

Final Statement of Reasons

Proposition Player Registration and Licensing; Gambling Businesses

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PART A. SECTION ONE

Proposition Player Registration and Licensing

Third-party proposition players are professional gamblers employed by companies who provide these proposition players with gambling money. There are currently approximately 21 companies in California that employ proposition players. The proposition player company signs a contract with the cardroom stating that the company will provide a proposition player to “bank” the game at a specified number of tables. Operating a proposition player company can be a very lucrative line of business. In a larger cardroom, the proposition player company may pay large sums of money to the cardroom each month for the privilege of operating the proposition player business in the cardroom.

The California Gambling Control Commission (“Commission”) has been working with proposition player providers, the cardroom industry, and local law enforcement for several years in an effort to identify and resolve issues that must be addressed by regulation. The Commission has conducted workshops to solicit input from the public and all interested parties. The proposition player regulations have been discussed in at least a dozen Commission meetings. The regulations have also been discussed with interested parties in numerous meetings and conversations.

The Commission is mandated by statute to adopt regulations governing the operation of third-party proposition player services.¹ Also, the Division of Gambling Control in the California Department of Justice (“Division”) is authorized by statute “pursuant to regulations of the Commission” to perform background checks, financial audits and other investigatory services as needed to assist the Commission in the regulation of third-party proposition player services, and to adopt emergency regulations establishing reasonable fees and deposits to fund these activities. The Division has adopted emergency regulations setting fees and deposits.

In order to more promptly address reported criminal activities and ensure that felons were not working in the industry, the Commission adopted

¹ "Gambling business" regulations will be discussed in Part A, Section Two of this document.

regulations on an emergency basis in October 2003. This Final Statement of Reasons has been prepared in support of the rulemaking action that will make these emergency regulations permanent. Part A of this document reviews the reasons for proposing the various regulation sections. Part B of this document summarizes and responds to public comments; often, responses consist of or include cross-references to the portion of Part A of the Final Statement of Reasons that discusses the specific regulation sections. Because many of the comments make the same points, many of the responses consist or include cross-references to earlier responses.

"Final Statement of Reasons" is sometimes abbreviated as "FSR." The term "proposition player" or "proposition play" is sometimes abbreviated as "PP." Business and Professions Code is sometimes abbreviated as "B & P Code." A list of attachments is included as the cover sheet for the attachments.

The key statutory authority for these regulations is found in the Gambling Control Act, specifically in Business and Professions Code section 19984. Section 19984 ("Contracts for Providing Proposition Player Services"), quoted in full in the footnote.²

²"Notwithstanding any other provision of law, a licensed gambling establishment may contract with a third party for the purpose of providing proposition player services, subject to the following conditions:

- (a) Any agreement, contract, or arrangement between a gambling establishment and a third-party provider of proposition player services shall be approved in advance by the division, and in no event shall a gambling establishment or the house have any interest, whether direct or indirect, in funds wagered, lost, or won.
- (b) The commission shall establish reasonable criteria for, and require the licensure and registration of, any person or entity that provides proposition player services to gambling establishments pursuant to this section, including owners, supervisors, and players. Those employed by a third-party provider of proposition player services, including owners, supervisors, observers, and players, shall wear a badge which clearly identifies them as proposition players whenever they are present within a gambling establishment. The commission may impose licensing requirements, disclosures, approvals, conditions, or limitations as it deems necessary to protect the integrity of controlled gambling in this state, and may assess and

The proposition player regulations are grounded on the public policy concerns articulated by the Legislature in enacting the Gambling Control Act. The basic purpose of the regulatory scheme is to protect the public by ensuring that permissible gambling is free from criminal and corruptive elements and that it is conducted honestly and competitively (see Business and Professions Code section 19801, subdivision (f)).³ “Public trust and

collect reasonable fees and deposits as necessary to defray the costs of providing this regulation and oversight.

- (c) The division, pursuant to regulations of the commission, is empowered to perform background checks, financial audits, and other investigatory services as needed to assist the commission in regulating third party providers of proposition player services, and may assess and collect reasonable fees and deposits as necessary to defray the costs of providing this regulation and oversight. The division may adopt emergency regulations in order to implement this subdivision.
- (d) No agreement or contract between a licensed gambling establishment and a third party concerning the provision of proposition player services shall be invalidated or prohibited by the division pursuant to this section until the commission establishes criteria for, and makes determinations regarding the licensure or registration of, the provision of these services pursuant to subdivision (b).” (Business and Professions Code section 19984; emphasis added.)

³ The basic legislative concern is to thus ensure that permissible gambling is free from "criminal and corruptive elements." Strong support for these regulations is found in a letter dated February 24, 2004, from the Robert Lytle, Director of the Division of Gambling Control in the California Department of Justice. This February 2004 letter (page one) advocates emergency readoption of these regulations in order to "protect the public from criminal and corruptive influences . . ." The letter goes on to list a series of specific criminal and corruptive problems that Special Agents employed by the Division of Gambling Control have encountered during the preceding five years. This letter is attached to this Final Statement of Reasons as follows. Attachment 1 is a letter dated July 2, 2004 from the Commission to the Office of Administrative Law. This July 2004 letter responded to comments opposing the July 2004 readoption of the emergency regulations; these comments strongly attacked the annual fees. The July letter basically stated that the Commission needed to charge substantial annual fees in order to fund oversight and enforcement activities conducted by the Division of Gambling Control and by the Commission. The legislatively mandated program to oversee the operations of proposition player companies is supported solely by fees levied against providers; funds are not available from other sources. The July 2004 Commission letter included three

confidence can only be maintained by strict and comprehensive regulation of all persons, locations, practices, associations, and activities related to the operation of lawful gambling establishments . . . (Business and Professions Code section 19801.) Proposition player services are required to maintain records in order to provide an audit trail which will facilitate detection of money laundering and other illegal activities. See Business and Professions Code section 19801(m) (records may have a high degree of usefulness in criminal and regulatory investigations). Costs of providing this strict and comprehensive regulation and oversight are to be defrayed by fees collected from registrants and licensees. See Business and Professions Code section 19984, subdivision (b).

The statutes and regulations governing the licensing of cardrooms and cardroom employees provide a rough model for many of the proposition player regulations. The basic licensing categories applying to cardrooms are (1) gambling license, (2) key employee license, and (3) work permit. See definitions in Business and Professions Code section 19805, subdivisions (n), (t), (u), and (ee), as well as sections 19850-19990 (licenses) and 19910-19915 (work permits). The proposition player regulations include the categories of primary owner, owner, supervisor, player and “other employee.” The primary owner and owner are roughly comparable to the holder of a gambling license; the supervisor to the key employee; and the player and “other employee” to the holder of a work permit.⁴ Commission

appendices: (1) Appendix "A," an August 19, 2003 letter from the San Jose Police Department urging immediate, emergency adoption of proposition player regulations in order to deal with current law enforcement problems and to prevent foreseeable future problems from developing; (2) Appendix "B," the February 2004 letter from the Division of Gambling Control, and (3) Appendix "C," cost data supporting the annual fee which applies not only to proposition player providers, but also to gambling businesses.

All of the numerous subsequent comments on the proposed permanent regulations should be read through the prism of the legislative mandate to protect the public from criminal and corruptive influences, influences specified in the above-noted letters from two leading law enforcement agencies.

One commenter (Stand Up for California, letter dated September 7, 2004)) argued in favor of a stringent, rigorous, and meticulous oversight program, given the cash-intensive nature of the business. This September 2004 comment supports the need for an adequately funded, effective regulatory oversight program.

⁴ There are also critical differences between permit holders and players. Players employed by primary owners typically work with a chip tray containing \$100,000 in chips. Thus, PP players handle much larger amounts of cash and chips than do dealers

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regulations concerning applications for gambling licenses and key employee licenses are found in Title 4 California Code of Regulations (“CCR”) sections 12250-12271. Commission regulations concerning applications for work permits are found in Title 4 CCR sections 12100-12142.

Section 12200. Definitions

Definitions for key regulation terms are needed in order to make clear what the terms are intended to mean. The need for most of the definitions is apparent, for instance, "Commission," "Division," and "Registrant." Other terms were included to deal with specific administrative issues that have arisen during the period of time the emergency regulations have been in effect. See, for instance, "additional badge," "reinstatement badge," and "transfer badge." These three terms were added to clarify the operational provisions in which they appear. As one example, "additional badge" means a badge issued by the Commission permitting the holder to work at the same time for more than one primary owner. Individuals have sought additional badges, transfers, and reinstatements; regulations providing procedures and definitions are needed.

Subsection 12200(b)(21): a definition of "rebate" was added to provide clarity to the reference in the text (see section 12200.7(b)(19)). The use of rebates was discovered through investigations; these rebates constituted undisclosed financial arrangements with the house. Rebates and qualifications for rebates were not disclosed in a consistent manner to participants. To protect the patrons and integrity of the games, the use of rebates must be disclosed in the contract.

Subsection 12200(b)(25): “Session of Play” was defined in order to identify the recording period (the shift) that must be accounted for on the

employed by gambling licensees (dealers are required to obtain work permits). PP players participate in the play of the game and occupy the player-dealer position. Dealers, by contrast, are house employees who facilitate the game and do not have an interest in the outcome of the game. Dealers generally handle only the chips or cash paid by patrons to play in each hand of a game (there is an established fee to play in each hand of a game). Many holders of work permits are servers or janitors. Thus, a higher level of scrutiny is applied to PP players.

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playing book form (see section 12200.13), and to provide consistency in the use of the term.

Subsection 12200(b)(27): “Supplemental Information Package” was defined to notify applicants of the forms and fees required to request to convert a registration to a license.

Three levels of investigation will be conducted. The level of review varies with the level of responsibility and thus the potential for misconduct of each of the four types of PP positions. These are the three levels proposed in the permanent regulations.

- A Level III investigation, which includes an extensive supplemental information form and supporting documentation, will be conducted on owners.
- A Level II investigation, which includes a less extensive supplemental information form and less documentation, will be conducted on supervisors.
- A Level I investigation, which includes the least extensive supplemental information form, will be conducted on players and "other employees."

Subsection 12200(b)(28) provides a basic definition of "third party proposition player services." This definition sticks very closely to the statutory language. A commenter has criticized this definition as overly broad and lacking substance. It should be pointed out that the program being implemented here is very new. As experience is accumulated, a new, improved definition may well emerge. We note that the commenter failed to offer any specific alternative language. If the proposed permanent regulations are approved by OAL in late 2004, the Commission plans to begin work in early 2005 on a regular rulemaking proposal revising these regulations. We encourage submission of alternative language for this and for any other regulation provision that members of the public feel could be improved.

Section 12200.1 Certificate

It is important to articulate the content and name of the document obtained in response to an application.

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Section 12200.3 Badge

For purposes of enforcement and compliance, each registrant or licensee is issued and required to wear a badge when on duty. Badges of one color are issued to players; badges of another color are issued to non-playing persons.

If an individual player resigns from a proposition player provider company, the company is required to report the resignation (etc.) and return the badge to the State. This will prevent misuse of a badge that has become invalid.

Section 12200.5 Replacement Badge

Procedures are needed when a badge is lost or misplaced.

Section 12200.6 Transfer or Reinstatement of Player Registration or License; Issuance of Additional Badge

Procedures are needed when a registrant desires to transfer from one primary owner to another, and when a registrant desires to work for an additional primary owner (for instance, when the first position is not fulltime).

Registrations may be also need to be reinstated. This section assists employees and employers by facilitating these transactions. A cost study has been done and the fee set at \$125.00. See Attachment 2.

Section 12200.7. Proposition Player Contract Criteria

Specific information is needed concerning, for instance, the parties to the contract. Provisions are included to ensure that proposition player employees are assessed the same fees as are assessed against all patrons by the house to participate in the play of the game. Other provisions are intended to ensure that PP providers are not in effect paying and the house is not receiving a percentage of the winnings, in violation of law.

B & P Code section 19984 authorizes contracts and regulatory oversight based on these contracts. Given this fact, these implementing regulations require that the contracts mandate and prohibit specified things. We have not followed a suggestion from the cardroom trade association that various provisions be transferred into disciplinary regulations because (1) doing this might raise questions concerning the enforceability of the provisions and (2)

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regulations prescribing disciplinary procedures are not yet in place. This issue can be revisited after the needed disciplinary regulations are in place.

Most of the required provisions of this section are self-explanatory, but the following are proposed for the indicated reasons:

- (5) Limits the number of proposition players from the same provider to help prevent the provider from maintaining the bank beyond what is provided by law. In addition, this protects the public and the integrity of the game. The risks of cheating would increase if more than one provider employee were present at one table.
- (7) Information regarding the location and security of cash or chips is required to identify internal control procedures and ensure the public is adequately protected.
- (11) This provision is needed in order to implement the legislative plan that PP services may be provided in a particular cardroom only by third parties. Thus, while some persons holding cardroom licenses or permits are not flatly prohibited from obtaining PP registrations or licenses, these persons may not provide PP services in the particular cardroom for which they are licensed, or to which their permit applies. See also Section 12201(d) (no business entity or sole proprietor shall be registered under Chapter 2.1 that is also licensed under the Gambling Control Act to operate a gambling establishment). Read together, these provisions--Section 12200.7(b)(11) and 12201(d)--state that the business entities and sole proprietors holding "state gambling licenses" may not be registered under Chapter 2.1, while other persons (typically, individuals) affiliated with cardrooms, can be registered under Chapter 2.1, although they may not provide PP services in the cardrooms to which their license or work permits pertains.
- (14) Any agreement for the primary owner of the PP provider to inspect or receive surveillance records must be disclosed to identify who has access to the gambling establishment's surveillance tapes.
- (18) Based on reports received by the Commission and as noted in Appendix B to Attachment 1, cheating has been a recurrent problem

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in cardroom operations involving proposition players. This provision is intended to permit the state to capture data on incidents so serious that they have been reported to "the house" (see B & P Code section 19805(q)) by a proposition player registrant or licensee. Reports indicate that the cheating is frequently against the PP player, the individual at the table who nearly always has the most money. It is significant that Network M, the dominant proposition player company, which has objected to a large number of provisions of these regulations, has made no objection to this cheating report provision.

Only reports made by a PP registrant or licensee must be reported by the primary owner and the house. Casual or other comments by individual patrons need not be reported. The Commission rejects the suggestion that only complaints made by primary owners of PP companies should be reportable. In order to protect the public, the State needs to be notified of all reports made by PP registrants or licensees, including not only primary owners, but also supervisors and individual players.

This provision requires reports both from the primary owner and the house. This dual reporting requirement is intended to increase the accuracy and completeness of reports. Similarly, FPPC campaign contributions laws require not only the donor, but also the recipient of the contribution to report the donation. This permits cross-checking by the regulatory agency.

If experience reveals that too many reports are being received, appropriate amendments will be made in the future.

- (20) Tipping arrangements must be disclosed in the contract to ensure the house is not receiving a percentage of the profits, which would give it an interest in the outcome of the game in violation of law.
- (21) If a primary owner of a PP provider requests a designated camera or extended video of the tables where it provides services, it is allowed to reimburse the house for the costs associated with the request. In addition, primary owners of PP providers have requested shuffling machines rather than manual shuffling to expedite play and increase security measures, and more frequent replacement of cards and dice.

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Although reimbursement is permitted, the primary owner of the PP provider is not allowed to purchase or lease these items as all gaming equipment must remain the property of and under the control of the owner-licensee of the gambling establishment. Pursuant to the Gambling Control Act (Business and Professions Code section 19800 et seq.), the owner-licensee of the gambling establishment is responsible for maintaining control of the gambling operations. This provision is also needed to ensure that costs are not improperly shifted from the house to the primary owner to a degree that would arguably constitute house banking.

Section 12200.9 Review and Approval of Proposition Player Contracts.

Procedures are needed concerning the review of proposed contracts by the Division, including forms, fees, deposits, and review by the Commission. At the request of the Division of Gambling Control, this very long section (section 12200.9) was broken down into several shorter sections (see sections listed just below), which should be easier to work with.

Contracts approved since October 2003 are limited to one year and have been expiring as time passes. Procedures are needed to deal with contracts proposed for expedited review of contracts, contract amendments, and contract extensions.

Section 12200.10A Expedited Review and Approval of Proposition Player Contracts

Section 12200.10B Review and Approval of Amendments to Proposition Player Contracts

Section 12200.10C Submission of Contract or Amendment to Commission

Section 12200.11 Extension of Proposition Player Contracts

Section 12200.13 Playing Books

To prevent money laundering, loan sharking, theft, etc., complete records are required: money and chips received at the start of a shift, credits and fills made during the shift, and money and chips returned at the end of a shift.

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Section 12200.14 Organization Chart and Employee Report

This section is needed because we need to be sure that everyone who is supposed to be registered has in fact registered, and that these persons are registered in the correct category (player, supervisor, other employee, etc.). This section is also needed in order to obtain information concerning organizational structure, to monitor persons affiliated and reporting lines, and to provide information necessary during investigations and inspections.

Section 12200.15 Transfers and Sales

To prevent criminal or corruptive elements from penetrating the industry, all proposed buyers apply for registration or licensing and be approved prior to taking over a proposition player business.

Section 12200.16 Inspections and Investigations

Public trust and confidence can only be maintained by strict and comprehensive regulation of all persons, locations, practices, associations, and activities related to the operation of lawful gambling. To protect the public, safeguard the integrity of the games, and ensure compliance with the laws and regulations, the Division may conduct overt and covert investigations and annual compliance inspections and audits.

Procedures are needed concerning access and timelines for providing requested documents, papers, books, and other records.

Section 12200.17 Emergency Orders

On occasion, it will be necessary to act quickly to shut down registrants or licensees in order to preserve peace, health safety, or general welfare, pursuant to B & P Code section 19931.

Section 12200.18 Revocation

This section lists grounds of revocation. The grounds include matters which are incompatible with functioning as a proposition player and handling large amounts of money, including violation of the Gambling Control Act, embezzlement, and engaging in activities that facilitate money-laundering or loan sharking.

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Section 12200.20 Annual Fee

Business and Professions Code section 19984(b) authorizes the Commission to “assess and collect reasonable fees and deposits as necessary to defray the costs of providing this regulation and oversight.” Section 12200.20 is intended to obtain sufficient annual fees to defray these costs. Cost data supporting the proposed fee is included as Attachment 3. This cost data statement was revised in conjunction with an amendment to the text of the regulation proposed in the third 15-day change.

Numerous comments were received stating that the annual fees were too high, that they were calculated incorrectly or without sufficient study, that they should not be graduated, that they should be phased in over several years, etc. The Commission has substantially revised section 12000.20 (and its parallel section in Chapter 2.2) in order to accommodate the expressed concerns. The fees have been lowered, they have been changed from graduated fees to a flat fee, and they are phased in over a period of three years.

Prior to the downward adjustment of the annual fees, hundreds of questions were submitted as part of comments in this rulemaking action. The Commission will generally not respond to these extremely numerous questions for these reasons:

- (1) The questions are not "comments" within the meaning of the APA definition of comment in Government Code section 11346.9 because they are not objections or recommendations concerning the proposed action.
- (2) The principle propounder of the questions is Network M Management, the dominant provider of proposition player services, and the plaintiff in a lawsuit challenging the validity of the annual fees and some aspects of the regulations. Questions such as those propounded should ordinarily be handled in the judicially supervised discovery process.
- (3) Some of questions, such as those focusing on the graduated nature of the annual fees, have become moot.

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Contrary to the apparent expectations of some of the commenters, the law does not require the Commission to prove "beyond a reasonable doubt" that a certain level of annual fees is necessary. All that is required is "substantial evidence" of the need for the proposed annual fee level.

The applicable APA provisions are as follows.

Government Code section 11342.2 provides that a regulation is valid if not in conflict with the statute being implemented and if reasonably necessary to carry out the purposes of the being implemented. Section 11342.2 provides:

"Whenever by the express or implied terms of a statute, a state agency has authority to adopt regulations to implement, interpret, or make specific or otherwise carry out the provisions of the statute, no regulation adopted is valid or effective unless consistent and not in conflict with the statute and reasonably necessary to effectuate the purpose of the statute." (Emphasis added.)

Here, B & P Code 19984 expressly authorizes fees. The level of the fees is consistent with and not in conflict with Section 19984. The level of the fees and the method of calculation as set in the permanent regulations are, in addition, "reasonably necessary" to effectuate the purpose of Section 19984. So long as the APA procedural requirements are satisfied, the exact level of the fees is committed to the discretion of rulemaking agency.

Government Code section 11349.1 requires OAL to review proposed regulation in light of six standards, one of which is "necessity." "Necessity" is defined in Government Code section 11349 in part as follows:

"(a) 'Necessity' means the record of the rulemaking proceeding demonstrates by substantial evidence the need for a regulation to effectuate the purpose of the statute . . . that the regulation implements, interprets, or makes specific, taking into account the totality of the record. For purposes of this standard, evidence includes, but is not limited to, facts, studies, and expert opinion." (Emphasis added.)

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Under the relevant OAL regulation, the rulemaking agency must provide "information explaining why each provision of the adopted regulation is required to carry out the described purpose [here, to collect money to fund a regulatory oversight program]." Title 1, California Code of Regulations, section 10. Subsection (a) of Section 10 provides in part that:

"OAL shall not dispute the decision of a rulemaking agency to adopt a particular regulatory provision when the information . . . is also adequate to support one or more alternative conclusions." (Emphasis added.)

