

CALIFORNIA GAMBLING CONTROL COMMISSION

Regulations Workshop Meeting Notes

February 25, 2014

- **Accounting and Financial Reporting Requirements for Gambling Enterprises, Third-Party Providers of Proposition Player Services and Gambling Businesses**
- **Third-Party Providers of Proposition Player Services: Contracts**

AGENDA

Introductory Comments

Chairman Richard Lopes and Commissioners Tiffany Conklin, Lauren Hammond and Richard Schuetz were present.

Executive Director Tina Littleton stated that this was the third regulatory workshop to discuss the Third-Party Providers of Proposition Player Services (TPPPS) contracts and the accounting and financial reporting requirements. Executive Director Littleton indicated that no action would be taken by the Commission at this workshop.

Executive Director Littleton also advised that the workshop for February 26, 2014 for the proposed Approval of Transactions and Enforcement of Security Interests regulations would be postponed until March 25, 2014 at 1 p.m. The comment deadline for that workshop would be extended until March 14, 2014.

Chairman Lopes welcomed everyone to the roundtable discussion.

- This is a deliberate and thoughtful process, and he would like it to remain a respectful process.
- He anticipates differences of opinion as we go through this process, but would like to maintain a respectful decorum.
- Advertising has come up as a topic that needs to be addressed, and may be added as an additional phase in this regulatory review of the Commission's regulations.

Executive Director Littleton began the workshop with the Accounting and Financial Reporting Requirements portion of the agenda and introduced Commission staff Helen Geoffroy.

Accounting and Financial Reporting Requirements

Ms. Geoffroy presented a summary of the proposed text. The text has three main components: (1) additions to the General Provisions section of Chapter 1; (2) the transfer of the current accounting regulations from Chapter 7 to a new Chapter 5, with the incorporation of TPPPS and

gambling businesses; and (3) the addition of a regulation to require information submittals for statistical analysis.

Summary of Comments:

General Definitions and General Requirements

- The definition of “drop” as written may include tournament fees, when tournament fees are ordinarily not considered to be part of the drop. If “total revenues” is intended, perhaps “drop” is not the correct term. (Cardroom)
- The definition of “gambling business” refers to those registered as a gambling business. Should the definition include those who should be registered as a gambling business? (Cardroom)
- The definition of “ownership interest” includes an investment contract. At what point in time should an investment contract be included? Should an investment contract be included only when it actually has a connection to a profit interest or ownership interest, rather than all investment contracts? If an option for an interest is included, should it be when the option is exercised, rather than when the option is negotiated? (Cardroom)
- The definition of “jackpot” should be more narrowly defined by referring to a “specific hand or game outcome” rather than the broader “pre-determined criteria.” The Bureau’s definition of “gaming activity” is broad, and can cause complications with the use of the broader phrase in this definition. (Cardroom)

The Inclusion of TPPPS and Gambling Businesses into the Current Accounting Regulations and the Transfer of the Regulations into a new Chapter 5

- No comments were made.

Information Submittal for Statistical Analysis

- Submitting this information on a monthly basis can be burdensome. This information may also be duplicative now that the companies may be audited. This requirement may be a burden upon the Bureau as well. (Cardroom)
- Before we can comment on whether the requirement is burdensome or necessary, we need to know exactly what information is being sought. (Cardroom)
- This industry began its evolvement with poker, which is relatively easy to protect. There is not a bank in poker, and there are people watching people. But the evolvement of the gambling industry now includes games with a bank, but without the monitoring normally present to regulate banked games. Specially, public statistical control monitoring is missing. (Commission)
- The information required in this regulation is collected daily, but it would be extremely cumbersome for a small business to collect this information for internal purposes and for audit purposes, and then statistical analysis purposes. This will be costly. (Cardroom)
 - If the information is present, it shouldn’t be additionally burdensome to submit if the right processes are in place. (Commission)

