



Memorandum

**TO: SHARON ERICKSON
CITY AUDITOR**

**FROM: DEBRA FIGONE
CITY MANAGER**

SUBJECT: SEE BELOW

DATE: April 9, 2010

**SUBJECT: ADMINISTRATION'S RESPONSE TO "AUDIT OF THE CITY'S
CARDROOM REGULATORY OVERSIGHT FUNCTION"**

RECOMMENDATION

Accept the Administration's response to the City Auditor's "Audit of the City's Licensing and Permitting of Cardroom Owners and Employees (Audit)"

OUTCOME

This response provides background of the City's gaming and regulatory history and how the current state of public policy and regulation has developed. This report demonstrates the complexity of gaming regulation and licensing and work permitting for the purpose of gaining a deeper understanding of how a thoughtful, measured, and well-paced response is needed to ensure that any changes do not adversely impact other regulatory elements of Title 16, Gaming Control Ordinance (Title 16). The Audit contains two findings and six recommendations; the Administration agrees with five and is reserving judgment/final conclusion on Recommendation #1. The Administration desires to explore other options that better meet the regulatory needs of the City. Staff requests the opportunity to evaluate those options to streamline the license and work permit processes, one of many functions performed by the Division of Gaming Control (DGC).

Our history shows why San Jose should be cautious, but our new context is also equally as important to acknowledge. Our two cardrooms have each expressed their support for regulation, with Bay 101 showing a stronger level of support for local regulation and law enforcement presence, and each have evolved into important contributors to the City's tax base. Further, each cardroom has demonstrated a willingness to work with the City to resolve issues that they see in our regulatory approval processes as impeding the ability to remain competitive in the cardroom/gaming market. The City Council has also placed a cardroom ballot measure¹ which intentionally preserved the current audit and oversight functions. **There is acknowledgement that the City and cardrooms have worked together collaboratively to address concerns and**

¹ The Cardroom ballot measure would raise the cardroom tax rate on gross revenues from 13% to 15%, allow each cardroom to seek City approval to increase the number of tables from 40 to 49, remove the limit on the number of permissible card games by permitting any card game allowed under State law consistent with City regulations and increase the current \$200 betting limit to that allowed under State law. In addition, the City Council will retain the authority to amend or to repeal provisions in the City's Gaming Ordinance (Title 16 of the City's Municipal Code) in order to revise the City's gaming control regulations.

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the Administration believes that we can continue to work together to address issues of cost, timeliness, efficiencies, and duplication of effort.

BACKGROUND

This Audit was developed with the input from the San Jose Police Department's (SJPD) DGC, City Manager's Office (CMO), Office of the City Attorney (CAO), Department of Finance, and Senior Staff from Garden City and Bay 101. The City would like to thank the Auditor's Office for completing this Audit, as well as the cardrooms for their participation of the Audit. The Audit acknowledges that the recommendations in the Audit represent one component of Title 16. As such, licensure and work permit functions would need to be evaluated against the entire regulatory program as contained in Title 16. This Audit was very welcomed by the Administration and, in fact, the City Auditor's Office and CMO worked to establish an appropriate timeframe to address the Administration's urgent concern to evaluate these key regulatory functions.

Sound and effective public policy is the underpinning of cardroom regulation which sets the basic standards for controlling cardroom activity and ensuring a safe local gaming industry. When the City Council adopted Title 16 in 1999, the Council adopted the key recommendations of the Spectrum Report (Report), a report developed by a consulting firm hired by the City to review the City's existing system of cardroom regulation and to offer recommendations for regulatory reform. The Report identified key fundamental principles ("bottom line" principles) which are still relevant today as we endeavor to streamline processes that achieve the City's public policy goals, which are:

1. Strict regulation of cardrooms, including detailed provisions pertaining to licensure, ongoing regulation and taxation;
2. Framing the granting of a cardroom license as a privilege that can be revoked by government if circumstances so warrant rather than as a right or entitlement;
3. Creation, by the enabling legislation, of an independent agency to oversee cardroom regulation, with law enforcement powers, isolated to the extent possible from political influences;
4. An all-encompassing and continuing obligation of individuals and companies to disclose information to the appropriate regulatory entities;
5. Companies receiving cardroom permits should pay for the costs associated with regulation of this activity through fees; and,
6. A strict code of ethics under which regulatory agencies should operate so that actual and perceived conflicts of interests can be avoided and regulatory decisions can be made on the basis of merit.

One of the fundamental methods used to preserve the integrity of cardrooms is an effective and comprehensive licensing and regulatory program. The City's past and current events underscore the importance of maintaining local control of the individuals that are permitted the privilege of working in the City's cardroom industry through a system that requires licenses for persons holding key employee positions and work permits for all gambling enterprise employees.