Subsection (a) of Section 10 was adopted by OAL in compliance with Government Code section 11349.1(c), which states in part that:

"The regulations adopted by [OAL] shall ensure that it does not substitute its judgment for that of the rulemaking agency as expressed in the substantive content of adopted regulations." (Emphasis added.)⁵

Here, commenters are in essence asking OAL to substitute its judgment for that of the rulemaking agency (the Commission) concerning the level of the annual fee. This inappropriate suggestion should be rejected not only by OAL, but also by any reviewing court. The Legislature has clearly signaled that regulations that are consistent with statute and supported by "substantial evidence" should not be overruled by either OAL or a court. Government Code section 11340.1(b) provides in part:

"It is the intent of the Legislature that neither [OAL] nor the court should substitute its judgment for that of the rulemaking agency as expressed in the substantive content of adopted regulations."

Section 12200.21 Compliance

This section is designed to ensure that proposition players (1) are not given an unfair advantage over other players and (2) comply with legal requirements concerning rotation of the player-dealer position, see, for instance, Business and Professions Code section 19805(bb).

⁵ See also Government Code section 11340.1(a).

Section 12201 Registration

This section outlines some of the basic features of the registration system. Originally effective on an emergency basis, this regulation provided in subsection (a) that no person currently providing PP services could continue providing such services—unless registered—beginning 120 days after the emergency regulation took effect. In a subsequent emergency re-adoption, the original 120-day deadline was extended to March 31, 2004. Subsection (a) is still needed in order to ensure that no person can provide PP services without first being registered with the Commission. Subsection (a) provides also that owner and supervisor registrations are for one year, while registrations for players and other employees are for two. This change reflects the pattern followed in the cardroom license context, and responds to public comments arguing that player registrations should be extended from a one year term to a two year term.

Subsection (c)

Subsection (c) reflects the fact that the registration program will be superseded by a licensing program, and that obtaining registration does not create any vested right to licensing. Requirements applying to licensing applications may differ from those that currently apply to registration applications: for example, there may be additional or more demanding requirements applying to licensing. This subsection explains the planned transition from registration to licensing, and makes clear that the Commission retains the authority to deny a licensing application despite the fact that the applicant may have previously been granted a registration. In contrast to registration, the licensing phase will entail a full background investigation, which may result in some denials.

Subsection (d)

Subsection (d) is needed in part to specify which persons related to a primary owner that is a business entity must individually apply for registration. Business and Professions Code section 19852, which by its terms applies solely to cardrooms, requires related persons such as corporate officers to apply for cardroom licenses. The related persons sometimes have past associations or criminal background that render them unsuitable for

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licensing as cardroom owners. The same policy considerations apply to owners of proposition player services.

In addition, Subsection (d) is needed to identify persons who are not eligible to obtain a PP registration. Subsection (d) prohibits any business entity or sole proprietor licensed under the Gambling Control Act to operate a cardroom from also becoming registered as a proposition player. This provision is needed in order to comply with the prohibition against house banking (see, e.g., Business and Professions Code section 19984(a)). During the public input process leading up to adoption of the emergency regulation that is currently in effect, consideration was given to additionally banning (for example) not just corporations that were licensed to operate cardrooms from PP registration, but also investors in these licensed corporations. Persons owning interests in cardrooms objected to this additional limitation as unnecessary, as infringing upon their constitutional rights; lawsuits were threatened.

The Commission selected the policy alternative reflected in the current Section 12201(d) (the emergency regulation). In compliance with the APA, this Initial Statement of Reasons included a showing of necessity for this adopted provision, which showing of necessity is repeated below. Because of the public interest in this issue, the Commission included in the text of the proposed permanent regulation two additional alternative approaches to this issue. The Initial Statement of Reasons stated:

"After considering public input concerning the three alternatives, the Commission will make a final decision later this year and submit the final text of the regulation to the Office of Administrative Law."⁶

The policy alternative reflected in the current Section 12201(d) (the emergency regulation) was originally selected for the following reasons:

⁶ During the October 22, 2003 meeting at which the emergency proposition player regulations were adopted, Commission staff advised the gathering that the permanent regulation might well contain more stringent limitations on involvement in proposition play services by cardroom investors. More stringent limitations were contained in alternative “(g)” — a policy option rejected by the Commission. The substance of this rejected proposal was contained in the proposed text of the permanent regulation as alternative three.

- (1) The issue of collusion has been dealt with by including contract review provisions designed to prevent the possibility of collusion between cardroom owners and PP providers. A provision was drafted ensuring that the Division would review all proposed contracts with an eye toward existence of any real or perceived collusive arrangement. Section 12200.9(a)(1)(D) of the proposed permanent regulation (Section 12208(a)(1) of the emergency regulation) provides in part:

“The Division shall approve a proposition player contract only if all the following requirements have been satisfied:

. . . .

“(D) The contract will not undermine public trust that the controlled gambling operations covered by the contract will be conducted honestly, by reason of the existence or perception of any collusive arrangement between any party to the contract and the holder of a state gambling license, or otherwise.”
(Emphasis added.)

The Division will also maintain a field presence in cardrooms, and will be in a good position to detect any collusive arrangements that might otherwise emerge. Finally, if reports from the Division, local law enforcement, or other sources suggest that there is a problem in this area, the Commission is prepared to take whatever action is necessary to address it, including amending the PP regulation.

- (2) Needless restrictions on private investment or economic activities are hard to reconcile with various Administrative Procedure Act provisions. One suggested alternative would flatly forbid a private individual who invests in a cardroom business entity from also investing in a PP provider that serves a different cardroom. Such a provision would not only prohibit private individuals from investing their money,⁷ but would also in effect ban the PP companies from receiving the money.

⁷ Investors frequently make the wisest decisions when they elect to invest in businesses with which they are familiar. Individuals associated with the cardroom industry are of necessity familiar with the workings of the proposition player industry.

Government Code section 11346.5(a)(13) (part of the Administrative Procedure Act) requires any state agency proposing to adopt a regulation to include in the notice of proposed action:

“A statement that the adopting agency must determine that no reasonable alternative considered by the agency or that has been brought to the attention of the agency would be more effective in carrying out the purpose for which the action has been proposed or would be as effective and less burdensome to affected private persons than the proposed action.” (Emphasis added.)

The first draft of the proposition player regulation banned cross-investment of the kind outlined above. Affected private persons then protested this tentative policy choice to the Commission, arguing that a narrower prohibition would be equally effective in furthering the purposes of applicable law, including Business and Professions Code section 19984, and would be less burdensome to them. Responding to these protests, the Commission determined that there was indeed a reasonable, legal alternative to the initial proposal. That two-part alternative is found both in the current emergency regulation and in the proposed permanent regulation. Part one of this alternative is Subsection (d), which prohibits any business entity or sole proprietor licensed under the Gambling Control Act to operate a cardroom from also becoming registered as a proposition player. Part two of this alternative is Section 12200.7(b)(11) of the proposed permanent regulation, which states that:

“A registrant or licensee may not provide proposition player services in a gambling establishment for which the registrant holds a state gambling license, key employee license, or work permit.”

Taken together, these two provisions (both of which are parts of the current emergency regulation) effectively protect the public interest, while at the same time lessening the burden on affected private persons.

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- (3) Individuals who have previously obtained licenses as investors in business entities owning cardrooms would in one sense be desirable proposition player investors. These individuals would have already succeeded in passing an intensive background investigation conducted by the Division, which was then reviewed by the Commission. One of the objectives of the PP registration/licensing program is to screen out individuals who are convicted felons, linked to organized crime, etc. Reviewing individuals who have already been licensed by the State in one capacity might well be less time-consuming than might otherwise be the case.

In order to obtain the fullest possible public input, the text of the proposed regulation (section 12201) included three alternative versions of subsection (d):

- (1) The language of the current emergency regulation,
- (2) A variation requested at the May 12, 2004 rulemaking workshop which makes clear that individual investors in cardrooms may invest in PP providers which serve other cardrooms, and
- (3) A variation that returns to the flat prohibition language originally circulated in January 2002 that was later effectively rejected by the Commission in October 2003.

The Commission reviewed these three alternatives in light of substantial public comment, determining finally that the existing policy (reflected in the emergency regulations) should be continued.

In addition to the reasons outlined in the Initial Statement of Reasons (and repeated above), the existing policy has the potential benefit of increasing competition among proposition player providers. Currently, one company dominates the industry.⁸ According to one of its officials, this dominant company realized gross revenues of \$85,000,000 in a recent fiscal year.⁹

⁸ Many of the commenters criticized subsection 12201(d) (version 1) as proposed for permanent adoption for the same reasons they criticized the emergency regulation version

Section 12202 Application for Registration

It is necessary to specify in the application the category of registration sought, who must sign the application, which form must be used, etc. Live Scan Service fingerprinting is required to initiate the background check process. The statutory \$500 application is required, plus photos, one for the badge, one for state records.

Section 12203 Processing of Applications for Initial Registration

It is helpful for both applicants and Commission staff to understand the timeframes within which applications must be processed. This regulation provides these timeframes, and also outlines how an application may be withdrawn and when it will be deemed abandoned (in situations in which the applicant fails to respond to written requests for information).

Section 12203A. Processing of Applications for Renewal of Registration

Paralleling cardroom application procedures, this section requires applications for registration renewal to be received 120 days prior to expiration of the current registration. This lead-time is needed to permit orderly processing of the application, including time to obtain missing information. An expedited processing fee is needed in order to fund overtime work that is typically needed to deal with late filings. The \$60 figure is derived as follows: one hour of Associate Governmental Program Analyst time costs \$28.83, the overtime work is estimated to take one and one-half hours for a subtotal of \$43.25; adding in overhead costs for one and one-quarter hours comes to a grand total of \$62.61. See Section 9.D of the rulemaking record.

of this provision. The Commission responded to these critiques earlier this year in a letter to OAL dated March 3, 2004, which is hereby incorporated by reference into this Final Statement of Reasons as Attachment 4. The documents appended to the March 2004 letter are also incorporated. These critiques have been rejected twice by OAL and twice by the Superior Court. The Superior Court not only denied a motion for interim relief filed in Sheldon v. Commission (the Traditional Values Coalition lawsuit), but also denied the writ. See Attachment 9.

⁹ See Declaration of Robert Lytle, dated August 19, 2004, included as Attachment 5.

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Section 12203.1 Temporary Player Registration

In response to requests, the Commission proposes this section and following three sections for the purpose of creating standards and procedures for temporary player registration, modeled on the system used for cardroom employee temporary work permits. These sections will permit individuals to begin work more quickly, will permit primary owners to fill vacancies more quickly, and will permit cardrooms to obtain needed coverage more quickly.

Section 12203.2 Temporary Player Registration: Application; Criteria

Section 12203.3 Processing Times for Temporary Player Registration

Section 12203.5 Cancellation of Temporary Registration

Section 12204. Ineligibility for Registration

This section lists grounds for denying registration, focusing on criminal convictions and violations of gambling-related statutes and regulations. This is intended to prevent criminal or corruptive elements from entering the industry.

Section 12205. Cancellation of Regular Registration

Registrations are issued based upon an abbreviated background check. This section permits the Commission to cancel a registration if disqualifying information subsequently emerges.

Section 12205.1 Transition to Licensing

Persons are prohibited from working as proposition players unless they have first been registered. A registration is subsequently converted to a license, following an application and completion of the background investigation process. Subsection (a) permits registrants to continue to provide services until the Commission grants or denies a license.

Staffing at the Division does not permit all needed background investigations to be conducted at the same time. Thus, this section outlines a system under which the Division will call forward registrants over a period of time, directing them to file a license application within 30 days. The registrations of any who fail to file within 30 days will expire by operation

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of law. This provision is needed to ensure that applications for licensing are submitted in a predictable and orderly fashion. To ensure that the transition to licensing is completed within a reasonable period of time, this section specifies that the transition is to be completed no later than July 1, 2007, approximately three years from the date that the Initial Statement of Reasons was prepared (May 2004).

Section 12218. Request to Convert Registration to License

Due to staffing limitations, registrants will be called forward by the Division over a period of time. Thus, registrants and other persons may not submit license applications without first having been called forward or “summoned” by the Division.

This section also prescribes standard application procedures: who signs the application, category of licensing sought, and identification of a standard form.

In order to maximize the amount of information received concerning applicants and licensees, subsection (d) permits¹⁰ the Commission and the Division to decline to release confidential information, including information that might reveal the identity of a source of information or jeopardize the safety of any individual.

Section 12218.1 Subsequent Registrants

When a registered primary owner is summoned to seek conversion to licensing by the Division, all registrants affiliated with that primary owner are also required to submit conversion requests. The question then arises about how to handle registrants who become affiliated with that primary owner after the primary owner has been licensed. This section answers that question: providing that registrants who affiliate with the primary owner after licensure are deemed to be covered by the earlier Division summons.

¹⁰ Cf.: B & P Code Section 19821(d): improper release of confidential information is a misdemeanor under the Gambling Control Act. On confidentiality, also see B & P Code sections 19828 and 19868.

Section 12218.5 Withdrawal of Request to Convert Registration to License

Modeled on provisions of the Gambling Control Act that apply to cardroom applicants, this section spells out standards and procedures concerning withdrawals. Sometimes an applicant facing denial for good cause will attempt to withdraw the application in order to avoid an adverse outcome, whereas the public interest would be better served if the denial were issued. Gambling jurisdictions typically require license applicants to reveal any prior denials in other jurisdictions.

Section 12218.7 Processing Times--Request to Convert Registration to License

It is best for all concerned if processing times are spelled out.

Section 12218.11 Ineligibility for Licensing

Modeled on Gambling Control Act provisions which apply to cardroom applications, this section provides that, for instance, applicants with prior felony convictions are ineligible for licenses under this chapter.

Section 12218.13 Term of License

Following the model set in the Gambling Control Act for cardroom licenses and work permits, owner and supervisor licensees will have a one-year term; player and other employee licenses will have a two-year term. However, due to nonrecurring workload problems at the Division, all initial licenses will be for two years. After the initial licenses have been processed, player and other employee licenses will continue to be for two years, while owner and supervisor licenses will be for one year.

Executive Order S-2-03

The Commission has complied with the requirements of Executive Order S-2-03. One part of the Executive Order required approval of all emergency or other any pending regulatory actions. The Department of Finance approved the Commission's request to continue with the rulemaking process as related to the proposition player regulation, i.e., to keep the emergency regulations in effect and to take the necessary steps to make them permanent. (See

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Rulemaking File, Section 1, Item C.) Another part of the Executive Order required a review of any regulations that had been permanently adopted during a specified period of time. Rulemaking File, Section 1, Item E indicates that the Commission had completed the review and prepared the required report concerning the one regulation to which the requirement applied.

Also, on December 10, 2004, the Department of Finance signed the Form 399, thus approving the permanent regulations. See Rulemaking File, Section 12, Tab F.

PART A, SECTION TWO

Gambling Business Registration Regulations, Sections 12220—12237

Though a cardroom is in fact a business that offers games in which patrons can gamble, the Commission regulations use the term “gambling business” in a special sense. For the purposes of the Commission regulations, a “gambling business” is a separate and distinct enterprise that operates within a cardroom. The gambling business performs the same function as a third-party proposition player, that is, have an individual sit at a table and play in a game with sufficient money on hand to cover all bets made in the game. (For the legal definition of a “gambling business,” see Title 4 California Code of Regulations section 12220(b)(11).) For the purposes of the Commission regulations, a cardroom (or “gambling establishment”) is not a “gambling business.” The crucial distinction between a third-party proposition player company and a gambling business is that there is a contract between the proposition player company and the cardroom. There is no contract between the gambling business and the cardroom. The regulations concerning gambling businesses were included at the request of DOJ’s Division of Gambling Control. The Division was concerned that, absent such regulations, third-party proposition player companies would be tempted to avoid the annual fee by tearing up their contracts and announcing that they were no longer in the third-party proposition play business. Then, the Division feared, the same companies would return to the same cardrooms and resume performing the banking function. Unless Commission regulations cover gambling businesses, there is no incentive for third-party proposition companies to register with or be licensed by the Commission.

These "gambling business" regulations are authorized by Business and Professions Code section 19853(a)(3), which empowers the Commission to adopt regulations requiring “any person who does business on the premises of a licensed gambling establishment” to register with the Commission, and are essential in order to effectively implement the legislative mandate found in Business and Professions Code section 19984. In other words, for authority, the Commission relies not only upon the express provisions of Business and Professions Code section 19853(a)(3), but also in part upon

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authority impliedly granted by Business and Professions Code section 19984. See Title 1, CCR, section 14 (OAL regulation providing that a statutory provision may be a source of implied rulemaking authority if the provision "impliedly permits or obligates the agency to adopt, amend, or repeal the regulation in order to achieve the purpose for which the regulation was granted.").¹¹

The specific provisions of these gambling business regulations were adopted for the same reasons as their parallel provisions in the proposition player chapter.

Section 12220.23 ("Exclusion"), which is not paralleled in the proposition player chapter, is adopted in order to (1) provide the Commission with the names of persons who should have registered but have not and (2) permit the Commission to advise the unregistered person of the violation.

¹¹ The Commission also relies in part on authority granted by Business and Professions Code sections 19840 (Commission "may" adopt regulations) and 19841 (regulations adopted by the Commission "shall" do all of the following).

Section 19840 provides in part: "The Commission may adopt regulations for the administration and enforcement of this chapter [chapter 5 of division 8 of the Business and Professions Code]."

Section 19841 provides in part:

"The regulations adopted by the Commission shall do all of the following:

...

"(c) Implement the provisions of this chapter [chapter 5 of division 8 of the Business and Professions Code] relating to licensing and other approvals."

Regulating gambling businesses is essential to the "administration and enforcement" of Business and Professions Code section 19984. See Section 19840. Regulating gambling businesses is essential in order to "implement the provisions of this chapter [chapter 5 of division 8 of the Business and Professions Code] relating to licensing and other approvals." See Section 19841.

Chapter 5 includes Business and Professions Code section 19984.

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Section 12220.20A ("Annual Fee as Applied to Those Registered or Licensed Under Chapter 2.1") was adopted in response to comments. This section addresses the situation in which a company may not only have employees assigned to work pursuant to contracts with cardrooms under Chapter 2.1, but also have employees who have been assigned to work as part of a gambling business operation under Chapter 2.2. This section is needed so that such providers are not required to pay two separate annual fees. However, so that the Commission and Division are aware of these gambling business activities, the company is required to apply for registration or licensure as a gambling business, and each affiliated individual is required to submit an application for registration or license.

Under subsection 12220.20A(b), if a particular employee works solely as part of a gambling business operation, then the company is required to pay the incremental per-registrant annual fees. This subsection is needed so that appropriate fees are collected to fund needed oversight and enforcement efforts.

Per subsection 12220.20A(c), applicants who have already undergone a background investigation under Chapter 2.1 are not required to undergo a second investigation under Chapter 2.2. There is no need for a second investigation.

As December 13, 2004, no gambling businesses had registered as such with the Commission.

REQUIRED DETERMINATIONS

LOCAL MANDATE

These regulations do not impose a mandate on local agencies or school districts.

REASONABLE ALTERNATIVES TO THE PROPOSED REGULATIONS AND REASONS FOR REJECTING THOSE ALTERNATIVES

No alternative considered by the Commission would be more effective in carrying out the purpose for which the regulation is proposed or would be as effective and less burdensome to affected private persons than the adopted regulation. The Commission is not aware of any reasonable alternatives that would effectively achieve the purposes of establishing regulatory standards and procedures which protect the public from criminal and corruptive influences.

Commenters requested creation of a temporary registration program and revisions to the annual fee. Changes to the regulation were made in response to both these major concerns.

REASONABLE ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESS

The regulations have been amended to substantially decrease the annual fee and to phase it in. Also, temporary registration provisions have been added. Most of the suggested changes to the regulation as proposed came from the dominant proposition player company, a company that does not qualify as a "small business." Insofar as additional suggestions were received that were intended to lessen any adverse impact on small business, those suggestions were not accepted for the reasons outlined in Part B of this Final Statement of Reasons.

REPORT BY BUSINESS

Pursuant to Government Code section 11346.3(c), the Commission finds that it is necessary for the health, safety, or welfare of the people of this state that these regulations (which require reports) apply to business.

INCORPORATION BY REFERENCE OF FORMS

Numerous forms have been incorporated by reference into these regulations. Pursuant to Title 1, CCR, section 20(c)(1), the Commission hereby finds that it would be cumbersome, unduly expensive or otherwise impractical to publish the forms in the CCR. The forms proposed for incorporation were made available to the public in two ways: (1) they were posted on the Commission website and made available to the public upon request; and (2) addition of the forms to the rulemaking action was also highlighted in the notice of the second 15-day change. See Section 8, Part E of the rulemaking record. See Title 1, CCR, section 20(c)(2).

PART B. COMMENT SUMMARY AND RESPONSE

PART B, SECTION 1. COMMENTS ON REGULATION AS ORIGINALLY PROPOSED 45-DAY COMMENT PERIOD, JUNE 11, 2004 – JULY 30, 2004; AUGUST 5, 2004

45-Day Comment Period June 11, 2004 – July 30, 2004; August 5, 2004

Comments Received – Index of Abbreviations

CP1: Certified Players, Inc., dated June 25, 2004, received July 8, 2004, signed by Trish LeBlanc, President. Two pages.