- This information is already submitted twice a year, and other submissions are required. And because the information is present, the submission would not be impossible, but to do so within seven days after the end of the month would increase the workload. (Cardroom)
- This information and the frequency may not be necessary at this point, especially given the understanding that the resources and infrastructure are not in place for the Bureau to handle this requirement at this time. The submission of this information with the renewals may be useful. (Commission)
- Most of the explanation provided centers upon the TPPPS, but not the cardrooms. Is this information necessary from both types of entities? What exactly would be looked for from the cardrooms with this information? (Cardroom)
- The information should be tracked by game type, and this is a security issue. Submission of statistical analysis on an annual or biannual basis only allows you to determine after the fact that something went wrong. Keeping the statistics current, you can better respond to variances. This is important to providing integrity to our gaming system. (Commission)
 - It is unclear why this information is needed at this level. (Commission)
 - Statistical analysis allows the discovery of outliers, which serves as a guide on where to look for integrity issues. This is necessary to protect the games, and is a current practice by the individual TPPPS companies. (Commission)
- There is a lack of good data in this industry and this is necessary. However, without a system in place at the Bureau, the information will not move beyond submission. It is suggested that a working group be created to phase into place a data collection program on a more gradual basis to ease the burden on the smaller cardrooms and to create an efficient process. (Cardroom)
- The Bureau does collect some of this information and is able to review this information when necessary. The Bureau does not have the resources at this time to review data on a more detailed basis. (Bureau)
- This information is probably something we need, but we may not be ready to implement this requirement. The gathering of these statistics would require growing a program, and currently the trend is to cut programs. This requirement may create an unfunded mandate for the Bureau. (Commission)
 - The Bureau is understaffed and underfunded for the demands of the workload currently in place, and is unable to add to this workload at this time. Additionally, this requirement would not only necessitate the collection of this information, but the publication of this information. The Bureau requests, at a minimum, a compromise on the time element of this requirement. (Bureau)
 - The Bureau supports the idea of creating a working group and developing this program on a more gradual basis. (Bureau)
 - Publication is not the priority for this requirement. Instead, it is the creation of an analytical tool to maintain game integrity that is the priority. (Commission)
- The industry should be concerned when the enforcement or regulatory agency is unable to develop the tools necessary to protect the integrity of the games. An error can damage

the credibility of the regulatory and enforcement agencies as well as the credibility of the industry as a whole. (Commission)

- Collection of the information is one step, but you also need to make sense of that information. With the rotating player/dealer position, the numbers collected that would make sense in a typical banked game may not be appropriate in this industry. Figuring out a system to not only get the information to the Bureau, but provide the information in a way that is useful is a huge undertaking. The workgroup is a great suggestion to create a solution for our unique industry. (Cardroom)

Executive Director Littleton closed the discussion on the proposed Accounting and Financial Reporting regulations by suggesting that the submission of statistical information be removed from the proposed regulations so that the remainder of the package could move forward to the formal rulemaking process. There are other options to continue the discussion on creating statistical controls. Since the Gaming Policy Advisory Committee (GPAC) is meeting regularly, perhaps this is an item that they could discuss, or perhaps this could be moved into its own phase of the regulatory review process. Executive Director Littleton also explained that the time to submit written comments for the proposed Accounting and Financial Reporting regulations would be extended until March 7, 2014.

TPPPS Contracts

Executive Director Littleton introduced the topic by informing everyone that copies of the current regulations were available for reference and to aid in comments or questions on the proposed concepts. Discussion would focus on the options and other sections would only be discussed if time allowed. Executive Director Littleton introduced Josh Rosenstein, an analyst in the Commission's Regulatory Actions unit.

Summary of Comments:

Tipping Policy

Mr. Rosenstein introduced the two options in this section. Option 1(A) would allow for tipping and includes two sub options, 4(A) and 4(B), which provide two options on the method of tipping. Option 4(A) would require that if a contract didn't include a specific policy, the third-party would be required to include a disclosure of any internal policy governing tipping. Option 4(B) would allow for tipping arrangements but not allow for tipping at the table. Option 1(B) would not allow tipping by the third-party to the gambling enterprise employees.

Option 1(A) [12200.7(b)(9) and 12200.7(h)(2-5)] – Tipping is allowed to be included in the contract.

