



# ***GAMING REGULATION:***

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## **Overview, Primer**

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# Gaming Regulation

## Overview of regulatory issues

For various reasons, casino gaming is one of the major worldwide growth industries, and that expansion of gaming has continued into the first decade of the new century. Legalized gambling has existed in Nevada for more than 75 five years, in New Jersey for more than 30 years and has been expanded to most of the states in the United States.<sup>1</sup>

Both the governments that legalize casinos and the casino industry face challenges in jurisdictions either expanding legalized gaming activity or considering casino gaming for the first time. The challenge for government is to put into place effective controls to oversee gaming and to maintain the will to regulate the industry for the public benefit. There is a direct nexus between effective regulation of the gaming industry and the long-term success of casinos. Those jurisdictions that create effective regulatory controls will not only protect themselves but will also provide a strong foundation for investment in the gaming industry.

This report will focus on those standards that gaming jurisdictions should consider in regulating and controlling casinos. In just about every successful jurisdiction that has legalized casino gaming, that activity is highly regulated. The elements of effective casino regulation include various operational controls and licensing of those companies and individuals who participate in the gaming industry. The goal of licensing is to ensure that only those companies and individuals who meet the standards of the particular jurisdiction actually receive a gaming license, that organized criminal elements are kept out of the ownership and operation of the casino industry and vendors that service casinos, and that otherwise unqualified companies and individuals do not receive a casino license. Additionally, from an operational perspective, the goal of casino regulation is to ensure that all monies are accounted for, the casinos are not used to launder money, and that the games are operated fairly.

Many jurisdictions have also incorporated in their gaming legislation public policy goals relating to the regulation and oversight of gaming including some or all of the following:

- 1) Strict regulation of the industry, including detailed provisions pertaining to licensure, ongoing regulation and taxation;
- 2) Framing the granting of a casino license as a privilege that can be revoked by the government if circumstances so warrant rather than as a right or entitlement. In this way, the holder of any type of license is placed on notice that it must conform its conduct to certain standards;

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<sup>1</sup> Every state in the United States except Hawaii and Utah has legalized some form of gaming.

- 3) Creation, by the enabling legislation, of an independent agency to oversee gaming activity. Alternatively, the oversight of gaming should be placed in an agency or cabinet department with sufficient authority to effectively regulate gaming activity. In either event, the regulatory agency should have law enforcement powers and should be isolated, to the extent possible, from the political whims of the day. The powers typically granted to regulatory agencies include:
  - Investigation of the qualifications of casino applicants
  - Issuance of casino licenses and permits
  - Promulgation of regulations
  - Investigations if violations of the gaming act and regulations
  - Initiation of regulatory compliance actions
  - Continuing reviews of casino operations
  - Financial and operational audits of casino operations
  - Hearings and adjudication of licensing and other cases
  - Collection of fees and penalties
- 4) An all-encompassing and continuing obligation of individuals and companies who want to participate in gaming activity to disclose information to the appropriate regulatory agency. A subcomponent of this category is that those companies and individuals applying for a casino or vendor license should be required to pay for all costs associated with the conduct of their background investigations. This requirement allows the regulatory agency to undertake what are often complex and multi-faceted entity and other investigations without having the taxpayers of the state pay for these types of investigations.
- 5) A strict code of ethics under which regulatory agencies and senior government officials should operate so that actual and perceived conflicts of interest can be avoided and the regulatory decisions can be made on the basis of merit.

## Casino licensing

One of the fundamental methods to preserve the integrity of casino gaming is an effective and comprehensive licensing process. Licensing standards are designed to allow regulatory agencies to perform these functions and maintain public confidence in the integrity of the process.

Licensing standards are commonly divided into affirmative and disqualification criteria. Many jurisdictions require that applicants for a casino, vendor and employee license affirmatively demonstrate qualifications for licensure. For example, an affirmative demonstration of good character, honesty and integrity for a designated period prior to licensure is a common feature of the licensing process. Generally, a demonstration of financial stability, responsibility and integrity relating to financial solvency, viability and honesty in business dealings is also required.

Disqualification criteria permit a casino regulatory body to deny a license even if the affirmative criteria have been met. Failure to provide information, failure to reveal material facts, or supplying false or inaccurate information are generally independent bases to deny licensure. However, not every failure to disclose information may lead to a licensure denial. For example, a failure to disclose must generally be willful or show a conscious disregard for the regulatory process; an inadvertent failure to disclose a non-material fact would not usually mandate automatic disqualification.

Other disqualification factors typically relate to criminal conduct and convictions. Convictions of certain offenses, generally felonies or first or second degree crimes, within a specific period of time, usually 10 years preceding the date of the casino application, results in automatic disqualification. Disqualification is also usually mandated if an applicant is a career offender, a member of a career offender cartel or an associate of a career offender cartel. Involvement in the illegal drug trade would also be a basis for denial.