NM1: Network M, dated July 19, 2004, received July 26, 2004, signed by Patrick Tierney, President. Thirty pages.

RR1: Robb & Ross, dated July 20, 2004, received July 22, 2004, signed by Alan Titus, writing on behalf of Artichoke Joe's. Eight pages plus attachments.

MF1: Michael Franchetti, dated July 29, 2004, received July 29, 2004. Seven pages.

GSGA1: Golden State Gaming Association, dated July 29, 2004, received August 2, 2004, signed by Andrew Schneiderman. Six pages.

AC1: Assemblyman John Campbell, dated August 4, 2004, received August 6, 2004. One page.

AS1: Assemblymember Tony Strickland, dated July 27, 2004, received July 28, 2004.

AP1: Assemblymember George Plescia, dated July 28, 2004, received July 29, 2004. Two pages.

SM1: California State Senator Kevin Murray, dated July 27, 2004, received August 2, 2004. Two pages.

**INTRODUCTION TO COMMENT SUMMARY AND
RESPONSE SECTION
("RESPONSE NO. 1")**

One comment contains several hundred detailed questions about a variety of regulation provisions, rulemaking matters, administrative matters, etc. This comment was submitted by a company currently engaged in litigation challenging these regulations; the questions are strikingly similar to interrogatories used in litigation. The Commission has responded appropriately to discovery requests made in the lawsuit.

Generally, responses to these and similar questions will not be provided in this Final Statement of Reasons. The APA summary and response requirement applies solely to "objection[s] and recommendation[s] concerning the specific adoption, amendment, or repeal." See Government Code section 11346.9(a)(3). Generally, these questions do not qualify as "objections" or "recommendations" within the meaning of the APA and thus do not require a response.

Several legislators submitted comments. Insofar as these comments require a response in the APA context, they will be addressed in this document. Most of these comments focused on the annual fee provision. Major changes have been made to the annual fee provision in response to public comments. Outside of the APA context, Commission staff will of course continue to work closely with these legislators and ensure that any remaining concerns or questions are dealt with.

Many questions call for interpretation of regulatory provisions. In addition to not qualifying as "comments" for APA purposes, it is inappropriate to answer such questions here because they may concern administrative issues which should be resolved based upon the specific facts of a situation which may or may not arise in the future, as well as upon a careful application of all pertinent laws to those facts.

Also, as is the case with regulations in general, experience using these specific regulations will likely in the future reveal the need for amendments, additions, and deletions. Early next year, the Commission will begin to gather ideas for another rulemaking focused on these regulations. Members of the regulated public, Commission and Division staff, as well as all interested parties will be encouraged to bring up any matters of concern.

General Comments

RR1:

The main concern of Artichoke Joe's with the proposition player regulations is to ensure that they do not create an uneven playing field among competing cardrooms as a result of being unclear, or violating statutory or constitutional law, or requiring unavailable levels of enforcement.

These regulations turn proposition players into exhibitors of the game and the games into banking games because proposition players share in the costs of equipment, promotion prizes, rebates, and advertising – all components of exhibiting the game. This is a violation of law. (Penal Code 330, 337a, 337j, case law.)

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RESPONSE NO. 2:

Artichoke Joe's is the name of a Bay Area cardroom which supported the 2000 legislation (Statutes of 2000, Chapter 1023; AB 1416) which added the predecessor of Section 19984 to the Business and Professions Code. See Senate Floor Analysis of AB 1416, dated August 28, 2000, page 8. See Attachment 6. However, Artichoke Joe's is not happy with the way in which the proposition player industry has evolved since the legislation took effect, or with the way the PP regulations have developed.

The Commission rejects Artichoke Joe's legal and policy arguments. In developing these regulations it has been necessary to deal with legal nuances, such as the statutory distinction between the house banking a game and a third party contracting with a gambling establishment to provide proposition player services, subject to specified conditions.¹²,¹³ However, the Legislature unambiguously approved proposition player activities and

¹² See (1) B & P Code section 19984; (2) B & P Code section 19805, subdivisions (c), (aa), and (ac); (3) Penal Code section 330.11, (4) the Legislative Counsel's Digest to the chaptered bill that added the above-cited statutory provisions, Statutes of 2000, Chapter 1023 [included as Attachment 7], (5) the bill analysis prepared for the final version of AB 1416 (as amended Aug. 30, 2000, prepared by the Senate Governmental Operations Committee) [included as Attachment 8], and (6) AB 1416's uncodified prefatory language, see Section 1 of Statutes of 2000, Chapter 1023.

¹³ The Legislature authorized the operation of proposition player services subject to specified conditions, including adoption of regulations. AB 1416's urgency clause (Statutes of 2000, Chapter 1023, Section 10) provides in part that the legislation must take effect immediately to ensure at the earliest possible date (1) that "gambling establishments are able operate within the law with respect to controlled games featuring a player dealer position, [and (2)] to provide the California Gambling Control Commission and Division of Gambling Control with necessary regulatory guidelines and enforcement powers"

Proposition player services have been in operation since Section 19984 took effect in late 2000. These services, however, have been virtually unregulated since late 2000. Many of the comments received in this rulemaking suggest that the proposition player companies and the gambling establishments would prefer to enjoy the benefits of the statute without having to deal with the state regulatory oversight clearly contemplated by the Legislature. The Commission takes the position that the public interest, not to mention the statutory mandate, requires strict and comprehensive regulation.

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mandated adoption of implementing regulations in B & P Code section 19984. In Section 19984, the Legislature also gave the Commission broad discretion to adopt appropriate regulations. In addition, the Legislature clearly determined that proposition player activities are constitutional and consistent with state law; for instance, pertinent Penal Code provisions were amended in AB 1416 to ensure that they were consistent with Section 19984.

The Commission lacks the power to find that the proposition player statute is unconstitutional. Article III, section 3.5 of the California Constitution provides in part:

- "An administrative agency, including an administrative agency created by the Constitution or an initiative statute, has no power:
 - (a) To declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional;
 - (b) To declare a statute unconstitutional ;

Though the comment is artfully drafted, it is in many respects an argument that Section 19984 is inconsistent with the state constitutional ban on house banking. The Commission rejects that argument. Section 19984 can be harmonized with the California Constitution. Even assuming *arguendo* that Section 19984 were inconsistent with the California Constitution, the Commission lacks the power to decline to enforce a statute on constitutional grounds. Only an appellate court can determine that a statute is unconstitutional.

The comment also suggests that the way in which the regulations have been drafted has created conflicts with Penal Code and constitutional provisions. The Commission rejects these suggestions. The Commission has taken a cautious, middle of the road approach to the question of payments by proposition player companies to cardrooms. The cardroom trade association, the Golden State Gaming Association, has also submitted comments on these regulations. In these comments, the trade association urges the Commission to amend the regulations to allow cardrooms to in effect recover operational expenses by charging high fees to PP providers for a wide variety of services. The Commission has rejected these cardroom proposals on the grounds that, if implemented, they could be found to create such close ties between the PP company and the cardroom as to violate the

ban on house banking. See Response No. 20. Specific objections to specific contract section provisions will be taken up under those provisions. See section 12200.7 in Part A of this Final Statement of Reasons and, for example, Response No. 23.

Concerning the suggestion that the regulations (or Section 19984, or both) cannot be reconciled with the Penal Code: the Commission responds as follows: it is a basic rule of construction that all statutes are to be read together making maximum effort to harmonize elements which might at first glance appear to be in conflict. Thus, a debatable interpretation of a Penal Code provision which would create a conflict with a Business and Professions Code provision should be rejected.¹⁴ The same principle applies to creative attempts to create conflicts between the Penal Code and the PP regulations.

Thus, the Commission has rejected the extreme suggestions of both Artichoke Joe's and the cardrooms, electing instead to pursue a moderate approach which attempts to faithfully implement the key legislative policy decisions reflected in Section 19984.

In 2002, the Legislature reaffirmed the policies reflected in Section 19984 (initially approved in 2000) by amending and re-enacting this section in Statutes of 2002, Chapter 738 (AB 2431).

Chapter 2.2 "Gambling Businesses," In General

RR1:

Chapter is beyond CGCC's authority.

RESPONSE NO. 3:

See FSR, Part A, Section Two.

¹⁴ Here, the issue is less difficult because the Legislature itself harmonized the Penal Code with the Business and Professions Code in AB 1416.

MF1:

If registered as a provider service, should not also have to register as a gambling business for operating in some cardrooms without a contract, based on Section 12220(b)(10) [now (b)(11)] and Business and Professions Code 19984. Clarify or create a section that expressly deals with provider services which also operate as gambling businesses in other cardrooms. Consider a notification form to advise Commission when provider service is operating as gambling business in another cardroom.

RESPONSE NO. 4:

In response to this and similar recommendations, the Commission added Section 12220.20A to Chapter 2.2. Though requiring registration under Chapter 2.2, Section 12220.20A waives the Chapter 2.2 annual fee for companies which are registered under Chapter 2.1 and current on their Chapter 2.1 annual fee payments. Separate Chapter 2.2 registration is needed so that the State will be aware of all persons operating a gambling business and so that all appropriate additional fees are assessed and paid. Use of a notification form would not adequately inform the State or protect the public.

AC1:

Does the CGCC intend to perform any oversight of gambling businesses? If so, to what extent? Will it be identical to the oversight and regulation of provider services? If so, how will it be funded? I am taken aback that CGCC chose not to assess annual fees on gambling businesses, even though they appear to be functionally equivalent to provider services. Did CGCC consider the disproportionate impact that a disparate fee structure might create? Provider services might forgo contracts and become gambling businesses to avoid the annual fee.

RESPONSE NO. 5:

It appears that the commenter was not provided with accurate information concerning the annual fee issue. See Response No. 6, below.

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AS1:

In what I call a “perverse, reverse incentive,” the CGCC seeks to put out of business proposition player provider services, which it could probably charge a reasonable fee, in order to promote gambling businesses, for which it proposes to charge no fees. Please reexamine your approach. It makes no sense, is patently discriminatory, and will only lead to job loss.

RESPONSE NO. 6:

It is true that the text of the permanent regulation as originally proposed in June 2004 did not include an annual fee for gambling businesses. The precise wording of the gambling business chapter had not been fully developed at that point in time.

As was indicated in the notice of proposed action published in June 2004, however, the Commission's intent was to adopt gambling business regulations which paralleled the proposition player regulations. Indeed, in June 2004, the Commission proposed amendments to the emergency regulation which imposed the same annual fee on gambling businesses as was proposed for proposition player companies. This emergency amendment proposal was approved by OAL and took effect on July 7, 2004. The Commission stated that the pending permanent regulation would be conformed to the amended emergency regulation, including the annual fee provision.

In August 2004, as soon as was permitted by APA procedural requirements, the Commission proposed amendments to the permanent regulation as originally proposed which carried out the intent of making the gambling business regulations parallel to the proposition player regulations. At no time were proposition player companies in fact subject to an annual fee while gambling businesses were not. At all times, the same annual fee has applied equally to both gambling businesses and proposition player companies. Also see FSR, Part A, section 12200.20.

SM1:

Why isn't CGCC charging annual fees to gambling businesses? Don't they do the same things as provider services, except without a contract?

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RESPONSE NO. 7:

See Response No. 6.

Definitions – Section 12200

RR1:

This definition is overly broad and without substance. It defines third-party proposition player services as "services provided in and to the house...under any ...agreement with the house." This is so over broad that it would encompass any services provided to the house by third parties. Thus, for example, a painter who offers services to the house would be covered by these regulations. While the definition goes on to specify one category of services that is included within the definition, namely, services which include "play as a participant in any controlled game that has a rotating player-dealer position," even that would seem to apply to all players and not differentiate between proposition players and other players.

RESPONSE NO. 8:

See Final Statement of Reasons, Part A, section 12200(b)(28) (definition of "third-party proposition player services").

Badges – Section 12200.3

MF1: Need for Temporary Badges and Approvals

Because of delays (such as getting a finger print check processed), there needs to be a provision allowing persons to be employed as players after submission of the application pending review and approval/rejection of the application.

RESPONSE NO. 9:

The regulations were revised to accommodate this and similar comments. See Sections 12203.1, 12203.2, 12203.3, and 12203.5, which create a temporary player registration program.

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Oral Comment by Michael Franchetti (transcript, page 21-23):

There is a need for a temporary badging system, so that companies can hire a player and have a good idea of when that player can start working. Local and state law has that option available for cardroom employees and there doesn't seem to have been any problems with it, no loss of public safety or protection.

RESPONSE NO. 10:

The regulations were revised to accommodate this and similar comments. See Sections 12203.1, 12203.2, 12203.3, and 12203.5, which create a temporary player registration program.

Contract Criteria – Section 12200.7(b)(11)

NM1

What do the criteria mean?

(b)(11) May an owner, supervisor, or player provide proposition player services in a gambling establishment which that person works in or owns?

RESPONSE NO. 11:

Section 12200.7(b)(11) provides that "a registrant or licensee may not provide proposition player services in a gambling establishment for which the registrant holds a state gambling license, key employee license, or work permit." This means, for instance, that if Ms. Jones holds a key employee license in gambling establishment A, then Ms. Jones may not also provide proposition player services in gambling establishment A.

The point of the question is not entirely clear. If there is a specific question reflecting a current problem that has not yet been resolved satisfactorily, then the commenter is encouraged to contact the manager responsible for the Commission's Licensing Section.

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GSGA1: Ownership

Ownership. The right of gambling establishment owners or operators to also own and operate a Third Party Proposition Company should not be limited or abridged. As you are well aware, this single issue elicited more comment and discussion at the last several Commission meetings than any other. There is no argument that a person registered under the regulations in question could not operate in a Gambling Establishment in which he or she held an ownership interest. All concerned agree this limitation would avoid even the appearance of impropriety or collusion and avoid the problem of "banked games".

However, there is simply no need to preclude a licensee of a Gambling Establishment from also owning or even investing in a Third Party Proposition Company. As was clearly stated to the Commission in a recent meeting, Gambling Establishment licensees are individuals who have a vested interest in this business and who have undergone the rigorous background investigation and financial inquiry associated with such a license. These individuals are a known quantity that both the Division and the Commission have approved, after the most painstaking scrutiny, for participation in the gaming industry. Why then preclude them from participation in another aspect of the industry? In adopting the Emergency Regulations recently, the Commission took the correct action in not including such a prohibition in the regulations. The Commission should again take the position that a Licensee of a Gambling Establishment may apply for and obtain a Third Party Provider registration so long as he does not provide Proposition Player services in a Gambling Establishment he owns.

Moreover, the Legislature already made its policy choice. In adopting Business and Professions Code 19984, the Legislature specifically barred gambling establishment licensees from operating or investing in a proposition player service at the same gambling establishment. The Legislature did not bar a licensee from investing or owning part of a service operating at a different establishment.

RESPONSE NO. 12:

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The commenter urged the Commission not to change the ownership provisions as they appeared in the emergency regulation. Since no change was made, no further response is necessary.

Contract Criteria – Section 12200.7(b)

NM1

(b)(20) Would tips refer to any service charge paid to a cardroom, whether or not passed on to its employees? Are contracts for tips to dealers prohibited? Are tips to cardroom house employees or other employees prohibited if not specified by contract?

(b)(21) Are provider players prohibited from cutting cards? Dealing cards? Shaking dice?

RESPONSE NO. 13: none required. See Response No. 1.

NM1

What does "substantially disproportionate to the value of the services or facilities provided" mean?

RESPONSE NO. 14:

The regulation speaks for itself and is clear. No further response is required.

GSGA1:

Contract Terms. The numerous items listed for inclusion in a contract between a Proposition Player registrant and a Gambling Establishment are problematic for several different reasons as explained below.

Contract v. Regulatory requirements. The regulations list multiple items that are required to be included in contracts between Gambling Establishments and Proposition Providers. It appears that the Commission is attempting to prohibit or mandate certain action by requiring prohibitive and mandatory language to be included in the contracts instead of simply regulating these areas. It is problematic to require a contract to contain certain provisions, which are not otherwise required by specific regulation. Further, even if these matters are included in the contracts, in the event that either the Establishment or the Proposition Provider breaches the contract provision,

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the only remedy would be a breach of contract action allowing termination of the contract.

The examples of contract requirements in the emergency regulations that should be re-organized as regulatory requirements (i.e., they don't need to be in the contracts) are: Section 12200.7(b) (5) limiting prop players from each service to one per table; (9) services provided only by authorized persons; (10) maintaining copy of license on file; (12) collection fees; (16) reporting legal disputes to the Commission and Division; (17) reporting arrests to Division and Commission; (18) reporting cheating allegations to the Division and Commission; and (21) purchasing and control of certain equipment.

In addition to removing these criteria from the contracts and finding a more appropriate place for them within the proposed regulations, there are specific areas that must be modified regardless of where the language may ultimately appear.

RESPONSE NO 15:

See FSR, Part A, Section 1, Sec. 12200.7.

RR1:

(b)(19) - These regulations turn proposition players into exhibitors of the game and the games into banking games because proposition players offer rebates to players– a component of exhibiting the game. This is a violation of law. (Penal Code 330, 337a, 337j, case law.)

This provision would allow proposition players to grant rebates to patrons. Although the regulation says that neither the house nor any employee of the house shall have any role in rebates, by paying a rebate, the proposition player is in effect promoting the game and assuming the role of an exhibitor. The proposition player is inviting people to come play, and has moved from the passive role of a player to an active role of an exhibitor. This turns the games into banking games in violation of statutory and constitutional law.

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RESPONSE NO. 16:

See response to earlier RR1 comment, above. The granting of a rebate does not transform the activity into a proscribed banking game. It is necessary to regulate rebates in order to ensure that the house does not improperly insert itself into the rebate process and thus arguably create legal problems of the sort to which the commenter alludes.

RR1:

(b)(21) - These regulations turn proposition players into exhibitors of the game and the games into banking games because proposition players share in the costs of equipment -- a component of exhibiting the game. This is a violation of law. (Penal Code 330, 337a, 337j, case law.)

This section, allowing proposition players to reimburse the house for costs of equipment, turns the games into banking games. The section allows reimbursement for "equipment such as surveillance cameras and monitors, or cards, shuffling machines, and dice." However, there is no justification for reimbursement from the proposition player. Proposition players pay the same collection fees as other players. Their participation in the game creates no additional costs. If the proposition player also shares in the costs of exhibiting the game, the game becomes a banking game. (This regulation also contradicts § 12200.7(b)(12) which requires that collection fees charged proposition players be the same as those charged other participants and § 12200.7(c) which provides that the house cannot receive any share of the profits of the registrant.)

REPOSENSE NO. 17:

See response to earlier RR1 comment, above.

Contract Criteria – Section 12200.7(c)(2) Advertising

NM1

(c)(2) Is a cardroom prohibited from charging a provider player a fee for making a wager?

What is "a reasonable share of the cost of advertising with respect to gaming at the gambling establishment in which the registered owner participates"?

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RESPONSE NO. 18:

See Response No. 1. No further response required.

RR1:

(c)(2) - These regulations turn proposition players into exhibitors of the game and the games into banking games because proposition players share in the costs of advertising – a component of exhibiting the game. This is a violation of law. (Penal Code 330, 337a, 337j, case law.)

This section requires that payments made by the proposition player to the house may not be based on a percentage of profits. All payments must be fixed, and shall only be made for services and facilities requested by the registrant and for a reasonable cost of advertising. As indicated above, this addresses the law on percentage games, not the law on banking games. No charges should be allowed other than those imposed on other players. Otherwise, the proposition player shares in the costs of exhibiting the game and the game becomes a banking game.

RESPONSE NO. 19:

See response to earlier RR1 comment, above.

GSGA1:

Advertising and Marketing. The regulatory language restricting the Proposition Service Provider's contributions to advertising is far too limited and does not appropriately represent what costs the Establishment should be able to share with the Proposition Provider. Business and Professions Code § 19984 simply bars the house from any interest in the profits or losses of the Proposition Provider. The statute does not bar flat fee payments, whether for advertising, rent or for any other benefit. And there is no basis in the statutory language for determining that Proposition Provider services can reimburse the establishment for advertising, but not marketing or promotions. Neither type of reimbursement violates the proscription against house banking. Rather, it should be permissible for the Proposition Providers to contribute to the overall marketing and promotional effort of a given Gambling Establishment. There are any number of marketing or promotional efforts that substantially benefit the Proposition Providers and in which they should share the cost.

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The terms "advertising," "marketing" or "promotions" are not interchangeable and have very distinct meanings in business. Yet, for the purposes of this regulation, there should be no meaningful regulatory difference. The club and Proposition Provider should be able to agree to reimbursement rates for each.

For example, "advertising" may include television or direct mail. "Marketing" might involve offering discounts or coupons to customers who stay in a certain hotel, or to first time players. "Promotions" might include giveaways for frequent play, like a trip, or bonanza prizes. In any case, these examples do not constitute banking or any interest in the profits or losses of the Proposition Provider. There is no reason why the Proposition Provider should be able to agree to reimburse the club 20% for television ads, but be barred from reimbursing 20% of the promotional coupon or the player trip.

Even prizes tied to the play of a game, and which involve a prize being awarded to a player do not create a banking game; in fact, there is no relation between the two. Any prize related to a promotional activity is separate and apart from the wagering and payoff that results from the play of a hand.

The regulations should be amended to allow the Proposition Providers to reimburse the Gambling Establishment for Marketing and Promotional efforts, not just advertising.