- If tipping arrangements are part of the contract then tipping should be added to the list of items that only require notification upon contract modification and not a full contract submittal. (Cardroom, Third Party)

- The supervisory description for those unable to receive tips should be revised to Key Employee as that position fits the description. (Cardroom)
- The restriction should not be applied to Key Employees in general, as just because someone is licensed to serve in that role doesn't mean they do so exclusively. A key employee license holder may work in a non-key employee position on occasion. (Cardroom)
- There could be a separate, segregated rack (of chips) for use in paying tips. This would protect the ability to track funding for statistics. (Cardroom, Commissioner)

Option 4(A) [12200.7(h)(1)] – Tips can be provided at the table and internal policies must be provided.

- Could tipping on the table be limited to a particular time, such as when the dealer is being rotated off the table? (Commissioner)

Option 4(B) [12200.7(h)(1)] – Tips can be provided but not at the table.

- The Bureau indicated they were in favor of this option. (Bureau) [Note: As justification for selecting this option, the Bureau cited the inclusion of paragraphs (2) through (5) of subsection (h). As drafted, these paragraphs would also apply to option 4(A) and are not exclusive to 4(B).]
- Cameras are focused on the table, so moving tips off the table would remove that protection. (Cardroom)
- The Bureau indicated they were in agreement that tipping beneath a camera was optimal. The Bureau cited their reasons for preferring option 4(B) to include the perception of tipping being done in front of customers. (Bureau)
- Topic should be broken up between tips for dealers and tips for others. Dealers don't make as much money as other employees and should not have to wait for a weekly/monthly distribution. (Cardroom)
- Tipping language, depending on wording, may allow an undocumented financial transfer. (Tribal)
- Taking money off the table is unfair to the dealers. Therefore, dealer tips should be looked at separately from other tips in the industry. (Cardroom)
- This is the only way to go. Taking money out of the bank pollutes the numbers. This is not an undocumented transaction as it can be tracked through the payroll process. (Commissioner)

Option 1(B) [12200.7(b)(9)] – Tipping may not be included in the contract.

- Tipping policies are a substantial transfer of money from the Third-Party Provider to the cardroom. Third-Party Providers are not providing tips because of service, but are required to include tips in order to get the contract – to subsidize the employees. (Commissioner)

- Contract mandated tipping is a mechanism that looks like an indirect transfer of winnings and therefore was not the intent of the Legislature. (Commissioner)
- A lot of businesses can offer great customer service without mandating tips. (Commissioner)
- Preventing tips would change a system that has existed for 100-150 years. (Cardroom)
- Easier to verify a tip if it's under video, but that doesn't mean it can't be tracked otherwise. (Cardroom)
- The transfer of wealth from the Third-Party to the cardroom should be limited. The methods for transfers should also be limited. (Tribal)

Tips in General

- Depending on the cardroom's policies, tips may be included in a tip pool in part, wholly or not at all. (Cardroom)
- Most cardrooms go through a process with the IRS and the amounts of the tips are part of those agreements. (Cardroom)
- Tips allow the customer to directly communicate their level of satisfaction to the dealer. (Cardroom)
- The system of tips began before there were prop players and before there were California games. (Cardroom)
- Tipping needs to be done so that there is no perception of collusion. (Commissioner)
- People that come to play at a cardroom are not concerned with tipping from the third-party to the dealer, neither the manner nor the timing. (Public)
- Recreational players tip much more than professional players. This holds true to the Third-Party Provider as a professional player. (Cardroom)
- In some situations the third-party tips the dealer for services rendered, not just when it wins a large amount of money. To have the third-party only tip upon a big win is not considered good customer service. (Cardroom)
- There cannot be a direct or indirect relationship between the third-party revenues and the cardroom and tipping is an example of it. Third-party companies don't want to tip, but it's required of them if they want to get the deal. (Commissioner)
- The majority of contacts that do contain tipping arrangements specify that the third-party will tip at discretion and when they tip it will be according to a specific agreement. (Bureau)
- The playing book could be used as a mechanism to track tips. (Bureau)

Chairman Lopes concluded the discussion of this topic by instructing staff to prepare additional options based on the comments received. Both he and Commissioner Hammond expressed interest in option 4(B), perhaps with the word "not" removed. Additional options could include having two chip racks.

Contract Reimbursement

Executive Director Littleton introduced the new topic by noting that the Contracts regulatory package would not be moving forward to the 45-day process after this workshop, but there would more than likely be a fourth workshop.