The licensing standard discussed above safeguards against infiltration of organized crime or other undesirables through the ownership or management of a casino. Qualification standards ensure that all individuals who have control or influence over the corporate structure of a casino licensee satisfy minimum standards for licensure.

The scope of the licensing process is important to note as well. Typically for casino entity licensing, the individuals who are required to file application forms include:

- Members of the Board of Directors
- Major stockholders owning 5 percent or more of the casino company or its parent company
- Company officers
- Key employees

Similar standards typically are applied to companies that engage in business activities with casinos and for casino employees.

Corporations and their board of directors, major stockholders of the casino companies, financial sources, casino service industries and casino employees are typically subject to licensure. Once a casino applicant receives a license, the licensee remains under government scrutiny, and its operations are subject to review, audit and regulation.

The standards discussed above are used by most gaming jurisdictions but the interpretation of these standards can differ among jurisdictions. Nevertheless, the basic goal of barring organized crime and undesirables from the industry and determining the “suitability” of applicants remains a universal goal of credible gaming jurisdictions. Strict licensing standards and their implementation has been successful in frustrating hidden casino ownership and ensuring that only qualified individuals are licensed and employed in the casino industry.

## Operational controls

Once a casino applicant has been licensed, it is important to monitor and regulate casino operations. Elements of effective casino control typically relate to:

1. Adoption and implementation of minimum accounting and other internal controls through the adoption of regulations
2. Generally uniform rules of the games
3. Effective oversight by casino supervisors
4. Internal controls for slot machines
5. Anti-money laundering controls
6. Viable surveillance
7. Regulatory oversight

The first element of effective control in casino operations relates to a system of minimum accounting and other internal controls (MICS) designed to safeguard casino assets. To the extent possible, MICS should establish accountability of casino revenues and pinpoint areas and individuals responsible for such funds during the gaming day.

The second aspect of casino control relates to having uniform and defined rules of the game for each game offered by the casino. Uniform substantive rules of the game permit casino supervisors and regulators to identify any deviations, which may indicate cheating or tampering with the games.

The third aspect of casino control relates to internal controls related to gaming equipment including casino chips, cards, dice, dealing shoes and casino software.<sup>2</sup>

The fourth aspect of casino control relates to slot machines. Electronic games are unique and subject to unique forms of tampering and cheating. Effective controls over slot machines start with the testing of the slot machines by a laboratory, either independent or state operated, to determine the randomness of the gaming related computer chips and to determine whether the payouts are fair. The next step includes an aggressive inspection program to ascertain whether tampering has occurred. A final step relates to the verification of slot machine jackpots to make sure they are legitimate.

The fifth aspect of effective gaming control relates to anti-money laundering programs. Since 1985, casino gaming come under the requirements of the Bank Secrecy Act. At that time, casinos were deemed to be financial institutions under this federal law. Specific requirements have been established through regulations issued by the Financial Crimes Enforcement Network (FinCEN) mandating the filing of Currency Transaction Reports (CTRs) and Suspicious Activity

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<sup>2</sup> The development of casino software to track patron play and audit various aspects of the gaming operation has made MIS auditing a critical component of the regulatory process. Regulators, as well as operators, need to know and understand this technology in order to effectively regulate modern gaming operations.

Reports (SARC). Many states have adopted parallel regulations that require the filing of CTRs and SARCs with state gaming regulators.

The final aspect of casino control relates to the clandestine surveillance of gaming operations by management and regulators. Surveillance personnel act as a check and balance over casino personnel on the casino floor and provide an independent level of review and observations. The surveillance department should operate independently of the management of the casino and should report to the casino entity's Board of Directors or Audit Committee, or both.

The element that ties all of the above together relates to an effective regulatory process. As noted, regulatory agencies should have full authority to conduct reviews, audits and observations of all aspects of a casino's operations.

The model of regulation described herein has proven to be effective for casino operations in many countries, including the United States, Australia, and some in western Europe. It serves to create public confidence in casino gaming and has led to the investment of billions of dollars in physical facilities and the creation of tens of thousands of jobs.

### **Case study: Singapore**

Singapore has not yet opened either one of its two planned integrated resorts, yet is already being defined positively by the expected success of its gaming industry. Singapore's economy grew by 8.2 percent in the quarter ending June 2007, led by a 17.9 percent growth in construction. In chronicling that growth, the *Financial Times* reported: "Lee Yuan Kew, Singapore's elder statesman, recently predicted that the city-state was poised for a 'golden age' over the next five years, owing to its transformation into a private banking and gaming center."<sup>3</sup>

Spectrum has been intimately involved in the planning and development of Singapore's gaming industry, having served as consultants to the Ministry of Home Affairs in advance of issuing licenses for the two planned integrated resorts. The following summarizes the Singapore experience to date.

