”

⁵ Subdivision (h) of section 19841 mandates that the Commission’s regulations shall “[p]rescribe minimum procedures for adoption by owner licensees to exercise effective control over their internal fiscal and gambling affairs, ...” as specified. Subdivision (o) of section 19841 mandates that the Commission’s regulations shall “[r]estrict, limit, or otherwise regulate any activity that is related to the conduct of controlled gambling, consistent with the purposes of this chapter.

Purpose:

In general, this proposed action has been drafted in an attempt to establish uniform procedures and standards to assist the Commission and the Bureau of Gambling Control (Bureau) in meeting their oversight responsibilities under the Act, while taking into account variations in the size of gaming operations. More importantly, the proposed action is intended to provide for minimum standards that protect public health, safety and general welfare.⁶ These regulations establish a baseline for gambling establishment (cardroom) operation, by requiring that licensees establish and implement written policies and procedures that meet or exceed the prescribed Minimum Internal Control Standards (MICS), as they relate to the established size category of the individual licensee. Establishing baseline standards helps to ensure consistency and uniformity.

Background:

The Commission's involvement in the development of MICS for cardrooms began in June 2004. A joint Commission-Bureau-Industry workshop was conducted to review preliminary draft proposals for regulations in September 2004. After consideration of the information and comments received through that workshop, the proposed MICS requirements or categories were deliberated. The conclusion was to have smaller rulemaking packages with topic-related MICS instead of one large rulemaking with many MICS included. Regulations for Gaming Activity and Additional Tables finished the rulemaking process in 2006, with the latter being adopted and approved. Subsequently, other issues arose which required the Commission to re-evaluate their regulation development priorities and work on the MICS regulations was suspended temporarily.

In September 2007, a joint Commission/Bureau MICS Regulations Workgroup was formed to continue the development of regulations to establish MICS for cardrooms. The workgroup discussed general MICS requirements and researched MICS requirements from other states. Due to the number of subjects and complexity of the MICS requirements, the workgroup segregated the requirements into separate subject areas in order to pursue regulations in phases, according to priority.

Multiple phases are being considered simultaneously and are currently in various stages of development. Phase I and II MICS regulations have both been approved by the Office of Administrative Law (OAL). The Phase I MICS regulations (General Terms, Conditions and Definitions; Policies and Procedures; Drop and Drop Collection; Count and Count Room Functions; and Cage Functions) became effective on September 24, 2009, while the Phase II MICS (Emergency Preparedness, Security and Surveillance) became effective on May 6, 2010.

Proposed Action:

This proposed action will make changes within Articles 1 and 3, Chapter 7, Division 18, Title 4 of the California Code of Regulations. The proposed changes are as follows:

1. Amend Section 12360. Chapter Definitions.

Within Article 1, Section 12360 provides definitions for the words that govern the construction of Chapter 7. This section currently incorporates the definitions in section

⁶ Business and Professions Code, section 19920

19805 and includes specific definitions for the words “licensee”, “security department” and “surveillance unit.

- a. This proposed action would amend Section 12360 by incorporating the definitions in Section 12002. The definitions in Section 12002 are applicable to all of Division 18. Since many of the terms that are defined in Section 12002 are used throughout Chapter 7, it is appropriate to specifically incorporate them by reference.
- b. This action would add a definition for the term “gaming activity” in a new subsection (a). This term is used in the text of proposed Sections 12391 and 12392. Subsection (a) would define a “gaming activity” to mean the same as is currently stated in Title 11, Section 2010(f), which defines “gaming activity” to mean any activity or event including, but not limited to, jackpots, bonuses, promotions, cashpots or tournaments that are appended to, or rely upon, any controlled game. In the construction of these proposed regulations, it is important that a *gaming activity* not be confused with a *controlled game*. Pursuant to Section 12002(c) and section 19805(g), a controlled game means the actual play of Poker, Pai Gow or California Games. Gaming activities are generally promotional in nature, while controlled games represent the actual play of the games being promoted.
- c. This action would add a definition for the terms “house prop player” and “public relations player” in a new subsection (b). These terms are used in Section 12391(a)(2) and (4), as well as in a previously adopted regulation, Section 12388(a). These are commonly used synonymous terms that are well understood throughout the industry and have not caused any confusion in other regulation applications.

