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DEPARTMENT OF JUSTICE

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April 18, 2012

Stuart Drown, Executive Director
Little Hoover Commission
925 L Street, Suite 805
Sacramento, CA 95814

RE: GOVERNOR'S REORGANIZATION PLAN

Dear Executive Director Drown:

The California Department of Justice, Bureau of Gambling Control (Bureau) appreciates the opportunity to submit written testimony relative to the Governor's Reorganization Plan as it proposes the consolidation within the Bureau of certain regulatory functions currently performed by the California Gambling Control Commission (Commission). The Bureau views the Plan as a necessary and appropriate step toward resolving the legal and operational problems stemming from the Commission's involvement in licensing, compliance and enforcement activities that were not intended for that agency under the Gambling Control Act. As such, the Bureau is supportive of the Plan.

As discussed in the attached document, the Bureau has identified certain functions currently performed by the Commission, which, if transferred to the Bureau, would significantly improve the efficiency and effectiveness of the State's gaming regulatory efforts. The Governor's Reorganization Plan would effectively serve to implement this action, as well as appropriately distribute other licensing processes.

Please contact me should you have any questions in this matter.

Sincerely,

MARTIN J. HORAN, IV
Acting Bureau Chief

For KAMALA D. HARRIS
Attorney General

Attachment

April 18, 2012

WRITTEN TESTIMONY BEFORE THE LITTLE HOOVER COMMISSION

GOVERNOR'S REORGANIZATION PLAN – GAMING REGULATION

SUMMARY

When creating California's current framework for gaming regulation, the Gambling Control Act in 1998 established two state agencies with clearly delineated roles and responsibilities to separate prosecutorial and adjudicatory functions and protect against improper ex parte communications in the licensing process. Fundamentally, the Bureau of Gambling Control (Bureau) within the Department of Justice is designated as the law enforcement component, encompassing background investigations of license applicants and oversight of gaming operations to ensure compliance with laws and regulations. The Gambling Control Commission (Commission) is primarily designated to serve as the judicial body that issues licenses, adjudicates licensing matters and other administrative actions, and as the policy maker that sets minimum standards for gaming operations. This dual-agency structure was designed to ensure the clear separation of powers as necessary for proper checks and balances.

Over the years, the role of the Commission has expanded to include compliance and enforcement activities not intended for that agency under the Act. The Commission now engages in comprehensive field inspections and financial audits of tribal gaming operations, as well as testing and analysis of gambling devices. This has resulted in disparate treatment of tribal and non-tribal gaming in which the Bureau exercises compliance enforcement over the cardroom industry, while the Commission exercises compliance enforcement over the tribal casino industry. This division of responsibility is not what the 1999 and subsequent Tribal-State Gaming Compacts contemplated. When the Tribal-State Gaming Compacts were negotiated, it was contemplated that the roles of the State's gaming agencies within Indian country would mirror their roles within the rest of California, but this is not currently the case. Additionally, the Commission has become increasingly involved in the licensing process, which includes determinations of suitability of applicants for tribal key employees and suppliers, by engaging in background investigations and supplementing the Bureau's reports that serve as the basis for suitability determinations.

The functional boundaries of both agencies are now blurred and deviate substantially from legislative intent, resulting in inefficient duplication of effort, dysfunction, inter-agency conflict, and lapses in proper administrative procedure. The Governor's Reorganization Plan would effectively alleviate most of these problems by properly realigning core functions between the agencies, as well as serve as the basis for commensurate adjustments in each agency's spending authority.

STATUTORY RESPONSIBILITIES AND POWERS

When enacting the Gambling Control Act (Business and Professions Code 19800 et. sec.), the legislature clearly envisioned a separation of powers between the two state regulatory agencies. In general, the Bureau was intended to function as the law enforcement agency that monitors industry participants, investigates gambling violations, enforces the State's gambling laws through use of the criminal laws and administrative processes created by the Act, and investigates the qualifications of applicants seeking licensure. The Commission was to function as a policy-making and administrative agency with respect to all matters relating to controlled gaming, and acting in an adjudicative capacity with respect to license issuance and discipline. These statutory responsibilities and powers are summarized below.