RESPONSE NO. 20:

The Commission rejects this comment. As pointed out in the Robb and Ross comments, if the cardroom extracts too much money from the proposition player company, this could arguably constitute house banking.

Contract Criteria – Section 12200.7(c)(3) – services and facilities

NM1:

What does "substantially disproportionate to the value of the services or facilities provided" mean?

(c)(3) For what "services or facilities" can a payment be made?

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RESPONSE NO. 21:

See Response No. 1. No further response required.

GSGA1:

Services and Facilities. Once again, we are asking that the Commission recognize that the Contacts between the Registrants and the Establishments are, as with all contracts, negotiated as an arms length transaction resulting in a presumptively fair market value. The current language of the regulation requiring the contract to identify each specific service or facility under the contract and to specify the total charge for services and facilities should be stricken. It serves no apparent purpose to require the parties to the contract to provide a veritable laundry list of services and/or facilities that may, and likely will, vary on a daily basis. In no other contractual situation involving a tenant and landlord situation is such an itemized list with corresponding fees included. Rather, the overall rent is stated for all services and facilities as well as the good will of the landlord's business. As the value of some of these services and good will items are difficult to quantify, the parties negotiate a monthly rent payment as do landlords and tenants generally, taking into account all of the variables and the overall value of what is being provided. There should be a presumption of reasonableness in regards to payments for services and facilities provided. If a situation arises where the Commission or Division comes across evidence that suggests something less than a contract negotiated in good faith as an arm's length transaction, then an analysis can be performed to determine if the price is substantially disproportionate as is prohibited elsewhere in the regulations. All costs or consideration for the contract should fall under the umbrella of "rent" and not require itemization.

RESPONSE NO. 22:

See Response No. 20.

Contract Criteria – Section 12200.7(c)(3)

GSGA1:

Exclusivity. As has been articulated before, exclusivity is a very valuable element of any contract. Obviously a beer or hot dog vendor will pay more

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to be the only approved vendor or "sponsor" for a concert or sporting event, than for shared access. Likewise, the granting of exclusivity by an Establishment to a Proposition Provider should be a permissible consideration for the contract price. Exclusivity provides a definite value, which is obvious by the fact that the Proposition Providers request it and that an Establishment can exclude proposition player business that have not signed contracts. Charging a premium for exclusivity is a common business practice as it is well understood to add value to the contract. There is no reason, and we have not been advised of one, for barring consideration for exclusivity.

RESPONSE NO. 23:

The Commission rejects this comment. Permitting payment for exclusivity arguably constitutes house banking, or at least could be cited as a factor contributing to a conclusion that a house banking situation has been created.

Contract Criteria – Section 12200.7(e)

RR1:

(e) - These regulations turn proposition players into exhibitors of the game and the games into banking games because proposition players share in the promotion of prizes– a component of exhibiting the game. This is a violation of law. (Penal Code 330, 337a, 337j, case law.)

This section contemplates that registrants/licenses might pay for prizes awarded as a result of promotions. A promotion is part of exhibiting the game, and as stated above, if the proposition player shares in the specific costs of exhibiting the games, the proposition player becomes an exhibitor and the game becomes a banking game.

RESPONSE NO. 24:

See Response No. 2.

Contract Review – Section 12200.9

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NM1

Network M requests a break down of all calculations in **(a)(3)(E) and (F)**, including what the costs defray, if the fee is applied toward processing costs, what the total processing costs for all contracts has been and how they break down, what the hourly rate for each category of employee that was included in the charges, the actual cost to the State of California, any costs in excess of salary and benefits, how much was paid by provider services, how many contracts have been approved, and the average processing costs.

RESPONSE NO. 25:

See above responses. No further response required, except to point out that the Gambling Control Act (B & P section 19951(a)) sets \$500 as the application fee. See earlier responses to emergency comments submitted to OAL. Finally, the initial deposit referred to in Section 12200.9(a)(3)(F) is required by a Division of Gambling Control regulation. The additional deposit referred to in (F) is limited to costs revealed in an itemized accounting.

NM1

(b)(1) and (3)(E) and (F) – How does expedited contract review process work?

What does "substantially identical" in section 12200.9(b)(1)(C) mean?

Does "substantially identical" in section 12200.9(b)(I)(C) mean that the gaming activities referred to in 12200.7(b)(3) must be the same?

Does "substantially identical" in section 12200.9(b)(1)(C) mean that the number of tables referred to in 12200.7(b)(4) must be the same?

Does "substantially identical" in section 12200.9(b)(I)(C) mean that the hours of operation referred to in 12200.7(b)(6) must be the same?

Does "substantially identical" in section 12200.9(b)(I)(C) mean that the logistical details referred to in 12200.7(b)(7) must be the same?

Does "substantially identical" in section 12200.9(b)(I)(C) mean that the financial arrangement referred to in 12200.7(b)(15) must be the same?

Does "substantially identical" in section 12200.9(b)(1)(C) mean that the rebates referred to in 12200.7(b)(19) must be the same?

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Does "substantially identical" in section 12200.9(b)(1)(C) mean that the tipping arrangements referred to in 12200.7(b)(20) must be the same?
Does "substantially identical" in section 12200.9(b)(1)(C) mean that the reimbursement referred to in 12200.7(b)(21) must be the same?

RESPONSE NO. 26:

See Response No. 1. No further response required.

Contract Review – Section 12200.10A

MF1: Need for Temporary Approvals

There needs to be a provision allowing a proposition player company and a cardroom to immediately implement a contract pending approval by the Division if the contract is substantially similar to other contracts which have been previously approved by the Division. This would give businesses greater flexibility needed to operate in a competitive business environment.

RESPONSE NO. 27:

See Response No. 73.

Oral Comment by Michael Franchetti (transcript, page 23):

Similar to comment in letter, summarized above, preceding Response No. 27.

RESPONSE NO. 28:

See Response Nos. 27 and 73.

Contract Review – Section 12200.11

NM1

How are the contract renewal charges calculated (application fee and deposit).

RESPONSE NO. 29:

The \$500 application fee is mandated by B & P Code section 19951(a). Also, subsection 12200.11 provides for two deposits in amounts to be set by

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the Director of the Division. The first deposit is intended to cover costs incurred by the Division in performing the needed review. The second deposit is intended to permit an additional sum of money to be obtained by the Division if the special circumstances of the situation indicate that additional staff time will likely be expended in performing the needed review. Any money received in excess of the costs incurred in the review will be refunded. An itemized accounting will also be provided to the application showing how the deposit was used.

Revocation – Section 12200.18 (i) – buying/selling chips

GSGA1:

The buying and selling of chips outside the cage is an extremely common practice. Proposition players currently sell chips and make change for players without a problem. Similarly, players make change for other players or loan chips or cash. This practice allows for fewer delays and interruptions in the play of the game and a more enjoyable experience for everyone. This is especially necessary in the smaller clubs who may not employ the manpower necessary to constantly run to the Cage to replenish a dealer bank or make change for a player.

RESPONSE NO. 30:

Regulation revised to accommodate concern.

Annual Fees – Section 12200.20

Group of Letters from Provider Service Employees:

The rulemaking record contains over one thousand similar letters, addressed to Governor Schwarzenegger, regarding the fees proposed in what are characterized as “job killing” regulations. These letters are numbered PPF 1 through PPF 1107. Most are one page in length; some are two pages in length. Many of the individuals writing these letters identified themselves as employees of Network M, working at a number of cardrooms in various areas of California. Some mention that they currently attend college and use the money earned to pay for their education. Some detail the dependents they support (spouse, parents, children) and the financial obligations they

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have (rent or mortgage payment, car payment, groceries, student loans, etc.). The letters indicate that the writers believe having to pay a \$500 fee plus background check would negatively impact their ability to financially sustain themselves. Further, the letter writers indicate that the total fees imposed on Network M might require Network M to go out of business, costing the employees their jobs, which would negatively impact the state in terms of loss of income/payroll tax and increased unemployment insurance claims because the job market is very slow right now. The cumulative request of the letter-writers is to eliminate or reduce the annual fees.

RESPONSE NO. 31:

See FSR, Part A, Section 12200.20 (Annual Fee).

The \$500 application fee is mandated by statute. In addition, the public cannot be protected from criminal and corruptive influences unless background investigations are performed; these background investigations must be paid for by registrants or licensees; funds are not available from other sources. The proposition player company is free to pay for employee application and investigation fees. The regulations do not require that employees bear these costs personally. Network M grossed \$85,000,000 in a recent fiscal year. See Declaration of Robert Lytle, Attachment 5.

Commission records indicate that Network M, as of November 27, 2004, is paying annual fees based upon 924 registrants, an increase of roughly 200 registrants since July 2004, prior to the annual fee. Network M has not gone out of business. On the contrary, it has more employees now than it did before it started paying annual fees.

CPI – Fees “excessive and punitive”

It is difficult to understand how a "secondary" business should be required to pay fees that are considerably higher than the primary business we are associated with? This is especially troublesome in light of the fact that we are already paying promotion dollars to the casino(s) we are operating in.

It is also difficult to rationalize the amount of the proposed fees when considered as a percentage of an employee’s wages. Other industries are subject to government regulation, certification, licensing and fees but it is hard to believe that their fees, as a percent of wages, would equal the 10%

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that employees of banking companies will be required to pay under the proposed regulations. By comparison this seems out of line and punitive to employees in our industry. These other industries logically require the same amount of administrative time and expense in the licensing/background check effort. Can you please offer an explanation justifying the relative high cost of licensing for third party proposition players as a percentage of income when compared to other similarly situated positions?

The regulations would mean that the 16 to 18 banking groups which employ approximately 1,200 people will pay more in licensing fees than the sum total of all the primary card clubs in which they operate which totals 103 enterprises and employ 10 times the amount of employees. How can this be justified?

Why does the employee of a banking group have to pay double the amount that a casino employee pays when the background process for a work permit is the same?

Why is there a \$250 transfer fee when there is no other investigative work involved?

If these fees do go into affect, it will force the banking groups to downsize thus causing the following ripple effect:

- loss of jobs for employees, creating unemployment.
- loss of revenue for the casinos due to less tables being staffed, causing a loss of tax revenue for the locals and state.
- possible loss of jobs for casino employees in the California/Asian games.
- the extra cost will force banking groups to lower wages and eliminate benefits.

RESPONSE NO. 32:

Proposition player services are more profitable than cardrooms. Insofar as the regulations impose new costs of doing business, the proposition player services can reflect these new costs in amended or future contracts with cardrooms.

See response to Group of Letters from Provider Service Employees, above (Response No. 31).

Proposition player employees handle much larger amounts of cash and chips than do work permit holders. There is a much greater potential for

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penetration by organized crime and other corruptive influences because of the uniquely cash-intensive nature of the work of the individual proposition player company player. See Letter of Robert Lytle, Director, Division of Gambling Control, dated February 24, 2004, Appendix B to Attachment 1.

MF1:

Many companies have non-employee investors who are not players and who have no role in the activity of the company; they should be excluded from licensing calculations unless they are players, supervisors, primary owners or other employees.

RESPONSE NO. 32A:

The risk of criminal penetration is too high to permit such special licensing exceptions for non-employee investors (or for employee small investors). Experience in other gaming jurisdictions reveals that criminal enterprises are resourceful and creative in gaining access to such things as money laundering and embezzlement opportunities.

AC1:

I am taken aback by the size and abruptness of the annual fees imposed. How are they justified? Was business impact considered?

RESPONSE NO. 33:

See FSR, Part A, Section 12200.20; earlier and later responses concerning the annual fees.

AS1:

The bulk of my opposition comes from the huge and patently unfair fees that CGCC has decided to impose on provider services. The massive size is truly staggering, with no lead time to adjust.

RESPONSE NO. 34:

The dominant proposition player company grosses \$85,000,000 annually. The annual fee regulation has been amended to lower and provide for a phasing in of fees.

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AP1:

Why did the CGCC enact, on an emergency basis, regulation on third party providers of proposition player services, that included annual fees that are assessed on a per employee basis? What was the "emergency"?

How much time elapsed between the publication of the version of the emergency regulations governing third party proposition players containing the per-employee annual fees and adoption by the CGCC? When was this particular emergency regulation process initially commenced? Did the CGCC consider giving more time to interested parties who must pay these fees to respond to the CGCC's hasty action?

Did the CGCC consider the job suppressing impact of such per employee fees?

Did the CGCC consider alternatives, such as the per table fees assessed against card clubs? If so, why did it choose a different approach?

Will any of the money collected from third party providers of proposition player services from any of the fees assessed be used, directly or indirectly, to police the activities or regulate in any manner non-third party proposition players and owners, such as card club employees and gambling business employees. If no, how do you intend to separate the policing functions to assure the fees assessed against third party proposition player service are used exclusively to defray the expenses associated solely with that industry?

Do "gambling businesses" and their employees pose the same or similar law enforcement concerns as third party proposition players? If yes, what is the CGCC's justification for failing to assess annual fees on those entities? Is your failure to assess annual fees on gambling businesses legally sound?

Has the CGCC's budget grown in the last year? If so, by how much and how many people? How has it been funded historically? For year 2000, 2001, 2002, 2003, 2004? What will the funding break down for 2005?

Why are the annual fees assessed TPPPPS so much higher than those assessed on card clubs?

RESPONSE NO. 35:

See earlier responses and Response No. 40A. Emergency regulations were adopted in order to protect the public from criminal penetration of a uniquely cash-intensive industry. The reasons for emergency adoption were provided in the finding of emergency, which was recently upheld by the Los Angeles Superior Court. The regulation has been substantively revised in response to public comments.

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SM1:

Why did CGCC adopt the fees schedule on an emergency basis, with only 5 days notice to the public? What emergency existed to warrant the imposition of such draconian fees? It is my understanding that fees are scaled. Does CGCC assume that the larger a proposition player entity, the harder to regulate? Please provide specific analysis and conclusions. How specifically will the annual fee, contract review fee, background deposit and annual fees be used? How many new employees does the CGCC plan to hire to police proposition players?

RESPONSE NO. 36:

See FSR, Part A, Section 12200.20 and Responses 1, 31, 32, 34, 35, 38, and 40A.

The portion of the comment concerning the emergency regulation does not address the adoption of the permanent regulation and thus does not require a response under the APA. Nonetheless, it should be noted that providers have generally been aware that fees were coming since the legislation was enacted in 2000.

Also, the topic of annual fees was discussed at a public workshop on May 12, 2004; the draft of an annual fee regulation was reviewed at that time. The specific amounts of the planned annual fees were made public in early June 2004 in the proposed permanent regulation. Next, the same annual fee language (including fee amounts) was included in a proposed emergency readoption and amendment that was posted on the Commission webpage on June 18, 2004 and then discussed in Commission meetings on June 22 and July 1, 2004. An additional comment opportunity occurred during the 10-day OAL review period: the emergency regulation was filed with OAL on June 24, 2004. Public comments were accepted by OAL between June 24 and 29, 2004.

According to the annual fee provision, section 12200.20, the annual fee was due September 1, 2004, based on the number of registrations in effect on August 15, 2004.

Oral Comment by Doug More, Gold Rush Gaming Parlor, Grass Valley
(transcript, page 6-8):

If we lose our Blackjack play we may be in a position where we are forced to close. Proposition player services bring continuity to the game in terms of game rules and stability. The fees being charged make it cost prohibitive for proposition players to bank tables in small cardrooms.

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RESPONSE NO. 37:

Commission records as of November 27, 2004 indicate that Gold Rush Gaming Parlor is still in business. See also FSR, Part A, Section 12200.20 and responses to other comments.

Oral Comment by Kent Kozal, California Gaming Consultants
(transcript, page 10-12):

These annual fees are not just another cost of doing business for us. These annual fees are actually going to necessitate laying off employees and possibly getting rid of some contracts. ...some small companies like us that these annual fees are not just a cost of doing business, they are likely going to maybe not put us completely out of business but certainly end several contracts.

RESPONSE NO. 38:

Commission records as of November 2004 indicate that California Gaming Consultants is still in business, with approximately the same number of employees as it had prior to implementation of the annual fee provision. Division records indicate that the company had five contracts in July 2004, and seven as of November 27, 2004. The number of contracts has increased, not decreased. See also FSR, Part A, Section 12200.20 and responses to other comments.

Oral Comment by Joe Capps, B.J. Gaming (transcript, page 12):

If these fees are implemented...we will have to leave all five of the clubs in which we bank, which amounts to 18-20 employees.

RESPONSE NO. 39:

Commission records as of November 27, 2004 indicate that B.J. Gaming is still in business, with approximately the same number of employees as it had prior to implementation of the annual fee provision. Division records indicate that the company currently has four contracts, versus the five contracts it had in July 2004. See also FSR, Part A, Section 12200.20 and responses to other comments.

Annual Fees – Section 12200.20 (b)

NM1:

What category of registration or license does an owner who is not present in the cardroom need to obtain? Section 12200 (b)(2) states that all owners have to be an “authorized player” while section 12200(b)(11)(A)(ii) seems

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to imply that an “owner” who is not present in the gambling establishment and, consequently, does not play need not obtain a license. Do all owners have to be registered or licensed as an “authorized player?” Do all owners have to be registered or licensed?

RESPONSE NO. 40:

Subsection 12200(b)(12)(A)(ii), formerly (b)(11)(A)(ii), has been clarified by deleting the language "if issued a playing badge." This deleted language was once part of a since-abandoned plan to base the annual fee on the number of "authorized players" rather than registrants or licensees. The final language of Section 12200.20 bases the annual fee on the total number of registrations or licensees affiliated with a particular primary owner.

All owners must be registered or licensed. All registered or licensed owners are authorized to serve as supervisors or players.

NM1: “Harmful, Discriminatory”

Annual fees for Network would be in excess of \$3 million because it employees over 750 registrants. Network will faced with prospect of reducing salaries, benefits, layoffs, etc. Treatment of Players versus Dealers in cardrooms is unfair. Players must wait far too long to receive registration, while Dealers can get temporary work permits. Network cannot hire a replacement worker without waiting 2-3 months. Players have to have state registration and local work permit, while Dealer only have to have local work permits. Players thus have to pay \$500 per year more than Dealers, and must pay more often (every year, instead of cardroom employees paying every two years).

Graduated fee structure is not justified either factually or legally. Costs for background research or preparing a final report / findings of single individual should not increase based on the size of the provider service or number of employees. On-site inspections, risk of operation, preparing reports, or instituting actions should not increase based on size and complexity of provider service. Economies of scale are ignored. CGCC assumes that larger provider services are more complex. There is no factual or legal rational to support the incrementally increased cost. Network questions how much of the annual fee will go towards supervision of

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cardrooms or gambling businesses or any other purpose other than regulating provider services and, if any, how much, for what purpose, and why. Network wants a break down of all the costs for which the annual fee is expected to defray, the hourly rate charged for each category of employee that was included in the charge, the actual cost to the State of California, any costs in excess of salary and benefits, what regulation and oversight functions are to be paid from based on the fees, and when and where these regulatory functions are performed. Provider services should not be defraying the cost of investigating or policing cardrooms, dealers, gambling businesses, etc. Nor should provider services pay logarithmically for administrative overhead of CGCC. This is impermissible under Government Code section 19984.

Provider services should not pay more than gambling businesses. Why is the CGCC not assessing non-refundable annual fees on Gambling Businesses? What, besides a contract, differentiates a gambling business from a provider service? Higher fees for provider services (as compared to gambling businesses or cardrooms) constitute a Bill of Attainder to punish provider services, and violates the Fourteenth Amendment to the US Constitution and Article 1, section 7, of the California Constitution.

The fee should be computed based upon the number of tables operated by a provider service, not the number of registrants. CGCC is multiplying the budget – why?

Network inquires as to why no refunds are given if the number of registrants decreases prior to the end of the year, why the same fee is charged for registrants who register mid-year as to those who register at the start of the year.

What specific costs justify the application fee and do any costs overlap with the annual fees?

RESPONSE NO. 40A:

See FSR, Part A, section 12200.20. See Response nos. 1, 5, 9, 10, 25, 31, 32, 34, 35, 36, and 38.

Re temporary registrations, see Response nos. 9 and 10.

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Re treating PP players differently from cardroom permit holders, some of whom are dealers: see FSR, Part A and Footnote 4. Also, PP personnel require a higher level of scrutiny than cardroom dealers due to the difference in responsibility. Dealers handle chips at the table; however, they simply deal the cards and distribute the winnings and losses. They make no discretionary decisions about the amounts of wagers or when wagers are placed. They do not engage in backline betting or other practices where large amounts of money are wagered at the table. PP players are responsible for all of these things and have in their possession a large amount of money: the PP player sitting at a particular cardroom table serves as “the bank” for the game, in a capacity similar to that of a Las Vegas dealer. In large and medium size cardrooms, this typically involves possession of a chip tray containing chips worth about \$100,000.

Re \$500 application fee: see Response No. 31.

Re the graduated fee schedule: the graduated feature of the annual fee schedule has been deleted. See FSR, Part A, Section 12200.20.

Re the allegation that annual fees are not assessed against gambling business under chapter 2.2: See Response No. 6.

Re cost data supporting the annual fee: See FSR, Part A, section 12200.20. The fee is not based on the number of tables served because the costs are based on numbers of registrants who must be reviewed and then monitored.

Re the objection to the refund provision: Refunds will not be given in response to mid-year decreases in the net registration level of a provider because the Commission and Division have ongoing personnel and other costs to cover. In addition, making such refunds would be time consuming and could conceivably lead to increased administrative costs.