### ***Decision to Allow Casinos***

The United States provided a backdrop in the decision by Singapore to allow casinos. In June 1999, the U.S. National Gambling Impact Study Commission (NGISC), established by President Clinton in 1996, delivered its Final Report to Congress. The report collated two years of comprehensive legal and factual study of the social and economic impacts of gambling in the United States. The basic issue addressed by the commission was simple: "Gambling, like any other business, creates both profit and jobs. But the real question ... is not simply how many people work in the industry, nor how much they earn, nor even what tax revenues flow from

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<sup>3</sup> "Construction Boost for Singapore," *Financial Times*, July 11, 2007, p. 2.



gambling. The central issue is whether the net increases in income and well-being are worth the acknowledged social costs of gambling.”

At the time when the NGISC delivered its report it was simply inconceivable that, within five years, Singapore would allow casino gambling. For decades, government policy had opposed resolutely any and all calls to legalize casino gambling, a position that was also seen to be aligned with public opinion on the issue. In late 2003, opponents of casino gambling seized upon the case of Chia Teck Leng, the former finance manager of Asia Pacific Breweries, who was accused of embezzled more than S\$110 million (US\$70 million) as he became mired in debt through gambling in casinos around the world. In April 2004, he was sentenced to 42 years in jail in what was Singapore’s biggest ever case of commercial fraud.

Yet in April 2005, a proposal to develop two multi-billion-dollar integrated resorts, each including a casino, was approved at a special meeting of the Singaporean Cabinet, following an earlier government call, in late December 2004, for interested developers to submit concept plans for such resorts; 19 responses were received.

In March 2005, Minister Mentor Lee Kuan Yew was briefed on the 19 proposals, and the next month, following four days of parliamentary debate, a formal announcement was made by Prime Minister Lee Hsien Loong in a speech that emphasized the pressing need for Singapore to take positive action in the face of clear indications that the country was losing its attraction as a tourism destination.

Deputy Prime Minister and Minister of Home Affairs Wong Kan Seng drew upon the NGISC report in a statement to Parliament, also made on 18 April 2005, in which he said: “The (report) analyzed data from 100 communities with varying degrees of proximity to casino gambling and concluded that casino gambling has had no effect on the rates of serious violent or property crimes.”

The decision to develop integrated sites at Marina Bay near the downtown city center and on the resort island of Sentosa reversed decades of official antipathy to casino gambling and was reached only following considerable discussion and public consultation. The Parliamentary debate saw many Members of Parliament share their concerns on gambling, and followed more than a year of vigorous public discussion on the subject.

Significant differences of opinion still exist within Singaporean society, with concerns focused primarily on the social implications of legalized casino gambling.

Against this backdrop it is noted that the decision to proceed with two integrated came as major global casino operators are turning to Asia for expansion, attracted partly by the explosive growth seen in Macau. Between 1993 and 2002, visitor arrivals to Singapore averaged between 6.5 million and 7.5 million visitors; over the same period tourism receipts fell by 17 percent, from S\$11.3 billion to S\$9.4 billion, reflecting a corresponding fall in the contribution of tourism to GDP from 6.1 percent in 1993 to 3 percent in 2002. At the same time, however, the Asia Pacific region as a whole recorded year-on-year growth in tourism traffic of more than 6 percent. Over the course of this 11-year period Singapore witnessed a decline of more than 50 percent in



its share of regional tourism receipts from 13.1 percent to 6 percent. In 2005, the tourism sector generated an estimated S\$10.8 billion in tourism receipts.

The integrated resort developments are regarded by the government therefore as essential components of the strategic drive to double tourist numbers to 17 million a year and significantly enhance annual spending by tourists. They are primarily envisaged to be iconic lifestyle developments showcasing a comprehensive range of world-class amenities including hotels, convention facilities, retail and dining, entertainment shows, themed attractions and of course casinos. The strategic objective is to broaden domestic leisure and entertainment options to enhance Singapore's reputation as a premium "must-visit" destination for leisure and business visitors.

It is the government's intention that the gaming resorts will have a compelling mix of non-gaming attractions, with casino gaming revenues constituting a minority component of total resort revenues. It is expected that international patrons, instead of local residents, will contribute the greater proportion of total gaming revenues.

In his speech, Prime Minister Lee noted that the Marina Bay and Sentosa sites attracted two very different types of proposals. The Marina Bay was deemed most suitable for a large business and convention facility specifically targeting MICE (Meetings, Incentive tours, Conventions and Exhibitions), while the Sentosa site was identified as more suitable for a family-friendly resort.

The total investment earmarked for both sites will exceed US\$ 7 billion. Gaming will occupy no more than 5 percent of the total floor area of the Marina Bay and Sentosa developments. The Ministry of Trade & Industry further estimates that, combined, the two gaming resorts will create some 10,000 direct jobs and indirect employment for a further 25,000 people. The contribution to annual GDP is expected to be in the region of S\$1.5 billion.

### ***Singapore regulatory framework***

In parallel with the decision to proceed with the IR projects, the government of Singapore has also worked to develop a transparent and effective regulatory framework to govern the operation of the casino components of these projects. Central to this is the Casino Control Bill, a 150-page document that was passed by the Singaporean Parliament in February 2006, and which came into force in June 2006.