In the previous adoption of Section 12388, these same terms were characterized as “*terms of art with settled meanings that are understood by affected persons in the gambling industry ... [and] ... widely accepted and commonly used by operators and patrons of gambling establishments ... in the State of California.*” Therefore, no separate definition was needed for those terms, as they were being used in Section 12388. Now that basic conditions and criteria are being established for the employees that perform as “house prop players” or “public relations players,” it is appropriate and desirable to provide a basic definition for those terms. This will help to ensure a consistent application and enforcement of the provisions of Section 12391(a)(2), and avoid any future confusion in the use of these terms.

- d. This action would also add a definition for the term “house rules” in a new subsection (c). Subsection (c) would define “house rules” as those which set general parameters under which a gambling enterprise operates the play of controlled games. Section 12392, which is also proposed by this action, would establish minimum standards for house rules. It is important to differentiate between “house rules” and “game rules.” In the Act, “game rules” refers to those published rules for *each specific game*.⁷ In contrast, this

⁷ Business and Professions Code, sections 19826, subdivision(g) and 19841, subdivision (b)

action would set general standards (house rules) for player conduct and etiquette that may *apply to any game*.

- e. These proposed regulations would also correct the statutory reference for the definition of a “licensee.” The current subsection (a) [renumbered as subsection (d)] refers to subdivision (ac) of section 19805. Recent legislation renumbered that subdivision as (ad). This change will merely conform this reference to the correct statutory subdivision. Additional non-substantive editorial, grammatical and conforming changes are also included which have no regulatory effect.

2. Adopt Section 12391. Gambling Floor Operations.

This proposed action would establish new Section 12391 within Article 3, Chapter 7, Division 18, Title 4 of the California Code of Regulations. Section 12391 would require cardrooms to adopt specified minimum policies and procedures that relate to the operation of the gambling floor.

- a. Subsection (a), paragraph (1) would require cardrooms to have a policy stating that their gambling floor must be *open to the public*. This proposed regulation is consistent with section 19841(p) which requires the Commission to adopt regulations that define and limit the area, games, hours of operation, number of tables, wagering limits, equipment and the method of gambling operations when local regulations are insufficient to protect the health, safety or welfare of residents near cardrooms. Requiring that all cardrooms be *open to the public* creates a consistent statewide standard, regardless of local requirements. This proposed regulation is also in compliance with section 19801(j) which states in part:

“To ensure that gambling is conducted honestly, competitively, and free of criminal and corruptive elements, all licensed gambling establishments in this state must remain open to the general public ...”

This proposed regulation also provides for exceptions to this *open-to-the-public* rule should the provisions of section 19861 apply to any cardroom in the state. This exception permits the licensing of small (Tier I) *private* cardrooms, provided that they are located in an area that has a local ordinance allowing only private cardrooms and provided that they existed on or before December 31, 1997. There is only one cardroom in the state that meets these criteria.

This proposed regulation would allow for additional exceptions when any of the following statutes apply:

- Section 19844 (Exclusion or Ejection of Individuals from Gaming Establishment)
 - Section 19845 (Removal of Persons from Licensed Premises; Reasons)
 - Section 19921 (Persons Under 21; Areas of Access)
- b. Subsection (a), paragraph (2) would require a cardroom to have policies and procedures that place conditions on the use of “house prop players” and “public relations players.”

When playing controlled games, house prop players and public relations players would be required to:

- (A) Hold a valid work permit or key employee license, and wear their work permit or key employee badge;
- (B) Comply with all house and game rules applicable to the game being played;
- (C) Comply with all laws and regulations applicable to the play of controlled games;
- (D) Not accept the deal when playing a California Game;
- (E) Not use house funds to wager;
- (F) Not be the house dealer for the game being played; and
- (G) Leave the table when a waiting list exists for the game being played.

