

The Compliance Department—Key to Protecting Gaming Companies Domestically and Internationally

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INTRODUCTION

THIS ARTICLE WILL EXAMINE TRENDS IN THE GAMING INDUSTRY that impact on compliance related issues. We conclude that the gaming industry is poised to meet challenges related to the expansion of gaming internationally and is unlikely to face the accounting crisis that has impacted many other segments of corporate America in 2002.

INTERNATIONALIZATION OF GAMING

We are presently witnessing a major expansion of gaming internationally. Many countries are considering the legalization of casinos or the expansion of previously approved gaming as vehicles to increase revenues and create employment opportunities. The expansion of gaming in Macau, the probable legalization of casinos in Thailand, and the expansion of casino gaming in the United Kingdom are just three examples of this trend.

Some casino companies licensed in major gaming jurisdictions have or are contemplat-

ing joint venture agreements with international partners. Macau last year awarded two new casino licenses to companies that include The Venetian and Wynn Resorts, casino licensees in Nevada. Other major gaming companies are exploring the development of casino projects outside of the United States. Finally, vendors, including slot machine manufacturers and casino software companies, licensed in major U.S. gaming jurisdictions such as Nevada, New Jersey, and Mississippi seek to sell their goods and services internationally.

We see the internationalization of gaming as a major trend that is in its infancy. This trend is likely to shape the gaming industry for the years to come. While international markets create tremendous opportunities for American companies, this trend also creates unique challenges as well. Will standards for suitability of licensees that have been used by, for example, Nevada and New Jersey, be applied internationally? What standards of conduct will companies licensed in Nevada, New Jersey, and other jurisdictions be required to adhere to as they contemplate international expansion? Will present standards inhibit American companies from effectively competing internationally? The answers to these and other questions are not clear. However, it is clear that there will be an increased emphasis on the role of the Compliance Committees and Compliance Officers. Due diligence of potential business partners, distributors for vendors, country assessments, and even customer reviews for vendors will become increasingly important.

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ACCOUNTING SCANDALS

A second trend also impacts on gaming industry compliance. The meltdown of formerly well respected companies such as Enron, WorldCom, Tyco, and Global Crossing due to corporate corruption, accounting scandals, and insider trading plagued American industry in 2002. Throughout America, stockholders and employees are concerned about how something like this could occur with all of the oversight that allegedly takes place through internal audits, board of directors' reviews, and compliance department scrutiny.

We submit that the gaming industry is unlikely to suffer these types of problems in large measure due to the proactive regulatory measures taken by state regulators over the years. A series of regulations that are typically applied in the gaming industry protect casino licensees and the general public from Enron-type scandals. These regulations include the establishment of an internal audit department that is independent from operation management and the submission of audit reports to regulators and the notification to regulators of company debt and financial information. These regulations minimize the chances that accounting scandals will occur in the casino industry because they provide opportunities for regulatory review of corporate refinancings and restructurings. In addition, the ability of regulators to examine the financial stability and responsibility of casino licensees along with the legal authorization to attach conditions to the license of casino licenses goes a long way to alleviate these concerns. Regulators in the U.S. do not hesitate to use their regulatory powers when circumstances warrant.

REGULATORY REQUIREMENTS RELATING TO COMPLIANCE COMMITTEES

New Jersey gaming regulations do not mandate that casinos or vendors have compliance departments at the present time. However, Nevada gaming regulations have required compliance committees and compliance officers for many years. Although some casino li-

cencees and vendors voice concerns about the burden of stringent regulatory oversight that these requirements create, it should be noted that the purpose of these regulations is to protect the company and to maintain the integrity of the industry.

Regulators are beginning to recognize that they may need to set some standards for structuring compliance related activities. We will discuss the New Jersey and Nevada approach to these matters.

In May 2000, the New Jersey Division of Gaming Enforcement recommended the adoption of Compliance Systems to the New Jersey Casino Control Commission. This proposed rule would require that Atlantic City casino hotel licensees establish Compliance Committees with a Compliance Officer and adequate support staffs. The Compliance Committees would be comprised of at least three individuals, one of which was to be an independent member. Minutes of all Compliance Committee meetings would be prepared and submitted to the regulators within 45 days of the meeting. The Compliance Committee would be charged with investigating all entities and individuals, including consultants having any proposed association with any efforts by the company to pursue gaming opportunities in any jurisdiction; the reporting of any proposed business association with payment to or the provision of gifts to or on behalf of a public official; and the reporting of all outstanding litigation on a semi annual basis to regulators. This proposed regulation was not enacted by the Casino Control Commission but served as notice to the industry that compliance related matters should be stepped up.

NRS 463.720 serves as statutory authority for the Gaming Control Board to monitor the activities of Nevada casino licensees outside of Nevada. Specifically, this statute requires that a licensee shall not, in a foreign gaming operation, knowingly violate a foreign federal, tribal, state, county, city, or township law, regulation or rule concerning the conduct of gaming. In addition, this statute requires licensees in Nevada to conduct their operations in accordance with the standards of honesty and integrity required for Nevada. Finally, this statute requires that a licensee shall not know-

ingly engage in an activity or enter into an association that is unsuitable because it: a) poses an unreasonable threat to the control of gaming in Nevada; b) reflects or tends to reflect discredit or disrepute upon Nevada or gaming in Nevada; or c) is contrary to the public policy of Nevada concerning gaming.

As noted, Nevada has also enacted regulations mandating the appointment of Compliance Officers since 1991. The Compliance Officer must be knowledgeable about the provisions of the Nevada Gaming Control Act and the regulations of the Commission. The Nevada regulation mandates the preparation of a written compliance plan, the filing of reports with senior management, and the filing of copies of reports with the Gaming Control Board.