In drafting the bill, the Ministry of Home Affairs (MHA) studied the regulatory practices of well-known casino jurisdictions in other parts of the world, including both multi-casino jurisdictions, such as Nevada and New Jersey; and single-casino jurisdictions, such as New South Wales and Victoria in Australia and Macau. MHA officials, including the Minister, Wong Kan Seng, visited casinos and regulators in Las Vegas, Macau and Australia to learn from their experience.

The draft Casino Control Bill was subject to public consultation in late 2005, and potential investors in the IR projects were also invited to provide feedback. In addition, the Singaporean government sent the draft to regulators in the United States and Australia for comments. The ultimate goal, as expressed by Minister Wong when presenting the Bill to

Parliament, was simple: “We aim to position our integrated resorts with the best in the world. Our regulatory standards must necessarily be on par with theirs too.”

The objectives of the Casino Control Bill are primarily to ensure that:

- The casinos remain free from criminal influence or exploitation
- Gaming in the casinos is conducted honestly
- The potential of casinos to cause harm to minors, vulnerable persons and society at large is minimized

The provisions of the Casino Control Bill will be implemented through two bodies, the Casino Regulatory Authority of Singapore (CRA) and the National Council on Problem Gambling (NCPG). The CRA will adopt primary responsibility for regulation, licensing and investigation, inspection and enforcement, adjudication of disputes between the casinos and patrons, and evaluation and audit of the casinos’ internal controls. The NCPG, which has already been established by the Ministry of Community Development, Youth and Sports, will be responsible for actions including the promotion of public awareness of problem gambling. The NCPG will also be empowered to exclude persons from the casinos.

The Bill also sets up a dedicated Casino Investigation Branch within the Criminal Investigation Department of the police to detect and investigate crimes that take place in the casino.

Each integrated resort operator has been granted a 60-year tenure over the land and awarded a concession to operate a casino for 30 years; this concession is independent of a casino license, for which the operator must apply to the Casino Regulatory Authority.

The Singapore Tourism Board has further stated that for a period of 10 years from the date of the signing of the second integrated resort agreement, only two casino licenses will be issued.

For each resort, the Controlling Shareholder, defined as the single entity that owns the largest direct and indirect stake of the voting shares, will not be permitted to hold an interest or a management contract for operating the casino in the other integrated resort. The resort operator can apply for the casino license only when at least half of the proposed gross floor area is ready to receive visitors and at least half of the committed investment has been expended. The operator is then required to expend 100 percent of its committed development investment within three years of the date of issue of the casino license.

The Casino Control Bill contains a number of provisions intended to control access to the two casinos by Singaporean nationals and permanent residents, primarily through a minimum age restriction and a requirement that these patrons pay either a daily or annual entry fee to gain access to the properties.

- The social safeguards delineated by the bill include:
- Entry prohibited to the casino for those below 21 years
- A casino entry levy of S\$100 (US\$65) per day or S\$2,000 (US\$1,300) per year for Singapore residents

- Provision of self and third party exclusion schemes (including requests by family members)
- Requirement to display information on problem gambling, help services, rules of games and odds of winning
- Restrictions on advertising of casino and casino gambling
- Restrictions on extension of gaming credit to Singapore residents, with the exception of premium players
- No automatic teller machines allowed within the casino
- Provision of a system to allow loss limits to be set voluntarily

Section 108 of the bill also prohibits casino and junket operators from extending credit to Singapore nationals and permanent residents, unless they maintain a credit balance of at least S\$100,000 (US\$65,000) with the casino operator at the start of their gaming, this being the sum needed to qualify as a premium player.

The legislation also requires the casino operator to put in place a robust anti-money laundering program that includes know-your-customer due-diligence, mandatory reporting for transactions above S\$10,000 (US\$6,500) and record keeping for transactions above S\$5,000 (US\$3,250).

Tax will be levied at 15 percent on monthly gross gaming revenue from mass market players, and 5 percent on monthly gross gaming revenue from VIP (premium) players. The Singaporean government has committed not to raise casino tax levels for at least 15 years.

Gross gaming revenue will also be liable to Goods & Services Tax, which was raised from 5 percent to 7 percent in July 2007.

A withholding tax of 3 percent of commissions earned will also be levied upon junket promoters

### ***Overview of bidding process***

In December 2004, the Singaporean Ministry of Trade & Industry issued the “Key Conditions & Requirements For The Request For Concepts,” which generated 19 responses.

#### **Marina Bay**

In November 2005, a formal Request For Proposals (RFP) for the Marina Bay site was issued by the Singapore Tourism Board to 12 short-listed respondents, with a deadline of March 29, 2006, stipulated for the submission of such proposals, and an expectation that the Marina Bay decision would be announced by mid-2006. The approximate weightings assigned by the tourism board to four evaluation criteria for the Marina Bay IR were identified as:

Tourism appeal and contribution:	40 percent
Architectural concept and design:	30 percent
Development investment:	20 percent
Strength of the consortium and partners:	10 percent

The Marina Bay site area covers approximately 51 acres and the resort will have a gross floor area no greater than 6.1 million square feet, and no less than 2.9 million square feet, with a maximum gaming area not to exceed 161,460 square feet and no more than 2,500 gaming machines.