The Commission and the Bureau have an obligation to establish policy regarding the operations of a gambling enterprise.⁸ The Act and the Penal Code clearly prohibit house-banked games in cardrooms.⁹ The Act instructs the Commission to adopt regulations that help to ensure that gambling activities are fair to the public¹⁰ and establishes penalties against licensees that engage in dishonest or unfair gambling activities.¹¹ Further, the Act assigns the Bureau with the responsibility to place restrictions and limitations on how controlled games are played.¹² This proposed regulation will help to ensure that controlled games are played fairly and will reduce the possibility of the house having a financial interest in the game by establishing conditions under which house prop players can play controlled games.

- c. Subsection (a), paragraph (3) would require owners and employees of cardrooms to comply with house and game rules and the applicable laws and regulations when playing controlled games on the premises of their own cardroom.

This proposed regulation will help to ensure that controlled games are played fairly and honestly. The Act instructs the Commission to adopt regulations that help to ensure that gambling activities are fair to the public¹³ and establishes penalties that may be imposed against licensees that engage in dishonest or unfair gambling activities.¹⁴

- d. Subsection (a), paragraph (4) would prohibit a licensee from taking or threatening to take, any adverse action against their employees for the employee's refusal to play controlled games when that activity is not included in their job duties. This paragraph would not apply to house prop players and public relations players because playing controlled games is at least a part of their job duties.

⁸ Business and Professions Code, sections 19801, subdivisions (g), (h) and (i), 19803, subdivision (a), 19811, subdivision (b), 19824, 19826, subdivisions (f) and (g), 19840 and 19841, subdivisions (b), (o) and (p)

⁹ Business and Professions Code, sections 19801, subdivision (a) and 19805, subdivision (c); Penal Code, sections 330 and 330.11

¹⁰ Business and Professions Code, sections 19801, subdivisions (g) and (h), and 19841, subdivisions (b) and (o)

¹¹ Business and Professions Code, section 19914, subdivision (a), paragraph (2)

¹² Business and Professions Code, section 19826, subdivision (g)

¹³ Business and Professions Code, sections 19801, subdivisions (g) and (h), and 19841, subdivisions (b) and (o)

¹⁴ Business and Professions Code, section 19914, subdivision (a), paragraph (2)

The Act and the Penal Code clearly prohibit house-banked games in cardrooms.¹⁵ To insure that the house is not providing funds to employees with which to play controlled games, house prop players and public relations players are required and agree to utilize their own money and discretion when placing wagers in the play of controlled games. [See proposed section 12391(a)(2)(E)] This is typically a condition of employment for house prop players and public relations players, who must also agree to absorb their losses. Other employees, with other duties that do not include the play of controlled games, should not be forced or coerced into playing controlled games, since that would also force them to involuntarily absorb any losses that they may incur. This proposed regulation would prevent cardrooms from arbitrarily requiring their employees to play in controlled games.

- e. Subsection (a), paragraphs (5) and (6) would require a licensee to maintain specified information relating to gaming table operation, and to make that information available to the Bureau within two hours of their request, when the request is made during normal business hours. If the request is made after normal business hours, the cardroom would have until two hours after the start of the next business day to provide the information. Paragraph (5) requires that the following information must be maintained, by shift and by date:
 - (A) The tables that were open,
 - (B) The games that were played and the collection rates,
 - (C) The total time that each table was in use, and
 - (D) The names of the house dealers that were assigned to work the tables.

The information required by subsection (a), paragraph (5) will help to encourage compliance with cardroom revenue reporting and drop collection requirements.¹⁶ Section 19841(h) mandates that the Commission's regulations prescribe minimum procedures for licensees to exercise effective control over their fiscal and gambling affairs, and section 19841(k) mandates that the Commission's regulations specify forms for reporting the results of gambling operations. Subsection (a), paragraph (6) will assist Bureau staff in verifying compliance with the laws and regulations that require controlled games to be pre-approved by the Bureau.¹⁷ Further, the Act authorizes the Bureau to monitor gambling operations, conduct investigations and inspect records.¹⁸ Determining which employees worked during specified shifts is well within the Bureau's responsibility to investigate possible violations of the Act.