The Nevada statute and regulations provide broad state power to monitor foreign gaming and establish a high standard of due diligence for companies that seek to do business internationally. Compliance Committees and Compliance officers have a significant responsibility to initiate due diligence review of countries, business partners, financial sources, potential distributors, and others that might raise the concerns of regulators.

COMPLIANCE DEPARTMENTS AND OFFICERS

Typically, the Compliance Officers either report to a Compliance Committee or the company's General Counsel. In smaller companies, the compliance function is generally part of the Office of General Counsel. Many casino licensees and vendors maintain compliance departments; however, their compliance programs are more reactionary than proactive. A compliance department in a small to mid-sized company may only consist of one or two individuals, usually an attorney with regulatory experience and an investigator. These professionals are responsible for a wide variety of compliance matters affecting the entire company. Oftentimes these compliance departments may lack the resources, expertise, or contacts to undertake due diligence on individuals or corporations situated domestically and es-

pecially internationally. Online databases and Internet searches can provide a substantial amount of information; however, this data must be analyzed to determine its credibility, before being relied on too heavily and is just the starting point for conducting effective due diligence. A second concern is that some licenses do not provide adequate budgetary support to the compliance function.

When conducting due diligence in foreign jurisdictions a compliance department should make use of existing professional investigative resources outside the corporation to enhance their capabilities in both acquiring and analyzing information. Independent investigative resources are also especially useful for conducting sensitive internal investigations, since they can provide an objective view to the investigative process.

Compliance officers for vendors have just as important a role as compliance officers affiliated with casino licensees. It is critical for vendors to have an effective and efficient compliance department since many of the vendors are publicly traded corporations and seek to engage in international business. In the vendor area, there is always a healthy tension between sales and compliance. Institutionally, it is crucial for management to provide sufficient time for the appropriate due diligence checks to be completed, especially in a jurisdiction that may not have a sophisticated regulatory process. In one instance in 2000, the Nevada Gaming Control Board criticized the level of due diligence undertaken by a slot manufacturer seeking to do business in a controversial Caribbean jurisdiction.

Since the compliance department is not viewed as a revenue generating department by management, more attention and resources are provided to other departments, such as sales and marketing, who are tasked with developing and maintaining customers, the "lifeblood" of the casino industry. Although the compliance department may not actually generate revenue, this department can save the casino and vendor licensees hundreds of thousands of dollars in regulatory and litigation costs. Thorough proactive due diligence and the utilization of outside investigative resources, in both domestic and foreign jurisdictions, is the best

safeguard to assure that the company does business in suitable jurisdictions with individuals and companies that satisfy basic integrity standards. This information allows management to make a more informed business decision before committing substantial corporate expenditures and personnel to new projects or sales that may be inappropriate. This has the effect of increasing the "bottom line" and making the best use of all corporate assets.

Frequently the management and the marketing department are involved in the formulation of new or more aggressive "sales" initiatives, without participation from the compliance department. Management or marketing employees may meet with individuals in new markets without the benefit of adequate due diligence being conducted proactively. The importance of knowing with whom the company is associating or is contemplating doing business with is critical in the highly regulated environment of the gaming industry. Becoming involved with individuals who might be deemed unsuitable by regulatory authorities could detrimentally impact the company and lead to protracted litigation in multiple jurisdictions. Casinos may be especially vulnerable to potential problems as they continue to establish marketing offices internationally. It is important that casino licensees assure that the individuals employed in these offices meet integrity standards and that the junket representatives used in these offices meet suitability standards. Moreover, it is important to task the Internal Audit Department or outside auditors with the task of auditing the operations of these offices to assure that funds are properly accounted for and that casino monies have not been improperly used. The Compliance Officer or Compliance Committee should be actively involved in the corporate oversight of these satellite offices.

Large hotel companies that contract with casino management companies to operate small to mid-sized casinos internationally, need to conduct due diligence of potential casino management. The contracts between the parties should include a mechanism to audit the casino, especially where there may be revenue sharing among casino revenues.

A majority of compliance programs primarily address problems the corporation becomes aware of, either internally or through outside sources. This type of knee-jerk reaction to events tends to be highly disruptive to the company and causes a continuous crisis management situation to occur on a repetitive basis. This approach is not only inefficient, but also costly to the corporation and its stockholders. The proactive approach not only helps to avoid negative publicity, but also avoids the potential for exorbitant legal fees resulting from civil litigation or regulatory hearings and possible sanctions. Historically, when regulatory complaints involving casino licensees are reviewed after the fact, it becomes apparent that the legal costs and the time spent by management devoted to dealing with some of these matters could have been prevented by conducting proactive due diligence, either in-house or through outsourcing.

CONCLUSION

In conclusion, one way to evaluate whether a casino or vendor licensee has an efficient and effective proactive domestic and foreign compliance policy is to ask yourself these questions: Would I feel confident in personally explaining to gaming regulators, under oath, what proactive steps were taken to ensure that the company and its personnel were dealing with individuals or companies that were people of good character, honesty, and integrity, in both domestic and foreign jurisdictions? Is the Compliance Department aware of the companies and consultants the corporation is dealing with regarding potential new marketing initiatives?

Since the burden of proof falls heavily on the casino licensee in regulatory matters, it is critical to anticipate potential regulatory issues involving associations with unsuitable individuals or companies, both domestic and foreign, and not merely be revenue driven without "reasonable" proactive due diligence. Thorough proactive due diligence is not a luxury, it is a necessity, since it protects not only the gaming licensee but also its employees and stockholders.