On May 26, 2006, it was announced that Las Vegas Sands had won the bidding for the Marina Bay development. The complex, to be called The Marina Bay Sands, is expected to be completed in 2009, and to generate an additional S\$2.7 billion (US\$1.8 billion), or 0.8 percent, to Singapore's annual GDP and create 30,000 jobs throughout the economy by 2015. Las Vegas Sands has committed to invest S\$3.9 billion (US\$2.7 billion) in the project, not including the fixed S\$1.2 billion (US\$800 million) cost of the site itself, which by most estimates will make it among the most expensive casino investments in the world. In addition to the casino, other key components of the plan are three hotel towers with 2,500 rooms, a museum and a convention center capable of accommodating over 52,000 people.

### **Sentosa**

An RFP for the Sentosa integrated resort was issued on April 28, 2006, and closed on October 10, 2006. The approximate weightings assigned by the tourism board to four evaluation criteria were identified as:

Tourism appeal and contribution:	45 percent
Architectural concept and design:	25 percent
Development investment:	20 percent
Strength of the consortium and partners:	10 percent

The site area is approximately 121 hectares with a maximum gross floor area of 3.7 million square feet. As with Marina Bay, the maximum gaming area allowed is 161,460 square feet and the maximum number of gaming machines allowed is 2,500.

On December 8, 2006, it was announced that Genting International had won the bidding for the Sentosa Island development. Together with the land price and other associated capital costs, the total investment by Genting will total S\$5.2 billion (US\$3.5 billion). The casino element of the development is to be accompanied by six hotels offering 1,830 rooms, and convention facilities for approximately 12,000 people. Sentosa will also host Universal Studios' largest theme park in Asia, with 22 attractions within seven themed worlds.

### ***Conclusion: Singapore case study***

The decision to allow casinos in Singapore was not made lightly and remains a controversial issue, and significant divisions still exist in public opinion. Just one week before the decision was made public, the Ministry for Community Development, Youth and Sports released findings stating that 58 percent of all Singaporean adults gambled, and that 2.1 percent were at risk of addiction. The findings arose from a survey conducted by the Ministry from December 2004 to February 2005.

The government's decision, founded on the need to bolster flagging tourism revenues, therefore reflected an approach adopted by many of the jurisdictions where casino gaming is legal. The core elements of this approach are essentially that:

- Limited casino gambling should be allowed, at least initially
- A small number of large casinos is preferable to a large number of small properties
- Casinos should visually enhance a locality, ideally constituting just one component of an integrated entertainment and leisure development
- Effective consumer protection policies and social safeguards should be in place.
- Regulatory and taxation frameworks need to be clear, fixed and reflect the realities of global capital markets
- Regulation and oversight regimes must ensure that casinos are free from crime and vice, and that they are owned and operated only by fit and proper persons

In his speech of April 18, 2005, Prime Minister Lee noted the concerns of opponents, but concluded his remarks with the following comment: "If we reject these Integrated Resort projects, the world's investors and players will mentally scratch us off from the list of countries that will go for business, for leisure and entertainment."

### **Case study: Kansas**

Kansas has had an interest in legalizing casino gaming, though lacking in consistency, for the last 15 years. Most recently, that interest has created the Kansas Expanded Lottery Act, which has provided for destination casinos in four locations. This act also has provided for a general outline and requirements regarding applicants and time frames for submission of documents.

The Kansas Lottery Commission was given the task of setting forth in regulation form, the specific time frames and rules that applicants must meet. At this time Kansas is still in the midst of a variety of issues relating to their Expanded Lottery Act, including the state constitutionality of the law itself and the selection of the best applicants, but their experience so far is worth examining.

As is often the case with legislation related to gaming, the law was passed amid some controversy. As a result, the legislation includes provisions that could prove difficult to implement. For example, the law requires persons that are 0.5 percent owners of applicant companies to qualify, rather than the more typical and practical 5 percent. Since 0.5 percent owners of a company can change, especially in a publicly traded company, on an almost daily basis, this will make it difficult to create a package of completed investigations in a timely manner. Thus, this alone could serve to emphasize the importance that legislation be based on a practical and logical foundation. It is all the more important to solidly establish this base on

specific matters and maintain it, regardless of any controversy that is engendered during the final debates.

The legislation requires that the Lottery Commission adopt and publish rules not more than 30 days after the effective date of the act. This again was a difficult practical hurdle for that agency to meet. Such timelines can also serve to create confusion and create rules that are not as practical as they would otherwise be. Spectrum recommends, in fact, that an emphasis be put on the early part of rule-making and development of policy, to the extent possible, since the consequences of those actions can be felt for years.