Oral Comment by David Tierney, Network Management Group (transcript, page 9-10):

Why does the fee per registrant increase with the size of the company?
What facts and data support this conclusion? Why do the proposed

regulations require an annual fee even after local government entities have issued work permits? Cardroom employees are not required to have an additional permit, so why should prop players?

Why must the third party players pay annual fees with regard to non-supervisory employees similar to a non-supervisor employee in a cardroom?

Where is the information showing the actual number of hours and costs to defray the Commission's actual cost of regulating third party workers?

RESPONSE NO. 41:

See Response No. 40A. Local issuance of work permits cannot substitute legislatively mandated state registration. Protection of the public requires uniform state regulation, ensuring, for example, that convicted felons are not working as proposition players. Also, while the Gambling Control Act provisions applicable to cardroom employees expressly recognize local regulation, B & P Code section 19984 outlines a straightforward state system of regulation. Early drafts of the regulations preempted local regulation. At the suggestion of the City of San Jose, the regulations now permit parallel local regulation.

Section 12201

NM1

(d) – What does this section allow? Can owners, shareholders, partners, key employees, landlords, or work permittee of a cardroom be issued a provider service registration or license as an owner, owner without playing badge, primary owner, supervisor, or player at the cardroom for which licensed or at another establishment?

Is the operation of a TPPPPS by an entity owned, in whole or in part, directly or indirectly, by a gambling establishment licensee or permittee ("Owner") constitute the operation of a TPPPPS by the house, when the gambling establishment affiliated with the Owner allows a TPPPPS owned, in whole or in part, directly or indirectly, by another gambling establishment licensee or permittee to operate in the gambling establishment affiliated with the Owner prohibited by the Penal Code?

Has the adverse impact been calculated? How? What is it?

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RESPONSE NO. 42:

See Response No. 1.

Applications for Registration – Section 12202

NM1:

Network M requests a break down of all calculations in **12202**, including what the costs defray, if the fee is applied toward processing costs, what the total processing costs for all applications has been and how they break down, what the hourly rate for each category of employee that was included in the charges, the actual cost to the State of California, any costs in excess of salary and benefits, how much was paid by provider services, how many applications have been approved, and the average processing costs.

RESPONSE NO. 43:

See FSR, Part A, Section 12202 and Response Nos. 1 and 31.

Applications for Registration – Section 12203

NM1:

How are the charges calculated? What fees are referred to by the phrase “all required fees” in **12203(f)**, and what the costs defray. What costs does the expedited processing fee in 12203(f) defray?

RESPONSE NO. 44:

The subsection in question now appears in Section 12203A ("Processing of Applications for Renewal of Registration"). The phrase "all required fees" has been deleted. Concerning cost data for the expedited processing fee, see FSR, Part A, Section 12203A.

Contract Criteria – Section 12207 (b)(18) – Report of Cheating

GSGA1:

The requirement that any cheating reported to the house by any registrant or licensee shall be reported within 5 days to the Commission and the Division

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is unduly burdensome as it will, by definition, require every assumption or suggestion of cheating by any Proposition Provider employee to be reported to the Commission. Sometimes, players just get frustrated and make snide comments that cannot be taken seriously and that the players themselves do not pursue. Or in some cases, they simply did not observe a wager being placed or card being dealt and accuse someone of cheating. In contrast, serious allegations are reported to the owners of the Proposition Provider. To avoid the requirement that every assumption or incorrect observation be reported, we suggest that only those incidents of cheating that are reported to the house by a Primary Owner of the Proposition Provider should require reporting to the Commission and Division.

RESPONSE NO. 45:

This subsection is now located in Section 12200.7(b)(18). See FSR, Part A, section 12200.7(b)(18).

Background Investigations

MF1:

Players are in positions similar to those of work permit employees at cardrooms and thus should not be subject to more costly and intrusive licensing criteria than are cardroom employees.

RESPONSE NO. 46:

See FSR, Part A, footnote 4, and Response No. 35.

Section 12201(d) – Ownership

Group Letters:

The rulemaking file contains over five hundred similar letters urging the Commission to deny gambling licensees the right to operate proposition player businesses by voting for Option Three in proposed section 12201(d). The reasons are a wish not to expand gambling in California, a desire that cardroom owners not be allowed to enter in possibly collusive agreements with potential criminal elements, and a request that the Constitutional ban on house banking not be eroded or degraded. A few letters also mention a

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Christian disposition against gambling and any expansion of gambling. These letters are numbered PPO 1 through PPO 567 and are each one page in length. They are signed by individuals who reside in various areas of California.

RESPONSE NO. 47:

See FSR, Part A, Section 12201(d). See Response Nos. 2 and 12. See Oral Comment by David Fried (immediately following).

Oral Comment by David Fried (transcript, page 13-20):

Concern that under the regulations a monopoly or near monopoly will be created in the provision of proposition player services. Barriers to entry to the prop player market are game play, finance, and compliance with regulations. First, game play – the people most likely to understand game, management of money, and management of employees are the people that operate cardrooms or those people that started out in small prop player businesses that grew over time. Second, finance – one can't finance prop player services through a bank like Wells Fargo or Union Bank or other traditional means. Third, compliance – in addition to hiring employees and get financing, someone entering this market must get licensed, pay fees, register. The most natural pool of people who could get through these three barriers are people already familiar with the cardroom business – maybe not necessarily an owner, but maybe a key employee or dealer who has saved money and want to start a small prop player business. The Commission may be creating a fourth barrier by not allowing an entire class of people to apply for a license. With this fourth barrier, the Commission may be creating a monopoly, since only one or two dominant providers will be able to break through all of the barriers. Then the Commission may face a dilemma when it needs to discipline such a provider service. Cardroom owners and key employees, while not being able to bank in their own establishment, should be able to bank in another establishment. The concern about collusion is a reasonable one, but should be easily solved. When the Division and Commission review the contracts, it should be possible to see a collusive agreement and they can make further inquiries to make sure it isn't collusive, or not approve one that is collusive.

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RESPONSE NO. 48:

Section 12201(d) was not revised. This comment provides additional support for adoption of Section 12201(d).

Preferences – Section 12212 - Compliance

GSGA1:

The subject of “preference” is one of much concern in these permanent regulations. Specifically, in the section entitled "Compliance" the regulations preclude a registrant from being afforded any preference by the house over other players in either the (a) continuous and systematic rotation of the bank, or (b) in the placement of wagers if such preference is sanctioned by the house rules or otherwise directed by the house or its employees.

The definition of "preference" is rife with ambiguity and open to interpretation. The phrase "placement of wagers" is not defined. Moreover, it seems anomalous to expressly prohibit any practices that may be contained in game rules *approved* by the Division. To avoid any such difference of opinion when it comes to enforcement, it would be preferable to instead create a safe harbor for approved game rules, and to more specifically define the phrase "placement of wagers" by tying that phrase to wagers made in the player-dealer position.

In other words, rather than bar preferences allowed by approved game rules, the definition of "preference" should be amended to exclude any practices contained in the game rules approved the Division. Otherwise, you would have the bizarre result that the Division could approve a game rule, but then later take the position that the practice contained in the approved rule represents a prohibited "preference."

Similarly, the regulations should define "placement of wagers." Consistent with the remainder of the "preference" definition to which we do not object ("any preference by the house over other players in either the continuous and systematic rotation of the bank"), the phrase "placement of wagers" should be changed to bar: "any priority in occupying the seated or back-line player-dealer positions." This would bar, for example, the PROPOSITION

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PROVIDER from having a priority in occupying the second position behind the seated player-dealer. The approved game rules already specify that the wagers are won or lost in order of the position.

RESPONSE NO. 49:

The definition of "preferences" has been deleted from the definitions section. The Compliance section has been renumbered as Section 12200.21, amended to delete the preference material, and otherwise redrafted.

Preferences – Section 12212 (b) Right to preclude others from banking

RR1:

This section allows the house to grant exclusive "banking" privileges to the proposition player and to exclude players of another registrant or of a gambling business from playing. This regulation violates a number of state laws, and also creates a banking game.

First, it violates the Unruh Civil Rights Act. As the courts have held, the Unruh Act's "Language and its history compel the conclusion that the Legislature intended to prohibit *all arbitrary discrimination* by business establishments," whether or not the ground of discrimination is expressly set forth in the Act. *Marina Point, Ltd. V. Wolfson* (1982) 30 Cal.3d 725, 732; *Isbister v. Boys Club of Santa Cruz* (1985) 40 Cal.3d 86. There is no good reason for precluding other proposition players from playing, and preclusion would be considered arbitrary.

The regulation also violates the Cartwright Act which is designed to prevent business combinations that result in restrictions on trade or commerce. (See Business & Professions Code § § 16727, 17045, 17048 and 17200.) Here there is a combination of the gambling establishment and the proposition player service for the purpose of excluding other players. Only proposition players which are in contract with the house (read: paying kickbacks) are allowed to play. This is a restriction on trade or commerce.

The combination of the functions of exhibitor and banker also turns the game into a banking game. As discussed above, the definition of a banking game involves the combination of these two elements. The relationship

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becomes akin to a partnership between the proposition player and the house, and the games become banking games.

As a side matter, we note that the section defines preference to include "any priority in the continuous and systematic rotation of the deal as required by Penal Code section 330.11." However, section 330.11 does not require continuous and systematic rotation but just provides a safe harbor so that games so played will not be considered banking games. Of course, in Sullivan, the First District court of Appeal held that banking games are limited to house banked games.

RESPONSE NO. 50: See Response Nos. 2 and 49. Limiting play at particular tables is consistent with Section 19984 and not inconsistent with any other applicable law. PP players not employed by the company under contract with a particular cardroom cannot, under Section 19984, show up and play unless this hypothetical second company is also under contract to the cardroom. Section 12200.21 is necessary to prevent confusion, to protect the public, and to simplify enforcement.

Section 12200.21(a) expressly requires registrants and licensees to "comply with game rules approved by the Division, including but not limited to, the rules regarding player-dealer rotation and table wagering.

The commenter is second-guessing legislative policy decisions, which the Commission is mandated by statute to implement.

Preferences – Sections 12212, 12218.15, 12229

NM1:

What are preferences? If preference is a priority given to a registrant over other players in dealing and placing wagers, do these sections require every player to accept player-dealer position or can a player decline? Do they apply only to seated players or players that have made a wager on the previous deal? How would non-seated players fit into the systemic rotation? Do the sections require a systemic rotation of wagers for the player-dealer position? Do they require the player-dealer position to be systematically rotated to participants other than players? What about side bets? Do the sections apply to participants other than players?

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Has the adverse impact of prohibiting the use of current rules regarding preferences been calculated? How? What is it?

RESPONSE NO. 51:

The preference definition was deleted from the final regulation. See also Response No. 1.

Conversion – Section 12218

NM1:

How does this section work?

RESPONSE NO. 52: Insofar as this comment is directed at the emergency regulation, it does not require a response here. Insofar as the comment is directed to the section proposed for permanent adoption, the Commission replies that the section speaks for itself.

Preferences – Section 12218.15

RR1:

This section is parallel to section 12212 and allows a proposition player contract to preclude players of other licensees or gambling businesses to play at a table while the proposition player is playing. We incorporate by reference the objections asserted to that section.

RESPONSE NO. 53:

See Response No. 50.

Exclusion – Section 12232

RR1: Vague and ambiguous.

This section requires the gambling establishment to notify the Commission of any person reasonably believed to be conducting a "gambling business" without a license. The section is vague and ambiguous since it does not make clear whether the reasonableness of the belief is measured by an objective or a subjective standard. Does the regulation apply only if the gambling establishment has an actual belief that has risen to a reasonable

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level or does it apply if a reasonable person would believe that an unlicensed gambling business is playing? The regulation is not clear. We suggest that notice be required only when the club has *actual knowledge* that a gambling business is operating without a license.

RESPONSE NO. 54:

This section has been renumbered to Section 12220.23. See FSR, Part A, Section 12220.23 ("Exclusion"). This section is needed in order to identify unregistered gambling businesses. The Commission has reviewed the Section in light of the comment and concludes that the section satisfies the APA clarity standard. Using the suggested "actual knowledge" test would impose an impossible enforcement burden on the State, and would make it very difficult to learn of the existence of unregistered gambling businesses. The individual cardroom is in the best position to know about such unregistered activity, and is only required file a report with the State if it "reasonably believes" such activity is occurring.

Economic Impact

NM1:

Significant sums will severely and adversely impact this industry, handicap the ability of California firms to compete with businesses in other states (patrons will go to Nevada to play).

RESPONSE NO. 55:

See Response No. 31.

**Oral Comment by Richard Shindel of Network Management
(transcript, page 26-27):**

Because of the financial impact to the industry, would like to see the financial impact study.

RESPONSE NO. 56:

See FSR, Part A, Section 12200.20.

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Business Impact

CP1: “Harmful”

The Governor signed an executive order (8-2-03) that discourages regulatory action that would be harmful to business and have the effect of further alienating business owners and operators in the state of California. The proposed fee table within this regulation is harmful to my business and may very well lead to its demise. For this reason and the concerns mentioned above I respectfully request that the amount of fee assessment be revisited with any eye toward reducing them by at least 80%.

RESPONSE NO. 57: See FSR, Part A, Section One, final page, "Executive Order S-2-03."

NM1: “Harmful, Discriminatory”

Gambling businesses need to be treated equally.

RESPONSE NO. 58:

See Response No. 6.

MF1:

Create a licensing category for small investors – some individuals meet the definition of “funding source” but have so small an investment that it is impractical to pay for the licensing costs of being an “owner.” Small businesses will be forced out. Suggestion to make a small investor (both employee-investors and non-employee investors) have a check that is not more costly than that required for a player. For employee investors, who help promote honesty and fair play in games, investing not more than \$20,000 should not require any other license than that of an employee. Small non-employee investors who have an investment which does not exceed 3% of the total amount of funds invested with the company should be licensed as an “other employee” and treated the same as player investors.

RESPONSE NO. 59: See Response Nos. 32 and 32A.

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Oral Comment by Michael Franchetti (transcript, page 24-26):

There should be an exception to “funding source” for people who are licensed as players or supervisors or other employees under the regs and have a small investment – maybe \$20,000, and these people should be allowed to invest without having to go through a background investigation. Employee-investors would help protect the game (preventing cheating), and profit sharing in a company is good public policy.

RESPONSE NO. 59A: See Response No. 59.

Necessity

NM1:

Statements by the Commission seem to contra-indicate the need for regulations to address criminal activity.

RESPONSE NO. 60:

The Commission stands by the findings of the Division of Gambling Control and the City of San Jose. See Appendices A and B to Attachment 1. The quoted statement of a former Commission staff member (not involved in development of the regulations) may simply reflect a lack of personal knowledge in this area.

PART B, SECTION 2. COMMENTS ON REGULATION,
FIRST 15-DAY COMMENT PERIOD, AUGUST 25, 2004 –
SEPTEMBER 9, 2004

**First 15-Day Comment Period
August 25, 2004 – September 9, 2004**

Comments Received – Index of Abbreviations

M1: Mahaffey & Associates, dated August 27, 2004, signed by Sean T. McGee. One page.

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- DF1: David Fried, on behalf of California Grand Casino and Oaks Card Room, dated August 23, 2004. Four pages.
- DF2: David Fried, on behalf of California Grand Casino and Oaks Card Room, dated September 9, 2004. Two pages.
- MF2: Michael Franchetti, dated September 2, 2004, received September 9, 2004. Six pages.
- MF3: Michael Franchetti, dated September 7, 2004, received September 7, 2004. Six pages.
- CS1: Stand Up For California!, dated September 7, 2004, signed by Cheryl Schmit. Two pages.
- HJR: Henri JeanRenaud, received September 9, 2004. One page.
- Mohr: Mr. And Mrs. Phil Mohr, undated.
- NM2: Network M, dated September 9, 2004, signed by Patrick Tierney, President. Two pages (plus attachment of July 19, 2004 letter, thirty pages).
- M2: Mahaffey & Associates, dated September 9, 2004, signed by Sean T. McGee. Six pages, plus attachments, to total forty-three pages.
- NM3: Network M, dated September 9, 2004, received September 13, 2004, signed by Patrick Tierney, President. Five pages.
-

General MF2:

As the Commission begins to finalize the permanent regulations, it would be of real benefit to everyone if it would take some time to focus on the practical impact of the regulations on the industry and ensure that the regulations fairly treat all of the entities and individuals who are impacted by them.

We all agree that the Commission's role is to protect the public welfare regarding gambling in California. However, it is my belief that the Commission can protect the public welfare while at the same time taking into consideration fairness and the practical needs of the many small businesses which for the most part make up the proposition player industry. Red tape, unnecessarily burdensome and impractical procedures, or rules which unfairly treat some of those being regulated are not necessary to ensure that the public welfare is protected.

The recommendations made in this letter focus on several areas that I believe the Commission should examine and fine tune. The amendments recommended further the goal of ensuring a high level of public protection. They also provide those who are regulated flexibility in business operations as well as a level and fair playing field.

RESPONSE NO. 61:

The Commission has reviewed the regulations in light of this comment. No further response is needed under this heading.

CS1:

In the year 2000 Assembly Bill 54 authored by Assembly Member Wesson was clean-up legislation recommended in Governor Davis's veto letter on AB 1416. Stand Up for California opposed AB 1416 believing it an attempt to legalize banking games in statutory law. Nevertheless this legislation was passed by the State Legislature, signed by the Governor and enacted into state law. Until a successful challenge is made regarding the constitutionality of the statutory language put forward in AB 54 the California Gambling Control Commission is mandated to establish a regulatory rule. It is without a doubt in the best interests of the public and good working order of the state to develop a stringent regulatory framework regarding 'Proposition Players'.

Proposition Player Corporations enter into contracts with California Card Clubs and provide players who act as a third party banker in card games. These third party bankers have the ability and provide a service of covering bets made by card room patrons. While this activity is often mutually beneficial to both the Proposition Player Corporations and the Card Clubs it presents many concerns which affect the well-fare of patrons and the general public.

Proposition Players deal in a cash intensive business. This business left unregulated becomes a magnet for crime and corruption. Regulation is necessary to ensure the public is not cheated or affected by organized crime, money laundering, or loan sharking. The industry has thus far developed without regulation with one corporation earning over 84 million dollars annually. The proposed regulation would require the payment of annual fees to cover the cost of regulating this growing industry.

Currently California Card Club owners have a stringent licensing program. Proposition Players licensing should be no less rigorous. Moreover, if current California Card Club owners are licensed as Proposition Players it is only common sense that they must be barred from operating in their own clubs.

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Perceptibly, there is a need to establish a meticulous licensing program which:

- Identifies, backgrounds and tracks Proposition Players in the gambling industry
- An audit program providing for transparency in the daily handling of cash by Proposition Players.
- Provides daylight and oversight to the contractual arrangements between Card Clubs and Proposition Player Corporations
- Prohibits Card Club owners from operating as a third party banker in their own clubs

Stand Up For California supports the need for this legislative mandated regulation. The regulation is in the best interests of protecting the well being of the public from the harm, mischief and corruptive elements which unregulated gaming engenders.

RESPONSE NO 62:

The Commission appreciates the expression of support for a rigorous regulatory program.

Gambling Businesses, In General

NM2:

2. **The regulations at sections 12207(b)(11), 12200.9(a)(1) and 12201(d) restrict who and where gambling establishments can participate in TPPP services. However, these same restrictions do not exist as it relates to the conduct of a Gambling Business. We anticipate this was an inadvertent omission, as we doubt the Commission intends to sanction a gambling establishment to own and conduct a gambling business in their own**

establishment. We suggest the addition of the same restrictions in the sections governing Gambling Businesses.

RESPONSE NO. 63:

The Penal Code currently prohibits cardrooms from themselves operating as gambling businesses. The Commission will review these matters in the coming year as part of the anticipated 2005 PP rulemaking. Meanwhile, we note that there are at present no registered or licensed gambling businesses.

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Section 12200 (9), page 8
MF2 and MF3:

1. Less Costly Background Investigations for Small Investors Who Are a "Funding Source"

The draft permanent regulations (Section 12200 (9)—Page 8) should be amended to create a licensing category which requires a less expensive background investigation for small investors who have invested in third party proposition player businesses.

The current regulatory scheme lumps all investors, regardless of the amount of their investment, into an "owner" category which requires an extensive and costly background investigation. In so doing, the Commission fails to recognize that there are individuals who meet the definition of a "funding source" who have an investment which is so small that it is financially impractical for them to pay for the extensive background and licensing costs currently required of an investor "owner." Adoption of the existing regulatory scheme will force these small investors out of the business to the harm of both the industry and the public welfare.

There are two types of small investors: employee investors and non-employee investors. It is recommended that such small investors should be allowed to invest a small sum with a background check which is not more extensive or costly than that required for a player.

Employee Small Investors. As an employee benefit, some proposition player companies allow their employees to invest a small amount of money in the company. Those who choose to make this investment are allowed to share in the profits, if any, in proportion to their investment. This is a good business policy and a good policy for the gaming industry. It promotes employee loyalty. Most importantly, it provides employees with an incentive to make sure that games are played fairly and honestly. This protects the public as these professional players are in the best position of any member of the public to detect cheating or improper procedures.

However, the cost of paying for the more extensive and expensive Level III investigation required by Section 12200 (b) (25) (A) (Page 13) of the proposed permanent regulations is so great in proportion to the benefit received by the players that this employee friendly practice of providing employees a "profit sharing" opportunity will be denied these workers.