Bureau responsibilities - Business and Professions (B&P) Code Section 19826:

> To investigate the qualifications of applicants; to monitor the conduct of all licensees and other persons having material involvement with a gambling operation; to investigate suspected violations of the Act or laws of this state relating to gambling; to investigate complaints that are lodged against licensees or other persons associated with a gambling operation; to initiate disciplinary actions; to adopt regulations reasonably related to its functions and duties; approve the play of any controlled game.

Bureau powers - B&P Code Section 19827:

> All powers necessary and proper to enable it to carry out fully and effectually the duties and responsibilities specified in the Act. The investigatory powers include: Visit, investigate, and place expert accountants, and technicians in all areas of the premises wherein controlled gambling is conducted for the purpose of determining compliance with the rules and regulations adopted pursuant to the GCA; visit, inspect, and examine all premises where gambling equipment is manufactured, sold, or distributed; inspect all equipment and supplies in any gambling establishment or in any premises where gambling equipment is manufactured, sold, or distributed; summarily seize, remove, and impound any equipment, supplies, documents, or records from any licensed premises for the purpose of examination and inspection; demand access to, and inspect, examine, photocopy, and audit all papers, books, and records of an owner licensee on the gambling premises in the presence of the licensee or his or her agent; obtain an inspection warrant pursuant to Section 1822.60 of the Code of Civil Procedure to inspect and seize for the inspection, examination, or photocopying any property possessed or controlled by any applicant or licensee; investigate for purposes of prosecution any suspected criminal violation of the Act; issue subpoenas to require the attendance and testimony of witnesses and the production of books, records, documents, and physical materials; administer oaths, examine witnesses under oath, take evidence, and take depositions and affidavits or declarations.

Commission responsibilities - B&P Code Section 19823:

> Assure that licenses, approvals, and permits are not issued to, or held by, unqualified or disqualified persons; assure that there is no material involvement with a gambling operation by unqualified or disqualified persons.

Commission powers - B&P Code Section 19824:

> All powers necessary and proper to enable it to carry out fully and effectually the duties and responsibilities specified in the Act. The powers include: Require any person to apply for a license, permit, registration, or approval as specified in the Act; deny any application for a license, permit, or approval; Limit, condition, or restrict any license, permit, or approval, or impose any fine upon any person licensed or approved; condition, restrict, discipline, or take action against the license of an individual owner endorsed on the license certificate of the gambling enterprise whether or not the Commission takes action against the license of the gambling enterprise; approve or disapprove transactions, events, and processes; take actions to ensure that no ineligible, unqualified, disqualified, or unsuitable persons are associated with controlled gambling activities; take actions to ensure that gambling activities take place only in suitable locations; grant temporary licenses, permits, or approvals on appropriate terms and conditions; institute a civil action in any superior court against any person subject to the Act to restrain a violation of the Act; issue subpoenas to compel attendance of witnesses and production of documents and other material things at a meeting or hearing of the Commission or its committees, including advisory committees. Pursuant to Business and Professions Code Section 19840, the Commission may adopt regulations for the administration and enforcement of the Act.

GENERAL FUNCTIONS OF THE BUREAU

In strict accordance with the Act, the Bureau historically has limited its fundamental roles to licensing investigations, criminal investigations, and compliance enforcement over the cardroom and tribal gaming industries. It conducts background investigations on specified applicants for licensure or Finding of Suitability and submits its findings and recommendation to the Commission. The Bureau also conducts on-site compliance inspections of cardrooms and tribal casinos, conducts criminal investigations of suspected violations of laws and ordinances, and initiates prosecutions and accusations as appropriate. As discussed later, the Bureau performs on-site financial evaluations and comprehensive compliance inspections of cardrooms, but the Bureau has little to no involvement in these activities as they relate to tribal casinos. All regulatory functions performed by the Bureau are within the Bureau's responsibilities and powers under the Act.

COMMISSION FUNCTIONS VERSUS STATUTORY INTENT

The Commission has become involved in regulatory functions for which the Bureau has responsibility and powers under the Act, as explained below.