- g. Subsection (a), paragraph (7) would prohibit a licensee from having on the gambling floor more gaming tables than that which is authorized by the license, unless all excess

¹⁵ Business and Professions Code, sections 19801, subdivision (a) and 19805, subdivision (c); Penal Code, sections 330 and 330.11

¹⁶ Business and Professions Code sections 19841, subdivision (h), and 19951, subdivisions (c) and (d); California Code of Regulations, Title 4, Sections 12357, subsection (b), 12384 and 12401

¹⁷ Business and Professions Code section 19826, subdivision (g); California Code of Regulations, Title 11, Sections 2038 and 2070, subsection (b)

¹⁸ Business and Professions Code, section 19826, subdivisions (b), (c) and (d), and section 19827, subdivision (a)

tables are covered or prominently labeled as non-operational and are under continuous video surveillance. The number of tables on the gambling floor of a cardroom is an important benchmark when considering the amount of controlled gambling that is permissible within the State of California.¹⁹ While the number of permissible tables is primarily determined by local jurisdictions, it remains part of the Commission's and the Bureau's responsibilities to ensure that licenses are issued to, and maintained by, only those cardrooms that adhere to these limits.²⁰

- h. Subsection (a), paragraph (8) would require that the purchase or redemption of chips be transacted only by designated cardroom employees who have received the training required by section 103.64 of Title 31 of the Code of Federal Regulations. This federal regulation requires cardrooms to train employees on the reporting requirements for cash transactions in excess of \$10,000 and other cash transactions that are considered unusual or suspicious. The policies and procedures put in place regarding this regulation must also ensure compliance with Section 12404 in Article 4, which also addresses these types of transactions.

This proposed regulation will help to ensure compliance with federal and state laws and regulations that relate to the reporting of large cash transactions.²¹ The widespread opportunity to launder large amounts of cash through the California cardroom industry makes compliance with these financial reporting requirements an essential component in combating crime. This proposed regulation is consistent with section 19841(d) which mandates that the Commission's regulations require licensees to report and keep records of these large cash transactions. It is important that this process be included in a cardroom's policies and procedures, as it would help employees to understand their role in documenting and reporting these transactions.

- i. Subsection (a), paragraph (9) would prohibit a licensee from providing house funds to any person for the purposes of playing a controlled game, except when extending credit, pursuant to Section 12388, and when providing payment to a third-party provider of proposition player services, in accordance with a Bureau-approved contract, pursuant to Section 12200.9.

When a cardroom owner provides money to employees to play California Games, the house may be taking advantage of the percentage odds in favor of the player-dealer and thus the house may have an interest in the outcome of the game. This may turn the games into house banking and percentage games. Further, a cardroom employee playing *any* controlled game with house funds may also increase the chances of an unfavorable decision against a patron who may have a game dispute with that employee. When making a decision about a game dispute, how could a house dealer or key employee be

¹⁹ Business and Professions Code sections 19801, subdivision (l), 19862, subdivision (b), and 19961, subdivision (b)

²⁰ Business and Professions Code sections 19801, subdivision (l), 19826, subdivision (c), 19841, subdivision (p), 19860, subdivision (a), paragraph (5), and 19960, subdivision (c), paragraph (2), subparagraph (E)

²¹ United States Code, Title 31, sections 5313 and 5314; Code of Federal Regulations, Title 31, Sections 103.21, 103.22, 103.23, 103.63 and 103.64; Penal Code section 14162, subdivision (b); California Code of Regulations, Title 4, Section 12404

impartial when house funds may be at stake? The Act requires the Commission to adopt regulations to help ensure that gambling activities are fair to the public.²²

For further information on this subject, please refer to the reasons for Section 12391(a)(2).