The Kansas Expanded Lottery Act gave responsibility to the Lottery Commission to approve a management contract with a licensee (called a lottery gaming facility manager in the law), by taking into consideration the following factors:

- The size of the location
- The geographic area in which the facility is to be located
- The proposed facility's location as a tourist and entertainment destination
- The estimated number of tourists that would be attracted by the proposed facility
- The number and type of lottery facility games to be operated at the proposed facility
- Agreements related to the ancillary lottery gaming facility operations

The law required that applicants needed to meet certain minimum criteria. Part of the process in Kansas was to give preference to Kansas-based Indian tribes. Beyond that criterion, the law required that a prospective applicant:

- Should have sufficient access to financial resources to support the activities required
- Is current in filing all applicable statewide tax returns
- Has three consecutive years' experience in the management of gaming which would be Class III gaming

Beyond those minimum criteria, the law required that there be an investment of at least \$225 million to \$50 million by the applicant, depending on the Kansas gaming zone. The law provides for a 90-day period for the negotiation period. This time frame also proved less than sufficient according to Lottery officials.

Once approved, the law specified that the contract would have an initial term of 15 years and include provisions for the applicant to pay for oversight and regulation, among other things. [A privilege fee of \$25 million or \$5.5 million was also required for the privilege of being selected as the lottery facility manager.] A privilege fee is also required if selected as the lottery facility manager. This fee is \$25 million for a lottery facility manager in the northeast, southeast or south central Kansas gaming zone. The fee is \$5.5 million for a lottery facility manager in the southwest Kansas gaming zone.

The act also creates a board (the Review Board) with a purpose of determining which contracts best maximizes revenue, encourages tourism and otherwise serves the interests of the people of Kansas. The law requires that the board hold public hearings, take testimony, solicit



the advice of experts and investigate the merits of each contract submitted by the executive director. The law requires that the board, within 60 days of submittal of all contracts, select by vote the contract which is the best possible such contract or, if just one contract is submitted, determine if that contract is the best contract. If agreement cannot be reached, the board can request that the contract be renegotiated.

After a determination by the Review Board that a contract is the best possible contract, the agency which is assigned to investigate the applicant, the Kansas Racing and Gaming Commission, is required to investigate the applicant and all officers and directors, as required. The Kansas Racing and Gaming Commission has 10 days after receiving the board's recommendation to vote to approve or reject in whole the background of the facility manager. It is apparent that this time frame, of 10 days, to make a determination on backgrounds of what can be a very complex application, presents practical issues. Though the Racing and Gaming Commission may start the process before the decision is made on the contract and may ask for additional time, this is another example of the need for a state to invest heavily in the beginning portion of a process.

### ***Conclusions: Kansas Case study***

The Kansas Expanded Lottery Act, while setting forth criteria and time frames for the selection of facility managers (destination casinos), may prove most useful in illustrating a law that is difficult and impractical to implement. In order to implement the law the Kansas Lottery and Racing and Gaming officials have now contracted with consulting companies that are more familiar with the gaming industry so as to make informed decisions in critical areas. It may have been worthwhile for such actions to take place at the earliest possible time. It appears that a number of small changes to the law could have saved time and money in the creation of an industry that will affect much of the state's population for many years.

The time frames and criteria for applicants should allow enough time for promulgation of regulations in the most efficient and thorough way possible. For example, the requirement for the filing of applications has been done by many gaming agencies in the past several decades and there are precedents that abound. A law that enacts gaming should allow for the agencies with those responsibilities to avail themselves of those precedents and use the time-frames that are practical and applicable.

Of considerable significance, the law should allow adequate time for the significant owners of the company to be investigated. If an unrealistic benchmark requiring qualification of all those who own 0.5 percent of a company is placed in the law, it could force the investigatory body to make unnecessary judgments as to what investigations to complete and prioritize. If an unrealistic timeframe to complete background investigations is imposed, it would diminish the serious treatment with which such an important function can be brought to completion. Such an investigation will take very serious resources, resources which a state is not familiar in dedicating. If mistakes are made and an applicant is accepted and then found to have background issues which are unacceptable, as has happened in other states and internationally, the consequences can be close to disastrous in terms of time and money for a jurisdiction.



None of these decisions or the others in the bid process should be casually addressed in enabling legislation. In each case in the Kansas Expanded Lottery Act, it appears a shorter time frame was allowed than has proven practical.

Kansas chose to allow simultaneous bids for contracts throughout its four designated zones. This has the advantage of reducing the amount of time in starting the industry but has an important disadvantage. Specifically, an applicant that loses a bid in one part of the state does not have the opportunity to rebid in another, nor the knowledge of how their bid will do in another area. In effect, this serves to diminish the attention that applicants can give to the bidding process and ultimately may deprive the state of the ability to take advantage of the best pool of applicants.