Financial Evaluations of Tribal Gaming Operations

Pursuant to the Tribal-State Gaming Compacts, tribal payments to the Indian Gaming Special Distribution Fund (SDF) became due in October 2002 (Compact Section 5.1(b)), and the Commission was authorized to exercise specified responsibilities with respect to the SDF in January 2003 (Governor Executive Order D-66-03). These responsibilities included the collection and accounting of tribal contributions deposited into the Fund, and the collection and analysis of certified quarterly reports submitted by the tribes. The analysis of the quarterly reports was conducted, primarily through a process of document desk reviews, to ensure the mathematical accuracy of the reports and the proper application of contribution rates in the Compact to the numbers reported by the tribes. As performed by the Commission, they also included tribal field compliance audits to verify the accuracy of "net win" reporting. While Compact Section 5.3(d) explicitly contemplates that the state may initiate an audit, and if "net win" reported by the tribe is found to be understated, the state shall notify the tribe. The Commission's administrative role was extended to include financial evaluations of tribal gaming operations as necessary to verify that tribes are accurately reporting "net win". As a matter of policy, based on functional allocation of responsibilities, the Commission's functions regarding the SDF might have been confined to the proper maintenance and distribution of specified portions of tribal gaming revenues, with the Bureau in its investigative capacity performing the functions that go beyond maintenance and distribution of the specified portions of the gaming revenues.

As the agency responsible for tribal compliance inspections, and on-site financial evaluations of cardrooms, the Bureau is the appropriate agency to conduct such evaluations of tribal casinos. To maximize efficiency, this function should be conducted in conjunction with the more comprehensive on-site inspections that focus on overall compliance with Minimum Internal Control Standards (MICS) and many other regulatory provisions of the Act and Compact. The Bureau could feasibly conduct financial field audits of tribal casinos to verify accurate accounting and reporting of "net win" and report that information to the Commission as needed to fulfill its role as administrator of the Fund. As discussed later, such inspections should also be performed exclusively by the Bureau.

Testing and Analysis of Gaming Devices

A key aspect of the Bureau's compliance and enforcement role is the technical analysis of the many types of gaming-related devices offered to the public both within and outside casinos. Aside from slot machines, there are video lottery terminals, electronic bingo devices, skill stop devices, coin pushers, internet café systems, and various other devices subject to regulatory scrutiny. Such analysis is particularly important in distinguishing between Class II and Class III devices as necessary to ensure strict compliance with tribal exclusivity provisions of the compacts, and consistent enforcement of state laws.

In 2004 the Commission requested and received budgetary approval to implement and maintain its own lab for this purpose. However, the Bureau considers the operation of a lab to be more in line with its field compliance and enforcement functions, particularly since such testing and analysis should extend to all questionable gaming devices, not only those offered in tribal casinos. Such an operation requires cooperative relations and close coordination with other local, state, and federal authorities, which the Bureau has effectively established in all other aspects of its enforcement and compliance activities. This function is also consistent with the Bureau's current role in reviewing and approving all controlled games offered in cardrooms.

Tribal Compliance Inspections Relating to Gaming Devices

Beginning in 2000, the Bureau appropriately took responsibility for on-site inspections of all tribal casinos to ensure compliance with regulatory provisions of the new Tribal-State Gaming Compacts (Compact). It assumed the role of the State Gaming Agency, which under Compact section 2.18, was defined as the entities authorized to investigate, approve, and regulate gaming licenses pursuant to the Gambling Control Act. Section 7.0 of the Compact, entitled Compliance Enforcement, further outlined the scope of this function. At this time, the Bureau assumed the complete role of the State Gaming Agency under the Tribal-State Compacts because the Commission had not yet been implemented.

Then, beginning in 2004, the many new and amended Compacts ratified during Governor Schwarzenegger's administration contained new language that effectively solidified the Commission's role in tribal inspections relative to gaming devices. Under the revised Section 7.0, Approval and Testing of Gaming Devices, new sections (7.1 through 7.5) were added entitled Device Approval, Gaming Test Laboratory Selection, Independent Audits, State Gaming Agency Inspections, and Technical Standards. Further, pursuant to newly added Section 7.6, entitled State Gaming Agency Designation, these Compacts for the first time explicitly designate the Commission as the agency responsible for compliance functions. Section 7.6 states, "For purposes of Sections 7.1 to 7.5, the State Gaming Agency shall be the California Gambling Control Commission, unless the State specifies otherwise by written notice pursuant to Section 16.0." The Bureau, rather than the Commission, could prospectively perform these functions, with proper notice to the tribes.