- j. Subsection (b) would require Tier III through V cardrooms to have at least one owner-licensee or key employee on duty during all hours of operation to supervise gambling operations and insure compliance with the Act and its regulations.

Section 2050, Title 11 of the California Code of Regulations already requires all cardrooms to have at least one owner-licensee or key employee on duty at all times, and provides an exception for smaller cardrooms to have this person available by phone rather than be present at the cardroom. However, Section 2050 does not specifically provide for the supervision of gambling operations. As a result, larger cardrooms (Tiers III-V) could theoretically comply with Section 2050 without actually having an owner or key employee on site to supervise gambling operations on the gambling floor. For example, an accounting manager (a key employee) on duty in the accounting office may satisfy Section 2050, but unless the accounting office is located on the gambling floor, the accounting manager would not be able to supervise the gambling operations.

This proposed regulation would require larger cardrooms (Tiers III-V) to have a licensee or key employee on duty specifically to *supervise* gambling operations on the gambling floor. These larger cardrooms can rival the size of a Las Vegas Casino, with 240 or more tables operating on the gambling floor. Direct supervision and oversight of these complex operations is critical in providing a secure environment for patrons and in ensuring that games are played honestly and fairly.²³ When developing regulations, section 19840 requires the Commission to take into consideration the operational differences between large and small cardrooms. Since the maximum number of tables in any cardroom below Tier III is 10, compliance with Section 2050 should be sufficient and this provision need only apply to Tiers III through V.

- k. Subsection (c) would require cardrooms to implement the provisions of Section 12391 no later than six months following the effective date of the regulation. This will provide licensees with adequate notice and sufficient time to develop appropriate policies and procedures in compliance with these newly adopted standards and requirements.

3. Adopt Section 12392. House Rules.

This proposed action would also establish new Section 12392 within Article 3, Chapter 7, Division 18, Title 4 of the California Code of Regulations. Section 12392 would require cardrooms of all tiers to adopt specified minimum policies and procedures regarding house rules.

²² Business and Professions Code sections 19801, subdivisions (g) & (h), and 19841, subdivisions (b) & (o)

²³ Business and Professions Code sections 19801, subdivision (g), 19823, 19826, 19841, subdivision (b), 19920, 19924 and 19971

- a. Subsections (a) and (b) would require cardrooms to adopt and implement house rules, written in English, which promote the fair and honest play of controlled games and gaming activity, and that those house rules be readily available and provided to patrons and the Bureau upon request.. Subsection (a) would also require that the house rules:
 - (1) Allow for the play of only those games that are permitted by local ordinances and state and federal laws and regulations;
 - (2) Address player conduct, etiquette and other general rules so as to promote the orderly conduct of controlled games and gaming activities;
 - (3) Include provisions that discourage players, during the play of a hand, from speaking in a language, or using any other form of communication, that is not understood by all persons at the table;
 - (4) Not conflict with Bureau-approved *game rules*; and
 - (5) Address the following situations as they may apply during the play of a controlled game or gaming activity:
 - (A) Customer conduct,
 - (B) Table policies,
 - (C) Betting and Raising,
 - (D) “Misdeals,”
 - (E) Irregularities,
 - (F) “The Buy-In,”
 - (G) “Tied Hands,”
 - (H) “The Showdown,”
 - (I) “House Way,”
 - (J) Player Seating and Seat Holding, and
 - (K) Patron Disputes.

By requiring that every cardroom have house rules and that they be available, subsections (a) and (b) will help to ensure that controlled games and gaming activities are conducted honestly and fairly and that cardroom activity does not endanger the health, safety or welfare of the public.²⁴ To ensure fairness to all cardroom patrons, section 19841(b) mandates that the Commission’s regulations provide for the approval of game rules by the Bureau. Section 19841(h) mandates that the Commission’s regulations prescribe minimum procedures for licensees to exercise effective control over their gambling affairs.