Each of these employee investors is licensed as a player, supervisor or other employee. This ensures that their backgrounds have been checked by the Commission. In view of that, it is recommended that employee investors who invest not more than \$20,000.00 not be required to obtain any other license than that required of them as an employee.

Non-Employee Small Investors. One public safety concern covered by the regulations is that third party businesses will utilize funds which are derived from prohibited or undesirable sources. This is the apparent reason why the investors are treated as a form of "owner" and subjected to the extensive background investigation involved in the Level III investigative report. As a practical matter situations involving questionable funding sources will invariably involve large investments in the proposition player company. For example, an organized crime family would only be interested in laundering or investing large sums of money. It would have no interest in an investment which involved a small amount of money with a small return.

There are, however, many individuals who have a small amount of money to invest who are interested in a small investment in a proposition player company. Some companies encourage investments from these passive investors who have no role in the actual play of games or the operation of the company.

This practice has a public policy advantage in that 1) it helps to ensure that funds invested are from legitimate funding sources as organizations with questionable sources of money will not be interested in a small investment which has a small potential return; 2) it helps to reduce the potential for one large investor to dominate the company and influence the company to engage in questionable practices; and 3) the oversight and interest of many small investors helps to ensure that the company's practices are in conformity with all laws.

However, as with the player investors, the cost of a Level III background investigation will be so great in relationship to the investment that these small investors will be forced to terminate their investment.

It is recommended that the small non-employee investors who have an investment which does not exceed 3% of the total amount of funds invested with the company should be licensed as an "other employee" and treated the same as player investors.

RESPONSE NO. 64:

See Response No. 32A.

MF3:

1. Less Costly Background Investigations for Small Investors Who Are a "Funding Source"

The draft permanent regulations (Section 12200 (9)—Page 8) should be amended to create a licensing category which requires a less expensive background investigation for small investors who have invested in third party proposition player businesses.

The current regulatory scheme lumps all investors, regardless of the amount of their investment, into an "owner" category which requires an extensive and costly background investigation. In so doing the Commission fails to recognize that there are individuals who meet the definition of a "funding source" who have an investment which is so small that it is financially impractical for them to pay for the extensive background and licensing costs currently required of an investor "owner". Adoption of the existing regulatory scheme will force these small investors out of the business to the harm of both the industry and the public welfare.

There are two types of small investors: employee investors and non-employee investors. It is recommended that such small investors should be allowed to invest a small sum with a background check which is not more extensive or costly than that required for a player.

Employee Small Investors. As an employee benefit some proposition player companies allow their employees to invest a small amount of money in the company. Those who choose to make this investment are allowed to share in the profits, if any, in proportion to their investment. This is a good business policy and a good policy for the gaming industry. It promotes employee loyalty. Most importantly it provides employees with an incentive to make sure that games are played fairly and honestly. This protects the public as these professional players are in the best position of any member of the public to detect cheating or improper procedures.

However the cost of paying for the more extensive and expensive Level III investigation required by Section 12200 (b) (25) (A) (Page 13) of the proposed permanent regulations is so great in proportion to the benefit received by the players, that this employee friendly practice of providing employees a "profit sharing" opportunity will be denied these workers.

Each of these employee investors is licensed as a player, supervisor or other employee. This ensures that their backgrounds have been checked by the Commission. In view of that it is recommended that employee investors who invest not more than \$ 20,000.00 not be required to obtain any other license than that required of them as an employee.

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This practice has a public policy advantage in that 1) it helps to ensure that funds invested are from legitimate funding sources as organizations with questionable sources of money will not be interested in a small investment which has a small potential return; 2) it helps to reduce the potential for one large investor to dominate the company and influence the company to engage in questionable practices and 3) the oversight and interest of many small investors helps to ensure that the company's practices are in conformity with all laws.

However, as with the player investors, the cost of a Level III background investigation will be so great in relationship to the investment that these small investors will be forced to terminate their investment.

It is recommended that the small non-employee investors who have an investment which does not exceed 3% of the total amount of funds invested with the company should be licensed as an "other employee" and treated the same as player investors.

RESPONSE NO. 64A:

See Response No. 32A.

Section 12201

M1:

As you are aware, Section 12201 (d) contains a footnote that states as follows:

In the original text, three alternatives were presented for subsection (d). Alternative (1) is shown here.

I am unclear as to why the other two choices have been omitted. I asked Mr. Kaufman whether this footnote was meant to signify that the Commission had chosen to adopt the first alternative and he indicated that he did not know and would get back to me. The Commission has not yet updated its website with the most recent meeting minutes, so I am unable to independently determine if a vote on the issue has been taken of which I am unaware. I would assume that if alternative three had been deleted, it would have appeared in "strike out" font. Regardless, if such a change has been made, then be advised that we want a full opportunity to file appropriate comments.

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RESPONSE NO. 65:

This is the text of a letter sent to the commenter:

August 31, 2004

Sean T. McGee
Mahaffey & Associates
18881 Von Karman Ave.
Irvine, CA 92621

Re: Proposed Proposition Player Regulations: 15-day Change dated
August 25, 2004

Dear McGee:

Last week, I asked Deputy Attorney General Peter Kaufman to return the voicemail message you had left for me concerning the above-noted subject. You represent the plaintiff in a legal action challenging the Commission's proposition player regulations: Reverend Louis P. Sheldon v. California Gambling Control Commission, Los Angeles Superior Court, Case No. BS087590. Mr. Kaufman is counsel for the Commission in that litigation. Your letter of August 27 indicates that you spoke with Mr. Kaufman on Thursday, August 26. I received your letter of August 27 yesterday. Mr. Kaufman indicates that he left a voicemail message for you at approximately 5:30 p.m. on August 27.

The first draft of 15-day change was posted on the Commission's website on August 13 and distributed to the Commission's rulemaking list on August 16. Comments were invited in a notice sent to the Commission's rulemaking list.

Though not required by either the Administrative Procedure Act or the Bagley-Keene Act, this advance posting and distribution was done in order to provide interested parties with additional time to review the material. This August 13 draft contained recommendations by staff. Among these recommendations was that, of the three alternatives presented for consideration concerning Title 4, California Code of

Regulations, Section 12201(d), that alternative (1) be selected as the alternative to be included in the 15-day change to be circulated for public comment. This recommendation was reflected in a footnote to Section 12201(d) stating:

“In the original text, three alternatives were presented for subsection (d). Alternative (1) is shown here.”

This footnote clearly indicated the alternative that had been selected. See Title 1, California Code of Regulations, section 46 (footnote may be used to illustrate changes).

At the meeting of August 24, the Commission approved the draft, as revised, for circulation to the public for the 15-day comment period required by the Administrative Procedure Act. The approved draft included the footnote quoted above. There was an opportunity for public comment during the August 24 Commission meeting.

As stated in the 15-day notice and the 15-day change document posted on the Commission’s website on August 25, the deadline for public comment on the 15-day change is 5 p.m., Thursday, September 9, 2004. Anyone with comments concerning any aspect of the 15-day change document--including the selection of alternative (1) for the content of Section 12201(d)--is encouraged to submit written comments to the Commission within the comment period outlined above. The proposition player regulations will likely be on a Commission agenda late next month. If you have comments concerning Section 12201(d), you may make them again during that upcoming Commission meeting.

I have asked that your name be added to our (1) rulemaking distribution list and (2) Commission agenda distribution list. The Commission’s website also contains information concerning rulemaking projects and Commission meetings.

Sincerely,

Herbert F. Bolz
Senior Legal Counsel and Regulations Coordinator

cc: Deputy Attorney General Peter Kaufman

Section 12200.7 (b)(20) – Tips, page 23

DF1:

We initially had four comments on the regulations, but following my telephone call with Debbie Dunn at the Division today, it appears the last two issues in this letter may be resolved. I will highlight those issues that remain open. In particular, with regard employee tips, because the Division is considering limitations on tips from all patrons and not just TPPs, we believe that the matter of tipping should be addressed separately and apart from these TPP regulations, and more time should be given for the consideration of this issue.

This section reverts to old proposed language that bars tips from a TPP to any employees with "decision-making or supervisory responsibilities." In July, the Division agreed to change this section to bar tips to the "House", which is what the emergency regulations provide. (Emergency Regulation § 12200.7 (20) (July 6, p.13): "... tips shall not be given to the house.").

I forgot to ask Ms. Dunn to confirm that the August 13 draft was supposed to refer to tips to the "house", but our conversation did address a second potential problem with this tip limitation that particularly impacts smaller clubs, as well as the Division's reasons for seeking a tip limitation. As you know, the Commission is required to take into consideration the operational differences between large and small establishments in adopting regulations. Business and Professions Code § 19840.

The term "house" includes key employees. Many medium and small clubs have listed a number of persons as key employees because they are required by other regulations to always have a key employee on site unless the club's annual revenue is less than \$200,000. (Title 11, Div. 3, Chap. 1 Art. 5, §2050 (a)).

In small and medium size clubs, some of these key employees function ordinarily as dealers, cage persons, floor persons, etc. They exercise key

employee responsibilities only occasionally. As an example, a person in a 5 or 10 table club may be a dealer, but has been licensed as a key employee so that if someone else does not show up for work, or takes a vacation, there will be a key employee on site.

As a consequence of the tip limitation above, these employees would *never* be allowed to receive tips from the TPP, even when acting in their primary role as a dealer and even if they spend 95% of their time acting as a dealer. If their average tip per shift from a TPP is \$40, their lost income would be \$200 per week, or **\$10,000** per year, a lot of money to an employee.

The Division has explained that the limitation is intended to bar tips to employees who may have to resolve disputes for patrons. Obviously, that concern would apply equally to any patron -not just a TPP- and the Division has related that they are considering a similar ban on tips to all key employees, regardless of whether the tips come from a TPP or another patron.

We would oppose such a limitation. But we also believe that the matter of tipping should be addressed separately and apart from these TPP regulations so that whatever tip rules are adopted, they are well-considered, and to the extent needed, consistent for all patrons. We respectfully request that limitation on tips to key employees in these regulations be eliminated, and subject to further discussions or action respecting tips generally.

If the tip issue is addressed now, we would suggest the following change in the regulation to address the concerns above:

"That any tipping arrangements shall be specified in the contract; that percentage tips shall not be given; and that tips shall not be given to a gambling establishment owner, shareholder, partner, landlord or key employee when the key employee is acting in the capacity of a key employee."

The Division would be able to determine whether a person was acting as a dealer, cage person or key employee on a particular shift by virtue of whether other key employees were present and who was exercising supervisory authority on that shift. And while this may not be a perfect drafting solution, it is a better temporary approach than an over extensive

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regulation that automatically cuts employee income regardless of their *true job* function.

RESPONSE NO. 66:

The regulation was amended to accommodate this comment.

DF2:

The most recent version of the tip restriction bars tips to *all employees*. It reads: "tips shall not be given to employees of the house." I doubt this is intentional. This would bar tips to every person employed in a card room regardless of position, including valet parkers, cocktail waitresses, waiters, and chip runners.

In addition, there may be some anomaly between what is proposed here and what occurs in other states. We understand the reason for the restrictions is to avoid "bias" in resolving customer disputes. However, in Nevada and New Jersey floor persons or key employees resolve disputes between the House and the players, even though the employees resolving the disputes are employed by one of the parties to the dispute. We believe that this arrangement is satisfactory because the employees must apply approved game rules and are not exercising discretion. We also believe that patrons have some right of appeal (we intend to review the Nevada and New Jersey procedures). Perhaps the answer lies not in barring tips, but in providing some level of review of patron disputes where customers are not satisfied with floor decisions.

We believe that this issue deserves further consideration and should not be included in these regulations.

RESPONSE NO. 67:

See Response No. 66.

Section 12200.7 (b)(18) – Cheating, page 22

DF1:

This section requires the Clubs to report any allegation of cheating reported by any TPP employee. This would be difficult to administer. I discussed

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with Ms. Dunn limiting this section to cheating reported by a primary owner of a TPP, which will serve to screen out inconsequential reports.

RESPONSE NO. 68:

See Response No. 45.

DF2:

The present section is unworkable because it will result in reporting every frivolous statement that may relate to cheating. Moreover, since any patron can conceivably report cheating, how and when to report of cheating allegations should be addressed with regard to reports by any patron, not just TPP employees.

RESPONSE NO. 69:

See Response No. 45.

Section 12200.7 (c), (e) – Restrictions on charges for Marketing, Promotions, and Exclusivity, pages 23-27

DF1:

These sections limit payments from the TPP to a club to payments for services, facilities and "advertising", and bar reimbursement for marketing, promotions or "exclusivity." We cannot discern a statutory basis or a policy reason for these distinctions.

Business & Professions Code § 19984 provides only that the House may not have an interest in the funds wagered, lost or won by the TPP. This provision parallels the Penal Code prohibition on the House operating percentage games where the House collection is based on a percentage of the funds wagered, lost or won. However, the Penal Code does not bar flat fees charged by the House for participation in controlled games. Similarly, § 19984 does not bar flat fee payments from a TPP to a club. Whether these payments are for advertising, services or facilities -- or for marketing, promotions or exclusivity -- all flat fee payments are permitted under § 19984 unless they are a disguised percentage payment. 1

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We see no reason why the TPP can reimburse the club 20% of the cost of a print advertisement, but not 20% of the cost of a promotional coupon. In either case, the amount spent by the club for advertising or marketing is readily ascertainable and the amount of reimbursement provided by the TPP can be evaluated for its reasonability. Likewise, there is no policy reason or rational basis for restricting payments for exclusivity. Exclusive access is a reasonable commercial term for which a licensee ordinarily pays a differential amount, whether it is the exclusive naming rights to a stadium, exclusive sponsorship of an event, or exclusive right to be the only travel agency in a shopping mall.

The regulations should allow reimbursement for marketing, promotions and exclusivity.

1. Sections 19840 and 19841(o) allow the Commission to adopt regulations to administer or enforce the Gambling Control Act ("GCA "), including § 19984. But these sections provide no additional substantive authority for restricting payments; they only allow the Commission to administer and enforce the limitations in §19984.

RESPONSE NO. 70:

See Response Nos. 20 and 23.

DF2:

Regulations should allow reimbursement for marketing, promotions, and exclusivity.

RESPONSE NO. 71:

See Response Nos. 20 and 23.

NM2:

1. Section 12200.7 (e) edits the second sentence to delete the proviso that "no contract provision shall require a registrant or licensee to pay for prizes awarded as a result of promotions." We urge the Commission reinsert this language. Currently TPPP's are required by gambling establishments to fund promotional games for which TPPP's are excluded from the opportunity to win. Versions of Jackpot Poker are notable examples. Requiring TPPP's to pay into the jackpot, but by excluding the TPPP's from winning the jackpot if the TPPP possesses the winning hand renders the game an illegal lottery. In the August 13, 2004 version, the Commission wisely avoided this potential with the quoted language by excluding TPPP's from having to pay, thereby eliminating the club by club and game by game problem of illegal lotteries. Moreover, it removes a group for which the regulations can be challenged.

RESPONSE NO. 72:

The change complained of was made because it was deemed to be a bad example. The conclusion was that the parties should be free to make financial arrangements of their choosing, so long as the broad standard stated in (e) was not violated. The Division retains the power to review specific cases and conclude that they violate the limitation stated in (e).

Section 12200.9 - Review and Approval of Proposition Player Contracts (a)(4), Expedited Review, page 28

MF2:

3. Expedite the Contract Review Process by Allowing Temporary Approval of Contracts Upon Their Submission to the Division (Section 12220.9 (4)—Page 28)

The Commission and the Division are regulating business entities which are engaged in legal business activities in California. These businesses, like all businesses, need to have the ability to quickly respond to changing business conditions if they are to be successful. This is particularly true if an existing proposition player company decides to substantially reduce its presence at a casino. The reduction in proposition player services will have a drastic negative impact on casino revenues. However, even if a second provider can be found, it will be many weeks or even months before the contract review process will result in approval of the agreement. This is true even though the contract written with the second provider meets all criteria of the law.¹

It is suggested that contracts be allowed to go into effect upon submission to the Division. Temporary approval of a contract will not in any manner negatively impact the public welfare. Both parties to any contract are now licensed by the Commission. As the result, any improper activity which might occur pursuant to a defective contract subjects both the casino and the proposition player to sanction by the Commission.

As a practical matter my experience has been that the Division has not rejected contracts. Rather it has required changes in portions of contracts to ensure compliance with state law and regulations. These changes could easily be made retroactively without the lengthy delays inherent in the current process. This change in policy would achieve the same goals as the existing policy

¹ The expedited review process of Section 12100.10A—Page 29, does not apply in such a situation because the existing contract is still in place

but allow the businesses involved the increased flexibility needed to operate in a competitive business environment.

RESPONSE NO. 73:

Section 12200.10A already provides for an expedited contract approval process which meets the specified need (a replacement provider). If the suggestion is that wholly new contracts be allowed to take effect prior to review, the Commission and Division reject that proposed change on the ground that the regulation thus revised would not provide sufficient protection to the public.

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MF3:

3. Expedite the Contract Review Process by Allowing Temporary Approval of Contracts Upon Their Submission to the Division (Section 12220.9 (4)--Page 28)

The Commission and the Division are regulating business entities which are engaged in legal business activities in California. These businesses, like all businesses, need to have the ability to quickly respond to changing business conditions if they are to be successful. This is particularly true if an existing proposition player company decides to substantially reduce its presence at a casino. The reduction in proposition player services will have a drastic negative impact on casino revenues. However even if a second provider can be found it will be many weeks or even months before the contract review process will result in approval of the agreement. This is true even though the contract written with the second provider meets all criteria of the law.¹

It is suggested that contracts be allowed to go into effect upon submission to the Division. Temporary approval of a contract will not in any manner negatively impact the public welfare. Both parties to any contract are now licensed by the Commission. As the result any improper activity which might occur pursuant to a defective contract subjects both the casino and the proposition player to sanction by the Commission.

As a practical matter my experience has been that the Division has not rejected contracts. Rather it has required changes in portions of contracts to ensure compliance with state law and regulations. These changes could easily be made retroactively without the lengthy delays inherent in the current process. This change in policy would achieve the same goals as the existing policy but allow the businesses involved the increased flexibility needed to operate in a competitive business environment.

¹ The expedited review process of Section 12100.10A--Page 29, does not apply in such a situation because the existing contract is still in place

RESPONSE NO. 74:

See Response No. 73.

Section 12200.18 (k) – Revocation/Compliance, page 40

DF1:

a. Page 45, § 12200.21 (a). I believe that this section was supposed to be eliminated. It contains an earlier version of the Compliance section now found at §12212 page 70, including the "preference" language eliminated on page 70. The language in § 12212 on page 70 is the correct language. (Also, § 12220.21 (a), the similar preference language should be deleted.)

b. Page 42, § 12200.18 (k). This section prohibits a TPP from making wagers not authorized by game rules. This is redundant with the § 12212 (a) page 70, which provides that TPP shall comply with "the rules regarding player-dealer rotation and table wagering."

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RESPONSE NO. 75:

- (a) The commenter is correct. This change was made subsequently.
- (b) Subsection is not redundant. It adds a prohibition against making wagers not specifically authorized, thus clarifying the issue.

DF2:

(Redundancy/Drafting) This section allows the revocation of a TPP license for making wagers not authorized by game rules. However, §12200.18 (a) (Page 40) already provides that a license may be revoked for any violation of the regulations, and §12200.21(a) (Page 45), already provides that TPP shall comply with "the rules regarding player-dealer rotation and table wagering." Hence, §12200.18 (k) is unnecessary.

RESPONSE NO. 76:

See Response No. 75.

Section 12200.20 – Annual Fees

MF3:

2. Use of License Fees

My information is that neither the Division nor the Commission has authority to increase personnel until the 2005-2006 budget year. As the result neither agency will be able to actually spend the bulk of the licensing fees paid during the 2004-2005 budget year. Under such circumstances the equitable and perhaps only legal course of action is to suspend collection of license fees which are in excess of what the Commission or the Division can reasonably spend. I do not believe that it is legal for either agency to collect fees beyond their costs.

RESPONSE NO. 77:

In response to concerns such as this one, the regulation has been amended to provide for phasing in over several years. The Division and Commission have authority to spend the money that is collected.

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NM2:

At the outset, we at Network Management, Inc., would like to commend the Commission for making certain substantial revisions in the Proposed *Permanent* Proposition Player Regulations, changes that bring the proposed regulations closer to compliance with California law. Specifically, we note the August 13, 2004 and August 25, 2004 version eliminates the disparate treatment of Third Party Proposition Players ("TPPP") and Gambling Businesses as it relates to fees. Of course, we still contend the fee structure, particularly the Non-Refundable Annual Fee, is legally flawed. However, in lieu of restating our objections, we wish to incorporate by reference our objections and questions set forth in our letter dated July 19, 2004, a copy of which is attached.

RESPONSE NO. 78

See Response No. 6. Only comments addressing changes made in the 15-day change require summary and response.

3. Putting aside for the moment our objection to the size of the Non-Refundable Annual Fee, we believe the notion that the annual fee is *not reduced*, even on a pro-rated basis, if the number of TPPP registrants reduces over a calendar year but will always go up if TPPP registrants *increase*, is fatally flawed. This "heads the Commission wins, tails the TPPP loses" approach lends support to our argument that these fees are driven by the Commission's overall annual budgetary requirements and not by the need to monitor and regulate specific conduct in the TPPP industry at any given moment. We reiterate that the Commission's authority to assess fees are statutorily limited to the cost to defray regulation of the TPPP industry only.