## State-by-state analysis of gaming regulation

The following tables provide an overview of the regulatory system in place in seven states with large commercial casino industries (that is, casinos that are not racetracks or Indian operations):

**Gaming Agency Operational Analysis**

State	Gaming Agencies (Primary Agencies Only)	Use of Police	Employee License Structure	Vendor License Structure	Inspectors Presence	Decision Making and Investigatory Structure
<b>Colorado</b>	Colorado Division of Gaming/ Colorado Gaming Commission/ Bureau of Investigation	Colorado Bureau of Investigation are State Police	License Required for Key and Support (Gaming) Employees	Slot Machine Manufacturers and Distributors only	Field Operations Staff not 24/7	Independent Commission is Part Time, Division makes Decisions on Employees
<b>Illinois</b>	Illinois Gaming Board	State Police are assigned to Gaming Board	License Required for All Employees	Gaming Related Companies only	No	Yes, Board is Part time
<b>Iowa</b>	Iowa Racing and Gaming Commission and State Division of Criminal Investigation	Division of Criminal Investigation work with Racing and Gaming Commission	License Required for All Employees	Gaming Related Companies must be investigated, Regular and Continuing Company Contracts examined only	Regulatory Officials at Casinos Business Days	Investigatory Agency is Independent Recommendations not made to Commission
<b>Louisiana</b>	Louisiana Gaming Control Board and State Police	State Police is the Primary Regulatory Agency	Key Employees Licensed, Work Permit for Gaming Employees	Gaming Related Companies only	No	Yes, Board is Part-time except for Chair
<b>Mississippi</b>	Mississippi Gaming Commission	Some Agency Employees are Law Enforcement Officers	Key Employees Licensed, Work Permit Required for Gaming Employees	Gaming Related Companies Licensed only	No	No
<b>Nevada</b>	Nevada Gaming Control Board and Gaming Commission	Some Agency Employees are Sworn Officers Local Police Assist in some Process	Key Employees Licensed, Gaming Employees Registered	Gaming Equipment Distributors only, no Renewal	No	Yes, Commission is unstaffed and Part time
<b>New Jersey</b>	New Jersey Casino Control Commission and Division of Gaming Enforcement	State Police Assigned to Division of Gaming Enforcement	Key Employees, Casino Employees Licensed, Employees with Access to Casino are Registered	Gaming Companies and Regular and Continuing Non-Gaming Related Companies Licensed	Yes, 24/7 at all casinos	Investigatory Agency is Independent, Decision Making Agency is Full time and Staff

## **Nevada model**

Nevada's Gaming Control Board was created in 1955, with the stated purpose to "eliminate the undesirable element in Nevada gaming and to provide regulations for the licensing and operation of gaming."<sup>4</sup> In 1959 the Nevada Tax Commission was relieved of its regulatory duties over the gaming industry and the Nevada Gaming Commission was created with licensing authority. In 1971 legislation expanded the duties of the State Gaming Commission to include tax collection. As the first modern gaming agency it has grown over the years.

Largely because of the toughened regulatory system respected companies were attracted to the industry and today the gaming industry in Nevada has become a multibillion dollar business. The Board is comprised of three members appointed for four year terms, and has approximately 450 employees in seven divisions.

## **New Jersey model**

New Jersey took a different approach than Nevada when it implemented gaming in 1978. New Jersey had a prior history of problems with organized crime and thus the desire to keep the industry crime free was upper most in those who drafted the New Jersey Casino Control Act. In addition, New Jersey clearly did not want to create a system where regulators were a captive of the industry, as they perceived existed in Nevada.

The result in New Jersey has been a stricter regulatory environment. Rules include a system of internal controls which help account for the movement of cash in the casino and divide functions between departments so as to eliminate incompatible functions. Licensing requirements were implemented for both employees and casino service companies.

New Jersey has gone through several periods of deregulation but a strict system still exists in areas deemed critical. Through their approach this state has largely accomplished its original goal, of establishing a crime free industry. The cost of regulation has been relatively high, as there are approximately 700 employees in the regulatory agencies now and a budget of about \$72 million. As a percentage of revenue, however, the cost is relatively small.

New Jersey undertook some major regulatory reforms in the early 1990s, streamlining the rules and eliminating most of the regulatory provisions that did not focus on what was determined to be the critical regulatory functions:

- Ensuring the good character, honesty and integrity of all operators, employees and suppliers.
- Setting the rules of the games to be fair and fixed.
- Ensuring the proper accounting of all revenues.

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<sup>4</sup> Nevada Gaming Commission. [http://gaming.nv.gov/documents/pdf/gaming\\_regulation\\_nevada.pdf](http://gaming.nv.gov/documents/pdf/gaming_regulation_nevada.pdf)

## Variations in gaming agencies

Gaming agencies vary, because of the differences in jurisdictions that they represent and also because of different approaches to regulating the gaming industry. The extent of attention that is given regulation, while different in budget amounts is not as different relative to gross revenue. More important than expense is whether those agencies are designed with the attention to the accomplishment of their charge. The public confidence and trust in the industry is a precious commodity that cannot be overestimated, for it allows for the existence of gaming industry itself. Moreover, it is not necessary today, with advancements in technology and well established networks of law enforcement and intelligence, to overlook areas of regulatory control that could allow for organized crime or theft of assets.