Mr. Rosenstein introduced the six options in this section. Option 2(A)(1) was noted to be an inaccurate reflection of a comment by the Pala Band of Mission Indians and is replaced by option 2(D). Option 2(A)(2) proposed to limit the contracts of a gambling enterprise with all third-parties to 15 percent of the enterprise's gross gaming revenue. Option 2(B)(1) proposed to limit any individual contract to 25 percent of the enterprise's yearly operating expenses while option 2(B)(2) would apply the cap to the total of all third-party contracts. Option 2(C) proposed to limit the contract to a fixed amount, with that amount not being connected to the funds wagered, lost or won, or any percentage value. Option 2(D) proposed to provide specific limitations to the reimbursable services and would require allowable services to be specified and justified as directly and solely attributable to the services provided to the third-party by the gambling enterprise.

Option 2(A)(2) [12200.7(c)(2)] – Up to 15 percent total from all contracts based on gross gaming revenue.

- This is an artificial and arbitrary limit. (Cardroom)
- This is an example of government fixing prices and governments don't do a good job of fixing prices. (Commissioner)
- If you create a cap for prices then the cap becomes the price. If you don't allow a company to differentiate through price, it's possible that other methods will be used and they may not all be legal. (Cardroom)
- There is merit in capping the price and looking at how the variables and costs should be delineated. (Commissioner)

Options 2(B)(1) and 2(B)(2) [12200.7(c)(2)] – Up to 25 percent based on yearly operating expenses {per contract [2(B)(1)] or all contracts [2(B)(2)]}.

- This is an artificial and arbitrary limit. (Cardroom)
- This is an example of government fixing prices and governments don't do a good job of fixing prices. (Commissioner)
- Fixing of expenses drives bizarre behavior. (Commissioner)
- If you create a cap for prices then the cap becomes the price. If you don't allow a company to differentiate through price, it's possible that other methods will be used and they may not all be legal. (Cardroom)
- This option was presented with the 25 percent to get the conversation started. We are not stuck on that percentage. (Bureau)
- "Indirect Interest" is when profits are received through another entity, like a trust, and not just a connection through fixed payment. This is applied to determine who should be

licensed for a cardroom, and should be applied similarly to allow for contract payments. Therefore what needs to be done is to determine how the contract prices are determined and modified. This is why payment should be linked to the costs of the cardroom, as it clearly separates the connection and makes clear the payment is not based upon the earnings of the third-party. This should include a limit to discourage the cardroom from inflating costs just to receive reimbursement and to provide the majority of coverage for running the business. (Cardroom)

- There is merit in capping the price and looking at how the variables and costs should be delineated. (Commissioner)
- This option is very concerning. Increased costs for the cardroom should not be transferred to the third-party. In a traditional business, costs are transferred to the customers. By transferring the costs directly to the third-party it allows for the reduction in collection fees which subverts the whole framework of gaming. (Tribal)
- This option punishes the operator who has done their best to trim and limit costs or who own their property. (Cardroom)

Option 2(C) [12200.7(c)(2)] – Fixed Amount.

- This option doesn't provide any guidance or articulable standard. (Tribal)

Option 2(D) [12200.7(b)(11), (c)(1) and (2)] – Pala Band Recommendation.

- The language is intended to provide a standard that the Bureau can use when considering each item proposed for reimbursement. (Tribal)
- If the third-party is paying "rent" then that makes the cardrooms and third-parties into partners. There shouldn't be any need to reimburse for "rent" but just for additional expenses. (Tribal)
- If a cardroom, as the landlord, is concerned about the success of a renting third-party, wouldn't that mean a cardroom's landlord has an interest in the cardroom? (Commissioner)
- Unlike a normal rental agreement, cardrooms are specifically prevented from having a stake in the third-party's revenue. (Tribal)
- The costs reimbursed for must be above any costs associated with any other individual acting as the bank. (Tribal)
- This proposal has several flaws. A cardroom could declare almost any cost in certain categories is related to the third-party being present, simply by saying that marketing and business strategy changes because of the presences of the third-party. (Cardroom)
- This option would require further clarification as it doesn't provide the parameters needed to enforce it. It would require more clarification of what would be allowable. (Bureau)

Reimbursement in General.