RESPONSE NO. 79:

See FSR, Part A, Section 12200.20 and Response No. 40A. As noted previously, the Commission will begin early next year to review the proposition player regulations with an eye toward making needed changes or improvements, based upon experience. Also see Response No. 31 (Network M registrant count has increased).

NM3:

Annual fee

We are concerned that the annual fee is unauthorized by B&P code § 19984. The Gambling Control Act permits the Commission to impose only those fees necessary to defray expenses. The annual fee is far in excess of any demonstrated amount necessary to regulate the TPPPPS industry. The amount estimated to monitor a TPPPPS worker annually is estimated as

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\$300 per your records in Appendix A. The budgetary allocation (attached) to the Commission and Division for the 2004-05 year indicates that you are budgeted for \$199,000 plus two-and-a-half positions totaling \$117,000 annually to support the increased costs associated with additional regulation of proposition player services. The revenues from the annual fee alone (not including the various registration, contract, badge, etc. fees) exceeds \$5,000,000. It is therefore in excess of the amount reasonably necessary to justify as a fee to defray costs but instead amounts to an unauthorized tax. We question why the fee per registrant increases with the size of the TPPPPS and have not seen any facts or data that supports the imposition of such a fee structure. If anything, the opposite should be true: economies of scale indicate that monitoring multiple employees of a single employer would reduce the cost of monitoring each employee since the Commission should be able to complete more investigations at the same sites and at the same time. There is no data in Appendix A or elsewhere in the rulemaking record that indicates how the Commission arrived at the conclusion that it costs more to regulate employees of larger companies. This appears to illegally discriminate against larger firms.

The per-player fee is higher than the entire per table fee that applies to gambling establishments (Bus. & Prof. Code § 19951 (c)). The only logical interpretation of the disproportionate size of these fees is that a portion of the fee charged proposition players will be used to regulate or supervise gambling establishments. The fees can be used only to defray the costs of regulating TPPPPS, not the gambling establishments and cardroom employees. Instead it appears that the annual fee is being used to subsidize costs of regulation of other, non- TPPPPS businesses beyond that authorized by the legislature.

The lack of information about the Commission's and Division's actual costs is disturbing. There is incomplete information without reference to any underlying data concerning the number of hours and charges to defray the Commission's actual costs of regulating TPPPPS workers. There is no information about how you reached the fee structure proposed in the permanent regulations.

RESPONSE NO. 80:

See FSR, Part A, Section 12200.20 and Response Nos. 1, 5, 25, 31, 32, 35, 36, and 40A.

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Application fee

We have concerns whether the registration fees are authorized by B&P code § 19984. While the Commission and Division are authorized to charge only the actual cost of processing applications, the fee to be imposed is set at \$500 while the cost estimate is \$300 per the Commission (Appendix A). The Commission's explanation for this discrepancy is to note that the Gambling Control Act mandates a registration fee of \$500 for gambling establishment employees, B&P Code § 19951 (Memo from Herb Bolz to Bradley Norris dated July 2, 2004, attached to defendants' opposition to motion for preliminary injunction as exhibit I-I). However, this has led to inconsistent logic: if the Gambling Control Act governs fees charged to proposition players as well, then you may not charge fees far in excess of that amount. If you were applying the Gambling Control Act to TPPPPS industry, you would be limited to charging a per-table rather than a per-worker fee, and to the amounts set forth in § 12200.20(c). If the existing fee structure currently applicable to gambling establishments applies to TPPPPS, how can you rationalize charging fees far in excess of those assessed cardrooms? In addition, the actual process appears duplicative of that already being performed by local authorities in issuing work permits: other than checking photos and requiring a Live Scan, it does not appear that the Commission or Division add anything new to that review. However, the proposed regulations would require TPPPPS players (unlike gambling establishment employees per B&P code § 19912) to pay for an annual permit even if they've obtained a work permit. This is duplicative and unnecessary. There is nothing in the rulemaking record to indicate that it is more costly to regulate proposition players than to monitor cardroom employees.

RESPONSE NO. 81:

B & P Section 19951(a) applies to "every application for a license or approval" under the chapter. By contrast, other Gambling Control Act provisions are expressly limited to cardrooms employees. See, for instance, B & P Code section 19915, which applies only to "work permits," a term defined in B & P Code section 19805(ee)(cardroom employees). The per-table fee provision, B & P Section 19951(c) is expressly linked to "state gambling licenses," as is stated in 19951(b)(2)(B).

The final regulation provides for a two-year period for player registrations.

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Proposition players handle more money than do cardroom dealers. More money means a greater risk of criminal penetration. See Part A, FSR, footnotes 3 and 4. See Response Nos. 32, 32A, and 35.

NM3

Contract review fees

It is unclear how the Commission arrived at the fees charged for contract review. You are permitted to assess fees only as "necessary to defray the costs" of the regulation and oversight. Bus. & Prof. Code section 19984(b). There is nothing in Appendix A that shows how the CGCC arrived at the actual costs of those activities. It is hard to believe that an alteration as simple as a new date change actually costs the Commission \$500 to review (§ 12200.11 (a)(2)(d))[sic], the same amount as reviewing a new contract (§12200.9(a)(3)(E)) assuming an additional deposit is unnecessary. What are the specific costs that justify these fees? Do any of these costs overlap the non-refundable annual fee? Similarly, the additional \$450 charged for expedited review is undocumented. If it takes additional man-hours to review a contract on an expedited basis, those work hours are presumably later saved when the review does not occur on the normal schedule; in other words there is no showing in the rulemaking record that additional hours must be spent to perform an expedited review, rather that those hours will be used earlier rather than later.

RESPONSE NO. 82:

See FSR, Part A, Section 12200.20 and Response Nos. 1, 25, 29, and 81.

The \$500 fee for an application for approval is mandated by B & P Code section 19951(a). See Response Nos. 25 and 29.

The costs associated with an application for expedited review and approval of a contract have been substantially changed. Specifically, the cost for an expedited review has changed from a \$550 processing fee to a \$150 processing fee and a \$360 deposit.¹⁵ Cost data supporting the \$150 fee is

¹⁵ Section 12200.10A states that the deposit shall be in an amount to be determined by the Director of the Division. In Title 11, CCR, section 2037(a)(2)(E), a Division regulation specifies the deposit as \$360. Section 2037(a) further provides that an additional deposit may be required if the actual costs of the review exceed the \$360 deposit.

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shown in Section 9, Tab C of the rulemaking record: the document is headed "Nonrefundable Processing Fee for Expedited Review." As pointed out in that cost data document, part of the cost consists of overtime pay.

The \$150 is used to determine if the contract meets the criteria for an "expedited contract review." Among other things, the contract must be reviewed line by line to ensure that the document is indeed substantially identical to a previously approved contract. Any time spent conducting the review after that initial determination, whether the contract is deemed to qualify for expedited review or must go through the normal review process, is billed against the \$360 deposit. Any unused portion of the \$360 deposit is refunded. Additional monies will be required if the actual costs of the review exceed the \$360 deposit. See footnote 15.

NM3

STD 399 Economic Impact form / Regulatory Notice Register

On what basis do you conclude in STD 399(A)(1)(a) that there will be no negative economic impact on businesses or employees resulting from these regulations? In light of the fees exceeding \$5M annually in an industry that has only 1,400 players, how can this conclusion be reached? What economic impact studies does the Commission have? Similarly, the Commission has concluded that the regulations will not result in any reduction of jobs in California. (STD 399 (A)(1)(c)). What data is this conclusion resting on? Especially in light of the delay in time before employees can begin working coupled with fees of thousands of dollars per worker -why wouldn't these regulations result in job losses?

In the notice of the proposed regulations, you wrote:

"The Commission has made an assessment and determined that the adoption of the proposed regulation will neither create nor eliminate jobs in the State" *California Regulatory Notice Register* 2004, vol. no. 24-Z, p. 767.

Where are the data, research and reports which reflect this assessment? Nothing in the rulemaking record reflects that the statement made in the notice register is based on any data, facts or reports, as required by the Administrative Procedures [sic] Act. Instead, it appears that the required analysis of costs and benefits was never performed by the Commission.

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On the other hand, the published notice of the proposed regulations acknowledges that there will be a significant negative effect on small businesses:

"The Commission has made the following initial determination: insofar as proposition player companies are small businesses, these companies will be required to pay substantial annual fees to defray the costs of providing regulation and oversight. The Legislature has directed that this program be fully supported by fees." *California Regulatory Notice Register* 2004, vol. no. 24-Z, p. 767.

What information, data or reports did the Commission or the OAL (Office of Administrative Law) use to reach this conclusion? Why would there be a negative effect on small businesses but not on the industry generally? Why weren't the initial and annual costs to small businesses estimated in STD 399 (B)(1) as required? Why are they not part of the rulemaking record as required?

Similarly, on what basis do you conclude that the regulations will not have any impact on California competitiveness? (STD 399(A)(1)(d)) Since you acknowledge that the fees are "substantial," what data, facts or reports do you have to demonstrate that there will be no impact on California competitiveness? The required cost/benefit analysis implicit in STD 399 has not been performed, for example:

What are the total statewide dollar costs that businesses and individuals may incur over the lifetime of this regulation? STD 399(B)(1) requires an estimate, but you left this section of the form blank. What cost estimates do you require?

What are the estimated dollar benefits of this regulation over its lifetime? STD 399 (C)(3) requires an estimate, but you left this section blank. What estimates do you have?

What are the alternatives to the proposed regulation? STD 399(D) requires an estimate, but you left it blank. What alternatives were considered?

The costs to California businesses of this regulation will presumably exceed \$10M (since it appears to do so in its first two years alone) -why did you fail to note that in the STD 399 statement? STD 399(E). For each such regulation, you must create total cost scenarios along with cost-effectiveness ratios of the proposed regulation along with alternatives. Where are these calculations?

The entire rulemaking record consists of only five pages. It contains nothing to show the actual costs, direct or indirect, to the industry, to the State of California or to employers and workers. There's nothing to show the kind of

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cost/benefit analysis, consideration of alternatives, and supporting reports, data and analysis required by law. Where is the data, reports and analysis that would support the need and benefits of the proposed regulation?

The notice states that

"The Commission finds that it is necessary for the public health, safety, or welfare of the people of this state that these regulations that require a report apply to businesses." *California Regulatory Notice Register* 2004, vol. no. 24-Z, p. 767. .

Since the rulemaking record consists of only five pages, none of which deal with the regulations' necessity, how did you reach the conclusion that these regulations are necessary for public health and safety? How are you able to do so without any supporting information in the rulemaking record?

The California APA (Administrative Procedures [sic] Act) requires that the Commission's record of comments received be made available so that the public can have a meaningful opportunity to consider the proposed rule. Yet you have failed to make the comment record available to us until after the public hearing of August 5, 2004 despite numerous telephone calls, faxes, and two letters (7/15/04; 7/25/04) over a three-week period coupled with our willingness to pay copying costs. How does the public have a meaningful opportunity to read and consider the public file when the Commission won't make it available?

The APA requires that the Commission make available all of the data, facts and reports upon which the proposed regulations are based. Yet when we asked for information about the Commission's and Division's budget, costs and revenue, the Commission (per Susie Hernandez) declined to do so unless we made a demand pursuant to the California Public Records Act, Gov. Code § 6250 et seq. How can this obfuscation be reconciled with the obvious goal of the APA, i.e. to provide public access to public information? Why wasn't such information part of the rulemaking record, since it should have been considered before the fee structure could have been created?

We remain concerned that the fees are excessive in that they do not reflect the actual costs of regulating the industry. The adverse impact of this costly regulation has not been investigated or reported as required by the Administrative Procedures [sic] Act, and thus has been ill-conceived and ill-managed. We hope to work with you to ensure regulation of an important California industry without an unnecessary and burdensome fee structure.

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RESPONSE NO. 83:

General

See FSR, Part A. See Response Nos. 1, 31, 34, 35, 38, and 40A.

Economic/fiscal impact

All assessments and determinations required by the APA have been made. See, for instance, page 35 ("Determinations") of this Final Statement of Reasons. The Commission completed the "fiscal impact" part of the Form 399; the Form 399 as completed by the Commission was formally signed and approved the Department of Finance on December 10, 2004. See Section 12, Tab F of the rulemaking record. The APA does not require completion of the "economic impact" part of the Form 399. In any event, it became clear early in the process that representatives of the regulated public were going to personally attend Commission rulemaking meetings and also submit impact data in writing. And, indeed, the record of this proceeding contains a great deal of information about the economic impact of the regulations on the provider industry. Some of the economic impact arguments and data have been submitted a dozen or more times. This material has all been reviewed and considered in process of developing the final regulations. Significantly, it appears from current data that Network M has added jobs since the annual fee took effect. See Response No. 31.

Delay in bringing employees on

The regulations have been amended to provide for temporary registrations. See Final Statement of Reasons, Part A, Section 12203.1 and Response No. 9.

Access to the rulemaking record

All Public Record Act and other access requests were dealt with appropriately. The Commission has taken extraordinary steps to maximize the opportunity for public input. For instance, the text of the first 15-day change was made available for public comment three times: (1) several days prior to the Commission meeting, (2) during the Commission meeting at

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which staff recommended approval, and (3) during the 15-day APA comment period. Similarly, though Network M missed the comment deadline for the third 15-day change, the Commission nonetheless summarized and responded to that late comment.

Section 12200.20 – Exclusion of Investors from License Fee Calculation, page 43

MF2:

4. Exclusion of Investors from License Fee Calculation (Section 12200.20—Page 43)

The rationale behind the existing fee calculation formula appears to be that a company with more registered or licensed persons generates more money and thus can afford to pay a higher rate of tax. While this may be true for a gambling establishment because in theory more tables means more revenue, it is not always true for proposition player companies.

The measure of revenue generation for a proposition player company is not the number of persons who are licensed but rather the number of persons employed by it who are actually involved in the play of games. In theory the more supervisors, players and other employees in a gambling establishment, the more tables which will be covered and the more revenue which will be generated.

However, many companies also have a large number of non employee small investors who are not players and who have no role in any of the activities of the company. Under the current regulations, these individuals are also counted when determining license fee levels. The result is that a company with many small investors, which helps to protect the public welfare as discussed above, is put at a disadvantage as regards a company with one major investor because it pays a higher license fee based on non productive registrants.

Unless investors are excluded from the license fee computation, this unfair situation alone may force companies to resort to a few large investors rather than many small investors. **Section 12200.20 should be amended to exclude from licensing calculations investors who are not players, supervisors, primary owners or other employees.**

RESPONSE NO. 84:

See Response Nos. 32 and 32A.

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MF3:

4. Exclusion of Investors from License Fee Calculation (Section 12200.20—Page 43)

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Lucky Chances would like to offer this game to its patrons. It has waited more than a year for a response from the Division.

5. Additional Comments

RESPONSE NO. 85:

See Response No. 84.

Section 12201(d)

This section dealt with the issue of ownership.

HJR:

The longstanding public policy of this state disfavors the business of gambling. The California Gambling Control Act was enacted to ensure that gambling is free from criminal and corruptive elements and that it is conducted honestly and competitively. There is no legitimate reason for allowing casinos to derive what will undoubtedly be significant profits from controlled gambling, as these regulations now condone. As drafted, the emergency regulations create an environment that is conducive to collusion

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between casinos, who are now free to enter into agreements with each other to provide reciprocal proposition player banking services.

Gambling registration regulations adopted under Business and Professions Code Section 19984 should tightly control proposition player providers, as the letter and spirit of the Gambling Control Act requires. The emergency regulations unlawfully expand the opportunities for gaming establishments to profit from controlled gaming. As a consequence, the Commission should vote to deny gambling licensees the right to operate proposition player businesses and opt for “option three: to proposed section 12201(d).

RESPONSE NO. 86:

See FSR, Part A and Response No. 88.

Mohr:

We are outraged by your recent failure to adopt regulations prohibiting card house ownership from operating third-party proposition player businesses. The gambling industry, more than any other publicly sanctioned enterprise, is rife with corruption and criminal conduct. Rather than meeting your duty to combat such corruption, your decision not to act decisively and prohibit gambling licensees from owning banking businesses will foster corruption and collusion between card houses.

As Christians, we believe that gambling subverts a strong work ethic and leads to idolatry and greed. We read in Romans 13 that government is to be a minister of God. Government should provide order in society and promote public virtue. Legalized gambling undercuts government's role and subverts the moral fabric of society through greed and selfishness promoted by a state-sponsored vice.

Simply put, gambling is bad social policy; it is bad economic policy; and it is bad governmental policy. Moreover, it undermines the moral foundations of society and invites corruption in government. As Christians, we believe we must stand firm against attempts made by the fringe elements of society to further expand the fundamental sin of gambling. We therefore implore you to enact regulations that prohibit gambling establishment owner from banking card house gaming by voting for option three to proposed Section 12201(d).

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RESPONSE NO. 87:

See FSR, Part A and Response No. 88.

M2:

This letter is written to comment upon changes adopted by the Commission relating to the proposed *permanent* proposition player regulations. In particular, we object to the Commission's decision to implement "option one" to Section 12201(d), instead of one of the choices stated within "option three" of proposed section 12201(d).

As you are aware, option one to 12201(d) expressly allows gambling licensees to register to provide proposition player services, as long as the licensee does not perform such services in a house in which he holds an ownership interest. By choosing option one, the Commission has unlawfully "altered, amended and enlarged" the scope of the California Gambling Control Act and transgressed over a century's worth of California jurisprudence prohibiting card house ownership from profiting in any way from wagers made in card games. *People v. Carroll* (1889) 80 Cal. 153. The Commission has yet to articulate a legitimate explanation for its departure from long established California gaming law prohibiting house banking. Therefore, the decision does not appear to have been reasonably necessary to effectuate the purposes of the Gambling Control Act, and instead was an arbitrary decision, made without substantial basis.

Below, we will address certain procedural deficiencies relating to the Commission's recent 15 day changes to the proposed permanent proposition player regulations. Thereafter we will demonstrate exactly how the proposed changes to Section 12201(d) will violate the Gambling Control Act, the Penal Code, the California Constitution and long established case law. Finally, we will present evidence that we have discovered during the course of our investigations that we feel should compel the Commission to change its position and vote to preclude allowing gambling licensees to operate as proposition player providers in any respect.

I.

THE ADOPTION OF OPTION ONE TO 12201(d) WAS PROCEDURALLY DEFECTIVE

At the outset we would like to highlight the fact that the Commission appears to have attempted to disguise or cloak their decision to adopt option one to Section 12201(d), in order to avoid further public scrutiny relating to their controversial decision to expand gambling in California. In this regard, the Commission has undertaken the following course of conduct:

(1) The Commission intentionally failed to give adequate notice that it planned to vote on Section 12201(d) during the August 24, 2004 meeting, instead only generally stating within the August 24th meeting agenda that they intended to take up unspecified 15 day changes to the regulations.

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(2) The Commission purposefully provided the public with an ambiguous 15-day change document that did not clearly indicate that the Commission had voted to adopt option one to Section 12201. In particular, the introductory paragraph of the document states; “[p]ursuant to the Administrative Procedure Act, changes to the text as originally proposed are shown in double strikeout/double underline style. Despite this statement, the alternative options rejected by the Commission were not presented in the body of the document in strikeout or double underline style, leaving one to reasonably conclude that they had not been deleted. Further, within the change notice itself at section 12201(d), the Commission placed a footnote that ambiguously stated: “In the original text, three alternatives were presented for subsection (d). Alternative (1) is shown here.” This ambiguous statement could easily lead one to conclude that the other choices were omitted simply to conserve space and that they had not yet been voted upon.

In fact, this was my interpretation when I first reviewed the document. Furthermore, when I first spoke to the Commission’s attorney, Peter Kaufman, about this issue he admitted that he had not yet reviewed the document and did not know what the language meant. Further, he indicated he would inquire with you and get back to me. However, when Mr. Kaufman first got back to me, he left a message stating that neither the Commission or he was willing to respond to my inquiry and advise me if a vote had been conducted. It was only after I pressed Mr. Kaufman further did he finally relent and inform me that a vote had in fact been taken adopting option one.

(3) The Commission also has failed to follow its normal custom and practice of timely updating its website with the minutes from the August 25, 2004 meeting. In fact, as of this morning, these minutes have still not been posted on the internet. One can only assume that the Commission chose this tactic in order to make it more difficult for the public to learn of its decision to adopt option one. I know that after I read the ambiguous agenda for the August 25th meeting, coupled with the misleading 15 day change notice, without the availability of meeting minutes to refer to, I had no idea if any action had been taken on Section 12201(d). Further, if Mr. Kaufman would have stood fast in his refusal to tell me what actions the Commission had taken, I still would not know the status of the proposition player regulations. Therefore, it appears that the Commission’s 15 day change notice was procedurally defective and in violation of procedural due process.

II.

SECTION 12201(d) IS CONTRARY TO ESTABLISHED GAMBLING LAW BECAUSE IT WILL ALLOW CASINO OWNERS TO PROFIT FROM GAMING

A. The California Constitution § 19(e) and Penal Code § 330 Prohibit Card Houses from Offering Banked or Percentage Games.