The budget for a gaming agency should be paid for not out of the general fund, nor out of taxes on gaming gross revenue, but out of fees and billings charged by the gaming agencies directly to the gaming industry. The extent of the budget should be sufficient to assure the gaining of the public confidence in the integrity of the industry and should include those areas that allow for the needed licensing, internal controls, and regulatory oversight.

## Recommendations for gaming regulation

As can be seen from the case studies and the above tables, gaming agencies vary in the following ways: with regard to license structure; presence of inspectors or other regulatory oversight; and decision making and investigatory structure. Our recommendations are that any state considering gaming adopts an efficient but relatively strict approach to the regulation of their gaming industry at least at the start because of the extreme value that such regulations hold relative to the public trust and confidence.

- Create regulations for the control of the assets that thoroughly address rule for table games and controls for slot machines, including the most recent technological changes in the industry
- Provide for sufficient regulatory oversight by creating a unit or team that is frequently on the casino floor, accessible to the public and visible to casino employees
- Create a license structure that addresses all those that participate in the gaming industry, including the casino licensees, the companies that service those licensees and the employees. It is only by examining the background of all those who seek to participate in the industry that integrity can be assured.
- Create a decision-making structure that allows for independence from the investigatory branch of the regulatory structure. In addition, sufficiently staff the decision-making agency to ensure it has adequate to resources to carry out its duties.

## About this Report

This report was prepared by Spectrum Gaming Group, an independent research and professional services firm founded in 1993 that serves private- and public-sector clients worldwide. Our principals have backgrounds in operations, economic analysis, law enforcement, regulation and journalism.

Spectrum holds no beneficial interest in any casino operating companies or gaming equipment manufacturers or suppliers. We employ only senior-level executives and associates who have earned reputations for honesty, integrity and the highest standards of professional conduct. Our work is never influenced by the interests of past or potentially future clients.

Each Spectrum project is customized to our client's specific requirements and developed from the ground up. Our findings, conclusions and recommendations are based solely on our research, analysis and experience. Our mandate is not to tell clients what they want to hear; we tell them what they need to know. We will not accept, and have never accepted, engagements that seek a preferred result.

Recent private-sector clients include Elad Properties, Harrah's Entertainment, Morgan Stanley, the Pokagon Band of Potawatomi Indians, and the Seneca Nation of Indians. Recent public-sector clients include the Massachusetts Office of Housing and Economic Development, the Connecticut Division of Special Revenue, Broward County (FL), the West Virginia Lottery Commission, the New Jersey Casino Reinvestment Development Authority, the Atlantic City Convention and Visitors Authority, the Singapore Ministry of Home Affairs, Rostov Oblast (Russia) and the Puerto Rico Tourism Company.

Within the past 18 months, Spectrum has performed work for a variety of state governments, including Maine, Massachusetts, Connecticut, Delaware, Maryland and Indiana.

We maintain a network of leading experts in all disciplines relating to the gaming industry, and we do this through our offices in Atlantic City, Bangkok, Guangzhou, Harrisburg, Hong Kong, Las Vegas, Macau, Manila and Tokyo.

Governments regularly call on Spectrum's expertise when debating public policy. Our principals have testified before the following government bodies:

- International Tribunal, The Hague
- U.S. Senate Select Committee on Indian Gaming
- U.S. Senate Subcommittee on Organized Crime
- U.S. House Congressional Gaming Caucus
- National Gambling Impact Study Commission
- Indiana Gaming Study Committee
- Illinois Gaming Board
- New Jersey Casino Control Commission

- Pennsylvania Gaming Control Board
- New Jersey Senate Wagering, Tourism & Historic Preservation Committee
- New Jersey Assembly Tourism and Gaming Committee
- Massachusetts Joint Committee on Bonding, Capital Expenditures, and State Assets

## Disclaimer

Spectrum Gaming Group (“Spectrum,” “we” or “our”) has made every reasonable effort to ensure that the data and information contained in this study reflect the most accurate and timely information possible. The data are believed to be generally reliable. This study is based on estimates, assumptions, and other information developed by Spectrum from its independent research effort, general knowledge of the gaming industry, and consultations with the Client and its representatives. Spectrum shall not be responsible for any inaccuracies in reporting by the Client or its agents and representatives, or any other data source used in preparing or presenting this study. The data presented in this study were collected in January 2010. Spectrum has not undertaken any effort to update this information since this time.

Some significant factors that are unquantifiable and unpredictable – including, but not limited to, economic, governmental, managerial and regulatory changes; and acts of nature – are qualitative by nature, and cannot be readily used in any quantitative projections.

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