Tribal Compliance Inspections Relating to Minimum Internal Control Standards

Historically, the National Indian Gaming Commission (NIGC) has been responsible for enforcing tribal compliance with MICS. The MICS encompass detailed minimum requirements and procedures associated with many key aspects of the gaming operations, such as security, surveillance, cash and chip handling, credit, information technology, complimentary services, accounting, internal audits, table games, gaming devices, player relations, etc. In 2007 NIGC's role in this regard shifted to the State Gaming Agency after the U.S. Court of Appeals ruled that the NIGC lacks the authority under the Indian Gaming Regulatory Act to promulgate or enforce MICS over Class III tribal gaming operations. In holding that the NIGC did not have that authority, it left a potential regulatory void that increased the importance of state inspected MICS regulations in accordance with Section 8.4 of the Tribal-State Compacts.

Commission Regulations on MICS

In 2010 the Commission, in accordance with its statutory function, implemented new regulations intended to fulfill the State Gaming Agency's new MICS enforcement role. The regulations, entitled CGCC-8, included uniform protocols for establishing and enforcing MICS among all California gaming tribes. The regulations specify that "For purposes of this Section, the Commission is designated as the State Gaming Agency. Only the Commission shall be permitted to conduct compliance inspections under this regulation until the State designates a different State Gaming Agency by providing written notice to the Tribes pursuant to section 13.0 of the Compacts. At no time shall more than one State agency serve as the State Gaming Agency under this regulation." The Bureau, rather than the Commission, could prospectively perform these functions, with proper notice to the tribes.

New Compact Language on MICS

During negotiations over CGCC-8, a new Compact was ratified that allowed the Commission to assume additional responsibility for compliance enforcement relating to MICS and other aspects of the gaming operations. The 2008 Compact with the Shingle Springs Band of Miwok Indians added Section 7.4.7 entitled Compact Compliance Review. It provides that the State Gaming Agency is authorized to conduct an annual comprehensive Compact compliance review of the Gaming Operation, Gaming Facilities, and Gaming Activities to ensure compliance with all provisions of the Amended Compact, including the MICS. The Compact also adds Section 8.7, Minimum Internal Control Standards, which specifies the Tribes' requirements for conducting audits and reporting to the State Gaming Agency, and for compliance review by the State Gaming Agency. Again, the Compact specified that the State Gaming Agency shall be the California Gambling Control Commission, unless the State provides otherwise by written notice. The Bureau, rather than the Commission, could prospectively perform these functions, with proper notice to the tribes.

As a consequence of these actions, the State's role in tribal compliance enforcement is divided between both agencies. The Bureau's role has been essentially reduced to inspections to verify the tribes' compliance with their own gaming ordinances and other limited provisions of the Compact. The Commission's role encompasses all other State compliance and enforcement functions relating to tribal gaming, including the comprehensive provisions of the MICS, financial evaluations, and gaming device operations. This arrangement has resulted in multiple tribal site visits by NIGC, the Bureau, and Commission, but with limited interagency coordination. It has also caused confusion among tribal gaming regulators and disruption to gaming operations, adding further to the dysfunction and inefficiency in the State's field enforcement activities.

Licensing Investigations

As required by statute and regulation, the Bureau conducts all background investigations of specified applicants seeking licensure in the tribal casino and cardroom industries. Following investigation, it submits a recommendation to the Commission together with a report containing all relevant findings of its investigation. Bureau representatives appear before Commissioners at meetings to respond to any questions relevant to the recommendation. In all cases in which the

Commission adopts the Bureau's recommendation to deny, restrict, or condition a license, the Bureau acts as complainant and represents the State in any related administrative proceeding. Under this arrangement, the Bureau serves in a law enforcement and prosecutorial role while the Commission serves in an adjudicatory role, as appropriate.