- The Commission is readdressing the exact same issue as those considered when the regulations were originally adopted. (Cardroom)
- Commercial leases have rent based on market conditions, what they can find someone willing to pay. There are no artificial caps on what a landlord can charge to a tenant. Third-party contracts should be allowed to be determined the same way as long as there is no percentage component. (Cardroom)
- There are many factors in the third-party determining the contract amount they are willing to pay, including, security, parking, space, and other services. There are also considerations from the cardroom's perspective such as HR practices, continuity, temperament, disruption to the business and how thoughtful they are in presentation [in willingness to lose and play]. (Cardroom)
- A consideration of parking facilities versus lease price would find no correlation. The dominate factor in determining the lease amount is the win [by the third-party]. (Commissioner)
- The question is not if the third-party can pay the cardroom, the question is how much and how is that value determined. (Cardroom)
- Cardrooms are focused on driving customers to their business and the third-party companies receive the benefit of additional traffic. Therefore it is fair for the third-party to share in the cost. (Cardroom)
- Isn't the collection the cardroom's incentive for increasing business? Why is the cardroom entitled to the third-party's increase as well? (Commissioner)
- There is no way for 'market value' on items to be determined when reviewing contract submittals. In addition, once denied there is no way to determine how much the dollar amount of the contract should change without specific line items. (Bureau)
- The lease price may be based on potential revenue. (Bureau, Commissioner)
- There are a lot of variables that go into determining the market value. What we need to do is figure out a way that is both fair and doesn't give money unduly to the cardroom. There is a middle ground. (Commissioner)
- Contracts cannot be amended to fluctuate with the winnings of the third-party. The review period is 90 days and requires an application fee. The Bureau doesn't see the workload that would support the contract price fluctuating with third-party winnings. (Bureau)
- There is no law that allows for reimbursement from the third-party to the cardroom, just the current regulations. (Tribal)
- Why are third-party companies being asked to participate specially with the costs of the cardroom (promotions, security upgrades, etc.) when a member of the public serving as the bank is not? (Public)
- It was suggested that the focus should be on assisting the Bureau with determining what a "reasonable" contract fee should be. (Cardroom)

- This is very similar to cardroom landlords. It's important that the contract includes an arm's length negotiation and not in any way be linked to the revenue of the third-party. (Commissioner)
- The Bureau already looks at rate increases for amendments and renewals and frequently denies increases. (Cardroom)
- The current process allows for any amount of money to be transferred based on so many available avenues. (Commissioner)
- Cardrooms don't make their money based on the actual revenue of their tables, but through collection fees. (Tribal)
- If it's too hard to come up with a regulatory structure that follows the law, then no reimbursement is the only option. (Tribal)
- Just because the cardroom gets more money doesn't give the cardroom an indirect interest in the third-party. Indirect interest comes with the control of the business, not in a fixed payment derived from market forces. (Cardroom)
- Is this even an issue for the Commission? (Commissioner)
- The old way, without contracts, is preferred. Let the third-party provider come to the cardroom and offer to pay for the exclusive right to be the sole provider. There is nothing illegal with that process. (Cardroom)
- This issue came up because some cardrooms stopped collecting, and other aspects of the gaming community became annoyed and raised the issue. Once raised, the Commission realized that there wasn't a good understanding of how contracts are priced and now the Commission needs to figure that out. (Commissioner)
- The practice of allowing payment to the Cardroom is illegal and doesn't fit into the law. (Tribal)
- The cardrooms benefit from the presence of the third-parties through collection. Therefore, advertising the California games should cause their collection to go up. And if it doesn't, then the cardrooms shouldn't advertise the game. The cardrooms should want the third-parties to generate activity, which will increase collections. (Commissioner)
- If we are going to regulate this more then we need to be specific in the categories of allowances. (Bureau)
- Any option that allows for reimbursement needs to be very simple; otherwise it becomes too easy to cook the books. (Commissioner)

Executive Director Littleton commented that due to the time, the third topic of Cross and Associated Banking would not be discussed. A future workshop, not in March, will be announced later.

ADJOURNMENT:

Executive Director Littleton adjourned the meeting at 4:02 p.m.