In 1984, the California Constitution was amended by ballot initiative to state a fundamental public policy against the legalization in California of casino gambling of the sort commonly associated with Las Vegas and Atlantic City. California Constitution, article IV, section 19(e). The court has interpreted this enactment as elevating existing statutory bars prohibiting card houses from offering “banked” or “percentage” games, such as they have in Las Vegas, to a new constitutional status. *Hotel Employees and Restaurant Employees Intern. Union v. Davis* (1999) 21 Cal.4th 585, 605.

The term "banked game" has come to have a fixed meaning: "the 'house' or 'bank' is a participant in the game, taking on all comers, paying all winners, and collecting from all losers." *Sullivan v. Fox* (1987) 189 Cal.App.3d 673, 678. The bank thus has the ". . . status as the ultimate source and repository of funds dwarfing that of all other participants in the game. *Id.* at p. 679.

In a percentage game, the house has a more passive role; "[w]here the house is not directly participating in game play, it can still be involved if it collects a percentage from the game. This percentage may be computed from the amount of bets made, winnings collected, or the amount of money changing hands." *Id.*

The *California Constitution* and *Penal Code* therefore establish a bright line rule that the house shall not profit in any way from gaming wagers. As stated in *Walker v. Meehan* (1987) 194 Cal.App.3d 1290, at p. 1296: "the legislature must have intended that the house not link its earnings to the profits derived from gambling, whether or not it participated as the banker." Because card houses are prohibited from banking or otherwise profiting from gaming action, these establishments are essentially limited to charging "rental fees" to patrons for the right to occupy a space at the gambling table to participate in card play. *Sutter's Place, Inc. v. Kennedy* (1999) 71 Cal.App.4th 674, 687. This restriction curbs the proliferation of large, "Vegas styled" casinos, as mandated by the People of this State in enacting the Constitutional amendment at § 19(e). In addition, this restriction helps to ensure the integrity of controlled gaming in our state.

B. *Business and Professions Code § 19984 of the Gambling Control Act Prohibits Card House Owners from "Directly or Indirectly" Profiting from Gaming, but Grants Card House Owners the right to Contract with Third-Party Proposition Player Providers who in Turn may Fund Gaming.*

As a result of the fact that banking games are illegal in California, one player may not function as the bank throughout the course of card games "taking on all comers, paying all winners, and collecting from all losers." Instead, California law requires that the banking position systematically and continually rotate amongst the players seated at the table. *Penal Code* § 330.11. To fund play when a given patron elects not to act as the banker, the Legislature has granted card houses the authority under the Gambling Control Act to contract with *independent*, third-party "proposition player" service providers, who may step in and fund game play in the place of the respective patron. *Business and Professions Code* § 19984.

Section 19984 was specifically adopted in reaction to court holdings that called into question the legality of all player-banked games.¹ The legislative history of Section 19984 establishes that its enactment was merely intended to preserve the *status quo* by keeping in place the decade old industry practice of allowing independent proposition players to fund card games in order to facilitate uninterrupted play.

As their title implies, third-party proposition player providers must be completely independent from gambling establishment ownership. In fact, under the express language of Section 19984(a), a **gambling establishment or house is strictly prohibited from profiting, directly or indirectly, from "funds wagered, lost, or won" through cardhouse play.** In addition, the term "house" is defined broadly within the Gambling Control Act to include all "owners, shareholders, partners, key employees and landlords" of each gambling establishment. (*Business and Professions Code* § 19805(q).)

¹ See *Oliver v. County of Los Angeles* (1998) 66 Cal.App.4th 1397 and *Kelly v. First Astri Corp* (1999) 72 Cal.App.4th 462.

The Commission admits that the controversial proposition player regulations it has enacted actually grant card house owners the right to provide proposition player services in gambling establishments in which they do not hold an ownership interest. These regulations, therefore, violate Section 19984, because they permit the "house" to indirectly, if not directly, profit from funds wagered, lost or won. As a result, the emergency regulations illegally "alter, amend and enlarge" the scope of the Gambling Control Act by granting house owners the right to bank card games.

The Commission has attempted to support their decision to allow house owners to profit from gambling by relying on a Legislative Counsel opinion dated April 11, 2001, that former Commission Chief Counsel, Peter Melnicoe, obtained from his former (and now current) superiors. (Exhibit "1") This opinion relies upon an unreasonable and strained interpretation of the Legislature's use of the clauses "a gambling establishment" and "the house" within Section 19984(a). According to the opinion, because the Legislature expressly modified the phrase "gambling establishment" with the indefinite article "a", it intended that no gambling establishment derive profits from gambling at any location. However, the opinion goes on to conclude that because the Legislature modified the term "house" using the definite article "the", it only meant to limit house owners from profiting from funds wagered, lost, or won, within their own establishments, and did not intend to preclude gambling establishment owners from profiting from gaming in other establishments in which the owner does not hold a direct ownership interest.

When interpreting the meaning of a statute, however, one must "give effect to the manifest objectives of the legislation, which appear from the provisions considered as a whole, in light of the legislative history and public policy considerations." *Masonite Corp. v. County of Mendocino Air Quality Management Dist.* (1996) 42 Cal.App.4th 436, 444. The court in *Santa Barbara County Taxpayers Assn. v. County of Santa Barbara* (1987) 194 Cal.App.3d 674, at p. 680, establish that the one is to construe the substance of a statute over its literal and strict form when it held as follows:

One of the oldest and most fundamental canons of statutory construction is that once the purpose of the legislation has been ascertained, it must prevail over a strict, literal reading, unless the statute cannot be viewed any other way. (Citations.) One ferrets out the legislative purpose of a statute by considering its objective, the evils which it is designed to prevent, the character and context of the legislation in which the particular words appear, the public policy enunciated or vindicated, the social history which attends it, and the effect of the particular language on the entire statutory scheme.

The interpretation of a statute should be practical rather than technical, so as to lead to a result of wise policy rather than to "mischief or absurdity". *Unemployment Reserves Commission v. St. Francis* (1943) 58 Cal.App.2d 271, 280. Stated otherwise, it is the duty of the courts, whenever possible within the framework of the statutes passed by the legislature, to interpret statutes so as to make them workable and reasonable. *Regents of University of California v. Superior Court* (1970) 3 Cal.3d 529, 536-537.

House banking has been illegal in California for over 150 years and has been specifically prohibited by the California Constitution since 1984. *Ex Parte Williams* (1932) 127 Cal.App. 424, 427-429; *California Constitution* article IV, section 19(e). In enacting the Gambling Control Act, the Legislature stated that nothing within the Act was to be construed, in any manner, to reflect a legislative intent to relax established gambling law and that the Act was not enacted to expand opportunities for gambling businesses. Sections 19801(a) and 19801(e). The Commission's proposed interpretation of Section 19984, as authorizing house owners to profit from gaming would, however, clearly alter, enlarge and abridge the gambling laws and would expand legalized gambling in California.

When interpreting Section 19984, the real emphasis should be upon the Legislature's proclamation within the final clause of Section 19984(a), that "the house" shall in no event have an interest, "whether direct or indirect," in funds wagered, lost, or won. Clearly, if a gambling house owner provides proposition

player services in a gambling establishment in which he does not own an interest, "the house" is at least indirectly, if not directly, profiting from funds wagered, lost, or won. Therefore, the Legislative Counsel's after-the-fact interpretation and justification for allowing house owners to bank gaming appears to clearly be invalid. As a consequence, the Commission should vote to preclude gambling licensees from registering proposition player providers.

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III.

GAMBLING ESTABLISHMENT OWNERS HAVE DECLARED THAT AS A RESULT OF THE ADOPTION OF THE EMERGENCY REGULATIONS THEY INTEND TO SEIZE CONTROL OF THE THIRD-PARTY PROPOSITION PLAYER INDUSTRY

The fact that proposed Section 12201(d) will greatly expand the opportunities for gambling licensees to profit from card house gaming in California was highlighted during the recent deposition session of state gambling licensee, Mr. Haig Kelegian. Mr. Kelegian owns and operates Commerce Casino, the largest cardhouse in California, as well as Oceans Eleven Casino and the Bell Gardens Bicycle Club Casino. Mr. Kelegian was also intimately involved in formulating the registration regulations as a leading member of the Commission's Gaming Policy Advisory Committee.

During his deposition, Mr. Kelegian stated that he has continually "reminded" various Commission members that proposition player providers "are a cancer in the gaming industry and . . . the sooner we can get rid of the bankers, the better off we are." (Kelegian Tr. 40:14-42:12, Exhibit "2".) Mr. Kelegian further testified:

The topic (of proposition players) always comes up with me. Every opportunity I get whether I'm having dinner with the attorney general or whether I'm meeting the governor's staff or I'm meeting people from the Commission . . . I keep repeating it, I get up publicly and I say it and I get up publicly and talk about they're a cancer and I don't stop.

(Kelegian Tr., 45:10-17; Exhibit "2")

Mr. Kelegian then brazenly asserted that it was his plan to "provide proposition player services for every single casino in the state that I'm not an owner of." (Kelegian Tr. 47:7-48:1, Exhibit "2".) Mr. Kelegian concluded by pronouncing that he was also interested in entering into a reciprocal banking relationship with the ownership of Artichoke Joes Casino, located in San Bruno, California. Under such an arrangement, Mr. Kelegian would provide proposition player services for Artichoke Joes and in return Artichoke Joes would bank gaming at the Bicycle Club owned by Mr. Kelegian. *Id.* This is the very type of business relationship that the Gambling Control Act was meant to protect against.

Mr. Kelegian is perhaps the most powerful card house owner in the state. As a result, his statements described above must be taken very seriously. If Mr. Kelegian's plans ultimately do come to fruition, there can be no doubt that casino gambling in California would be substantially equivalent to the house banked casinos of Las Vegas and Atlantic City. We hope the Commission will not stand by and allow such a result.

2

When Commissioner Palmer was subsequently asked whether Mr. Kelegian's plans to take over the proposition player industry would be allowable under Section 12201(d) as now configured, Commissioner Palmer answered affirmatively. (Palmer Tr. 26:5-12, Exhibit "3")

[sic]

can be no doubt that casino gambling in California would be substantially equivalent to the house banked casinos of Las Vegas and Atlantic City. We hope the Commission will not stand by and allow such a result.

IV.

CONCLUSION

Reverend Sheldon and the Traditional Values Coalition fully support the adoption of reasonably tailored regulations to combat the types of serious criminal activities that the regulations were meant to guard against. However, the Commission's adoption of regulations that authorize house banking represents an "end run" around the expressed will of the people of California who overwhelmingly passed the Constitutional amendment prohibiting Las Vegas styled house banked games. The Commission should reconsider its position and choose to adopt one of the choices under option three to Section 12201(d), which would preclude card house owners from profiting from card play.

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RESPONSE NO. 88:

The legal arguments of the Reverend Sheldon (represented by Sean T. McGee of Mahaffey & Associates, author of this comment letter) were rejected by the Los Angeles Superior Court in the minute order dated Nov. 24, 2004 in Sheldon v. California Gambling Control Commission (included as Attachment 9), which denied the petition for writ of mandate.

See Final Statement of Reasons, Part A, section 12201(d). See April 11, 2002 Legislative Counsel Opinion No. 5175-Gambling: Proposition Players, Appendix 1 to FSR Attachment 4. See earlier responses, especially Response Nos. 1, 2, 65.

The commenter complains about possible future plans of a Mr. Kelegian. This matter concerns a hypothetical application of the regulation. The Division of Gambling Control is responsible for reviewing applications for approval of contracts under Section 12200.9(a)(1)(D). This provision states that the Division shall approve a contract only if four specified requirements have been satisfied. The fourth requirement is that:

"The contract will not undermine trust that the controlled gambling operations covered by the contract will be conducted honestly, by reason of the existence or perception of any collusive arrangement between any party to the contract and the holder of the state gambling license, or otherwise."

Section 12200.9 thus provides specific protections against the alleged problems outlined in the comment. The Commission submits that the regulation as proposed fully satisfies all relevant legal requirements. Appropriate administrative actions will be taken in the future. Parties in disagreement with specific actions taken in the future under the regulations are free to seek judicial review under B & P Code section 19804.

Section 12220. Definitions, page 91

MF2:

2. Licensed Third Party Providers Who Also Act as a Gambling Business Should Only Require One License (Chapter 2.2 Section (b) (10)—Page 91)

On some occasions entities which are registered/licensed as providers of third party proposition player services may also operate in gambling establishments with which they do not have a contract. Such entities are fully compliant with the proposition player regulations and their employees are fully registered with the Commission. To require that such an entity register/be licensed twice makes no sense in terms of public policy and raises serious questions as to whether or not such a requirement is truly authorized by the Gambling Control Act.

The regulations should make it clear that an entity registered/licensed as a provider of third party proposition player services may also engage in non contract activities as a gambling business.

To clarify this issue it is suggested that the draft regulations be amended to:

- 1) Amend Section 12200 (b) (10) (Page 91) to expressly exclude from the definition of gambling business proposition player companies which also operate at gambling establishments with which they have no agreement or contract;
- 2) Require that licensed/registered proposition player companies file with the Commission a form notifying the Commission when they have a presence in a gambling establishment without any agreement with the establishment.

RESPONSE NO. 89:

The regulation was amended to accommodate one underlying concern reflected in the comment: payment of duplicate annual fees. See Final Statement of Reasons, Part A, section 12220.20A. It is appropriate to require a separate license application because operating a gambling business under Chapter 2.2 is a separate and distinct activity from providing proposition player services under Chapter 2.1. Eliminating duplicative annual fees takes care of the core problem.

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MF3:

2. Licensed Third Party Providers who also act as a Gambling Business Should Only Require One License (Chapter 2.2 Section (b) (10)—Page 91)

On some occasions entities which are registered/licensed as providers of third party proposition player services may also operate in gambling establishments with which they do not have a contract. Such entities are fully compliant with the proposition player regulations and their employees are fully registered with the Commission. To require that such an entity register/be licensed twice makes no sense in terms of public policy and raises serious questions as to whether or not such a requirement is truly authorized by the Gambling Control Act.

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RESPONSE NO. 90:

See Response No. 89.

Section 12220.21 (a) – Preferences, page 109

DF2:

Page 109, §12220.21 (a) contains "preference language" already eliminated in Chapter 2.1. We previously discussed that what is a "preference" is vague and undefined.

RESPONSE NO. 91:

This language was deleted. See Response Nos. 49 and 51.

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Part-Time Workers

MF3:

Part Time Workers—The existing licensing fee process discriminates against part time employees. These individuals are often college students who work on weekends. It is doubtful that part time workers will be used in the future given the high costs associated with counting them toward the licensing fee even though they work only a few hours a week. This problem can easily be solved by basing licensing fees not on the number of actual employees but on the number of full time equivalent employees working for a provider. The full time equivalent concept is widely used in business and easy to calculate.

RESPONSE NO. 92:

The same amount of State time (to review applications, conduct background investigations, and evaluate candidates for licensure) must be spent on part-time employees as on full-time employees.

Criminal Activity

MF3:

3. Absence of Criminal Activity

Although it may be a moot point, I believe that the Commission should clarify the record regarding the allegations made in relation to the emergency regulations that proposition player businesses were a threat to the public safety because of the presence of criminal activity in their operation. Reports relating to criminal activity at card rooms of which I am aware do not support that allegation. The allegations were based, I believe, on speculation, not fact. The Commission should not be involved in making unfounded generalized accusations against persons against persons engaged in a legal business in California.

RESPONSE NO. 93:

The Commission defers to the two law enforcement agencies that submitted comments expressing strong concerns about criminal activity. See Final Statement of Reasons, Part A, footnote 3. Much of the underlying information could not be revealed in order to avoid jeopardizing ongoing investigations.

PART B, SECTION 3. COMMENTS ON REGULATION, SECOND 15-DAY COMMENTED PERIOD, SEPTEMBER 30, 2004 – OCTOBER 21, 2004

No comments were received during the public comment on the second 15-day change.

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PART B, SECTION 4. COMMENTS ON REGULATION,
THIRD 15-DAY COMMENT PERIOD, OCTOBER 13, 2004 –
OCTOBER 29, 2004

**Third 15-Day Comment Period
October 13, 2004 – October 29, 2004**

The third 15-day change concerned only the annual fee sections, 12200.20 and 12220.20.

No comments were received during the comment period. However, one late comment did arrive on Monday, November 1, 2004, from Network M. This late comment is summarized below:

Network M's comments concern 12200.20. Network M appreciates the Commission's revision, which places all proposition players on an equal ground, regardless of the size of the firm for which they work. Network M contends that the proposed fees still exceed the amount that the Commission and Division actually spend or are authorized to spend and are therefore excessive.

Network M notes that the costs rise from fiscal year 2004-5 at \$1,750 per registrant to \$2,500 per registrant in fiscal year 2006-7. The company states that it is unexplained in the "materials relied upon" why it will take 24 hours to conduct compliance and enforcement in 2004-5, but will rise to 34 hours in 2006-7. Network M argues that the "reverse engineering" of fees is an attempt to generate revenue to fill budget shortfalls incurred in other compliance activities and urges the Commission to look at actual expenses authorized by the state legislature and to impose fees consistent with that level of regulation.

Finally, Network M suggests that there was not enough review time (eight rather than 15 days) under section 45 of the California Code of Regulations for the "materials relied upon" before the final Commission vote on October 29, 2004.

RESPONSE NO. 94:

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The Commission rejects the assertions that the reduced, flat, phased-in annual fees are unauthorized or excessive or were calculated improperly. The fees are needed to protect the public from criminal or corruptive influences. The Commission has demonstrated the necessity of the fees, thus satisfying the applicable APA requirement. See Final Statement of Reasons, Part A, section 12200.20 and earlier responses to comments regarding these fees. The fees were reduced in order to diminish any arguably adverse impact on business and were phased in to provide time for contracts to be revised to reflect the annual fees as a cost of doing business. Phasing in will also allow time for the State to hire the personnel required to perform the enforcement function.

The Commission rejects the argument that the procedure followed in issuing the "new data" notice violated applicable law by not allowing "the required 15-day review" of materials relied upon. Network M stated that failure to allow 15 days to review material relied upon violated "California Code of Regulations section 45." There are two flaws in this argument.

First, the cited OAL regulation (Title 1, CCR, section 45) was repealed in December 2000. A repealed regulation cannot be violated. If the intended reference was, however, to OAL regulation 44, then the argument stills fails because section 44 applies to changes to regulation text, not to material relied upon. Here, we are dealing with cost data supporting the amount of the annual fee, not with the wording of the regulation.

Second, the correct citation to the applicable law (as was indeed noted in the "new data" notice) is Government Code section 11347.1, added to the APA by Statutes of 2000, Chapter 1059, which was drawn from former OAL regulation 45.

The Commission satisfied the requirements of the applicable law.

Section 11347.1 clearly requires the adopting agency to provide to specified persons:

"At least 15 calendar days before the proposed action is adopted by the agency, . . . a notice identifying the added document and stating the place and business hours that the document is available for public inspection." (Emphasis added.)

The Commission provided the mandated notice on October 13, 2004, specifying 5 p.m., October 28, 2004 as the comment deadline. See Tab A of Section 10. This October 13 notice provided a 15-day notice of availability, satisfying the statutory requirement.

Though Government Code section 11347.1 merely requires the adopting agency to make the documents available in the agency offices, the Commission took the additional step of faxing the document to Network M. The document was available for public inspection from October 13 through October 28 (and thereafter), satisfying the statutory requirement. Network M concedes that it received the requested document from the Commission on October 21, eight days before the regulations were to be considered at the October 29 Commission hearing. The fact that Network M filed a written comment concerning the new cost data suggests that the company had adequate time to review the data. Also, a Network M representative attended the October 29 meeting at which the regulations were adopted, and could easily have brought any concerns to the attention of the Commission in an oral comment, but did not do so.

Thus, the Commission satisfied both the letter and spirit of the APA requirement (Government Code section 11347.1) by providing adequate notice to the public. Opportunities were provided for both written and oral comments.

ATTACHMENTS TO THE FINAL STATEMENT OF REASONS

ATTACHMENT 1: July 2, 2004 memorandum from Herb Bolz, to Bradley J. Norris, OAL, re: Response to Comments received concerning Readoption/amendment of Proposition Player Emergency Regulations

APPENDIX A: August 19, 2003 letter to Commission from Richard Teng, San Jose Police Department

APPENDIX B: February 24, 2004 letter to Commission from Robert Lytle

APPENDIX C: Proposed Categories, Fees, and Costs for Third Party Providers of Proposition Player Services and Gambling Businesses

ATTACHMENT 2: TPPPPS Costing for Transfer, Reinstatement or Additional Badges Transactions

ATTACHMENT 3: Annual Fee for TPPPPS and Gambling Businesses

ATTACHMENT 4: March 3, 2004 memorandum from Herb Bolz to Bradley J. Norris, OAL: Response to Comment received concerning Readoption of Proposition Player Emergency Regulations

APPENDIX 1: April 11, 2002 Legislative Counsel Opinion # 5175 – Gambling: Proposition Players

ATTACHMENT 5: Declaration of Bob Lytle

ATTACHMENT 6: Senate Floor Analysis of AB 1416

ATTACHMENT 7: Chaptered Bill: AB 1416, Statute 2000, Chapter 1023

ATTACHMENT 8: Senate Operations Governmental Committee's Analysis of AB 1416

ATTACHMENT 9: November 24, 2004 Minute Order in Sheldon v.
Gambling Control Commission, Los Angeles County Superior
Court

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