It is important that house rules do not permit the operation of games that are prohibited by local ordinance. The Bureau has recently investigated a case where a local ordinance had been changed to prohibit the play of a specific game, but the cardroom continued operation of that game because it had been previously approved by the Bureau. This

²⁴ Business and Professions Code section 19801, subdivision (g), 19823, 19826, 19841, subdivision (b), 19920, 19924 and 19971

provision provides clarification and should assist in resolving any future controversy of this nature.

House rules can also help to prevent one or more players from obtaining an unfair advantage over others, and reduce the opportunities for cheating. Allowing two individuals to communicate with each other in a way that is not understood by all parties at the table makes it easier for them to collude to obtain an unfair advantage over the others. For example, by learning the identity of each other's cards, two players may be able to more accurately predict the identity of the cards in the hands of the other players, or to plan strategies that could affect the play of others. This would give them an unfair advantage in making decisions about the play of their hands, or the ability to take certain actions affecting the outcome of the game. Controlling the language spoken or the method of communication used during game play can be an important, if not essential, component in protecting and maintaining the integrity of a controlled game and thereby protecting the interests of all parties; the players, the house and others. Paragraph (3) of subsection (a) is narrowly tailored to further the Commission's interest in maintaining the integrity of games without requiring, limiting or prohibiting the use of any particular language. No alternative has been found or suggested that would be as effective in accomplishing the intended purpose of this provision with any lesser potential impact on those who may wish to speak a different language.

The subjects and situations listed in paragraph (5) of subsection (a) that must be addressed in house rules are among the most common areas where disputes may arise. Whether those disputes are between patrons themselves or between a patron and the house, establishing standard rules will promote their fair and consistent resolution. The terms used in paragraph (5) are all terms that are regularly used throughout the gaming industry. Some of those terms are unique to controlled games and have a commonly understood meaning or have standard definitions found in widely recognized industry publications.

In general, it makes little sense to require that licensees adopt house rules if there is no obligation to make them available. Requiring that house rules be made available will help to ensure that patrons will have access to the rules governing their participation in the controlled games offered for play in a cardroom. This is advantageous for patrons as they may be better informed and more knowledgeable of what to expect in certain situations. It is also advantageous for the licensee in that patrons are placed on notice of the rules which may help to avoid potential disputes or at least make it easier and less confrontational to resolve them. Of course, the Bureau must have access to a licensee's house rules in order to confirm compliance and to assist them in their investigations. Moreover, having written rules and making them available will help to ensure that rules are applied consistently and equitably, and not made up on the spot to favor the cardroom in a particular situation.

- c. Subsection (c) would require cardrooms to implement the provisions of Section 12392 no later than six months following the effective date of the regulation. This will provide

licensees with adequate notice and sufficient time to develop appropriate policies and procedures in compliance with these newly adopted standards and requirements.

Underlying Data:

Technical, theoretical or empirical studies or reports relied upon:

While no studies or reports are being relied upon, throughout the development of these proposed Phase III MICS regulations (*Gambling Floor Operations and House Rules*), Commission staff has worked directly with Bureau staff in an effort to accommodate their regulatory needs. In addition, Commission staff has conducted three public workshops and one informal written comment period to solicit information and recommendations from the Bureau, the cardroom industry and other interested parties. The resulting body of information was carefully considered and formed the basis for the development and refinement of these regulations. The proposed regulations represent approximately 1½ years of negotiations between the Bureau and the cardroom industry. Every effort has been made to accommodate the needs of both without compromising the regulatory purpose.

REQUIRED DETERMINATIONS:

Business Impact:

The Commission has made an initial determination that the proposed regulatory action may have a significant statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states, if those affected businesses do not already have internal control standards in place which satisfy the minimum standards proposed by these regulations.

Specific Technologies or Equipment:

These regulations do not mandate the use of specific technologies or equipment.

Consideration of Alternatives:

No reasonable alternative to the regulation would be either more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed regulation.

Set forth below are the alternatives that were considered and the reasons each alternative was rejected:

No reasonable alternative has been considered or otherwise identified and brought to the attention of the Commission.