Contrary to the process prescribed by statute, however, the Commission has become involved in the Bureau's investigative process. As a normal practice, Commission analysts evaluate the Bureau's investigation reports and attempt to identify and resolve questions they believe Commissioners might ask. In many cases, Commission personnel independently collect material information directly from applicants or, alternatively, include the applicants in their communications with the Bureau in which they request and receive supplemental investigative information they deem necessary. Commission personnel routinely submit a separate staff report to Commissioners that basically summarizes the Bureau's findings and any other information they independently acquire. The staff report also includes a second recommendation, although it is not used as a formal basis in administrative actions.

Such involvement by Commission staff is both unnecessary and legally problematic. Too frequently, the Bureau has already considered the requested information and deemed it irrelevant, prejudicial, or unsubstantiated, and thus purposely excluded it from the investigation report. It is the Bureau's investigative findings, as contained in its report, that serve as the basis for adverse administrative action, and as complainant, the Bureau must determine on its own what information and supporting evidence is to be presented at hearing.

Besides being duplicative and therefore unnecessary, the Commission staff's direct involvement in collecting material information and disclosing it to Commissioners raises serious risk of prohibited ex parte communications that can jeopardize administrative actions. While applicants must be included in such communications to avoid such risks, inclusion unnecessarily and inappropriately alerts them to what Commission staff may perceive to be deficiencies in the investigative process or in the findings used to support the Bureau's recommendation, thus encouraging applicants to advance unwarranted and sometimes frivolous arguments attacking the investigative process or the findings, rather than respond on the merits of the issues presented. Further, information independently obtained by Commission staff may lack the trustworthiness of information relied upon by the Bureau's recommendation. Injected into the licensing process at the stage of the Commission's initial hearing, the untrustworthy information may be relied on by Commissioners to deny the license application, but would be required to be excluded in the Bureau's pleading as a basis for denial in any subsequent evidentiary hearing.

It is the Bureau's view that Commission analysts should have no significant involvement in the investigative process other than to perhaps relay any relevant questions that Commissioners intend to ask the Bureau when the matter is heard at a public meeting. The Bureau should maintain sole responsibility for developing and presenting investigative findings for the purpose of the Commission's suitability determinations and to support its recommendation in any administrative proceedings.

STRATEGIC ADVANTAGE

From an organizational and staffing perspective, the Bureau is much better suited than the Commission to perform field enforcement and auditing activities. A key difference is the qualifications of personnel. With six strategically-placed regional offices, the Bureau has teams of sworn Special Agents, Field Representatives, and Investigative Auditors with years of specialized experience and knowledge in such matters. These personnel have developed cooperative relations with gaming regulators, both at the tribal and federal levels, as well as law enforcement agencies statewide, with whom they have effectively coordinated extensive investigative and intelligence activities. Unquestionably, they are better positioned to perform the full scope of tribal compliance enforcement and auditing functions than are the Commission's general auditors and analysts housed in Sacramento.

Additionally, the Bureau is organizationally structured to more effectively coordinate the operations of compliance enforcement, auditing, and licensing components. Under the Bureau's management, the Compliance and Enforcement Section (Special Agents and Field Representatives) and its Licensing Section (Investigative Auditors and Analysts) are able to systematically share information of mutual interest and staff resources, as appropriate. Also, their functions often overlap: criminal investigations involving licensees can have significant bearing on their qualifications for renewal, while licensing investigations can prompt further criminal investigations that result in prosecutions and accusations. As a result, the Bureau's Licensing Section and Compliance Section work closely and cooperatively on licensing and regulatory matters.

CONCLUSION

The proper realignment of compliance and enforcement functions and the elimination of duplicative license-related investigative tasks, as identified above, would result in significant improvements in the overall efficiency and effectiveness of the State's regulatory efforts. The Governor's Reorganization Plan would serve to amend and clarify statutory provisions as necessary to accomplish this very goal. It also proposes other adjustments in the various aspects of the licensing process that would achieve still other efficiencies, which the Bureau fully endorses. Therefore, the Bureau fully supports the timely adoption of the Governor's Reorganization Plan as it relates to gaming regulation.