The City has worked to strike a better balance between regulation and responding to the cardroom's business needs; and, has demonstrated a good faith effort to maintain its regulatory interests while infusing flexibility in practices. The City has a proven record that it has made adjustments to address cardroom concerns, and understands and agrees with the need for more

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efficiency of the City's licensing and permitting function. In fact, over the past year, the City Administration has twice advanced structural changes that would directly enable greater efficiencies with respect to licensing and work permits (See FY 2009-2010 Manager's Budget Addendum (MBA) #28 and September 1, 2009, City Council Agenda, Item 8.1). While both reports had a level of conceptual approval by the cardrooms, Council directed staff to meet with the cardrooms on their business growth concerns and directed an audit to evaluate the licensing and work permit process before any permanent structural changes were put into place. It is equally important to note, and as the Audit itself suggests, that the Audit findings should not be used to make conclusions about other cardroom regulatory functions, given the very limited scope of the audit which reviewed only the licensure and work permit functions and not the total regulatory program. The Administration is very interested in a broad approach in bringing about efficiencies and effectiveness in all areas of Title 16 regulation.

The Administration fully believes that a more efficient licensing and work permit process is needed; however, any change should not lessen the "bottom line" regulatory principles nor result in the weakening of other provisions contained in Title 16. This is particularly important, and timely, in light of Cardroom Ballot Measure, which would significantly enlarge the City's cardrooms operations by allowing an increase in the number of cardroom tables and to align with State requirements regarding betting limits and permissible games.

Structure of the Administration's Response

It is important to provide information regarding the history of gaming in the City so that a reader can understand how this unique sequence of City events has led to the current state of regulation. Based on the City's more recent history, the City Council deliberately established an oversight model which is based on gaming models used in Nevada and New Jersey, which are the strictest gaming regulation models in the nation. This report provides discussion on: 1. Expanded History of Gaming in San Jose; 2. San Jose Regulatory Reform; 3. Title 16 Overview, and Core Principles and Background About the DGC; and, 4. Responses to Audit Recommendations.

The first three sections demonstrate the fragile nature of regulation and incidents that have resulted in the current state of regulation and public policy. Additionally, as staff stated during the ballot measure discussion, the Administration has been waiting for several key sets of information to proceed with a set of cardroom regulatory improvements. Listed below are the areas that will help determine next steps:

- Civilianization Audit
- City-Cardroom Workplan Activity/Results
- Cardroom Ballot Measure Results
- Police Department FY 2010-2011 Reductions in Operating Budget
- Cardroom License and Work Permit Audit

Given the complexity of changing the City's regulatory practices, the City is in the process of developing a Request for Qualifications (RFQ) for Gaming Regulation Consulting Services to better inform the future of the DGC structure. The purpose of the consultant would be to focus on efficiency measures, as well as providing insight and recommendations on regulatory and law enforcement practices and procedures based on the aforementioned recently issued reports and audits (see background section). The scope would be advisory and not technical in nature.

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Therefore, it should be noted that the Administration's response is preliminary in nature and further analysis is needed on several of the audit recommendations to be able to implement based on various factors discussed in this report.

1. Expanded History of Gaming in San Jose

See Attachment A for a detailed summary of the history of gaming regulation in San Jose and significant criminal events that shaped the current state of regulation.

2. San Jose Regulatory Reform

Concerns about the criminal events and social effects of gambling raised questions by the City Council about the adequacy of the City's regulation of cardrooms, furthermore the State had just passed the Gambling Control Act and the City was looking at local regulation with that Act in mind, which led to the City Council's 1998 direction to the Administration to hire a gaming expert (consultant), the Spectrum Gaming Group (Spectrum), to review and recommend changes to the City's regulatory approach of controlling cardroom operations. Spectrum's analysis focused on how to ensure that the cardrooms operate effectively and in a manner which is safe and socially responsible. The Spectrum Report (Report) recommended a variety of regulatory, law enforcement, and cardroom operational enhancements, which further shaped the current regulatory oversight structure. It should be noted that the Report not only referred to the general historical pattern of organized crime influence on casino gambling in Nevada and in legalized gambling in the rest of the country, but also devoted a section of the report to the serious crimes related to San Jose cardrooms.

In 1999, in response to the Spectrum Report, the City Council adopted Title 16 of the San Jose Municipal Code, which contained the changes recommended by Spectrum Gaming Group, other provisions directed by Council and the Administration, as well as the minimum requirements required by the recently enacted Gambling Control Act. Based on a desire to put into place advanced and complete regulatory practices, the City Council approved an oversight structure modeled after the Nevada and New Jersey oversight models, which reflect the strictest form of regulation. It is necessary that past City Council actions, such as the adoption of Title 16, be taken into consideration when the **City's current local regulation model is compared to that of the State of California or other California cities because the City's gaming regulation model was intentionally based on the models of Nevada and New Jersey, not California's gaming regulatory model.**

Based on this strict regulatory model for San Jose, City Council, as part of Title 16, authorized the creation of the Gaming Administrator position to administer the DGC as a division of the Police Department. In 2002, the Administration hired a Gaming Administrator with specific experience in Nevada and other state jurisdictions with legal, regulated gambling to administer and enforce Title 16. (From 2000 until 2002, the DGC had an acting Administrator who was a full time Deputy Director of the Finance Department.) The DGC begun the process of accepting applications for key employee licenses prior to the 2002 hiring of the Gaming Administrator, so that when the Gaming Administrator began work, there was already a backlog of 37 gaming license applications filed and waiting for investigative review.

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In addition to putting in place a full regulatory program, including drafting and going through the rule-making process for required Minimum Internal Control Standards and Accounting regulations, developing comprehensive license and work permit procedures, the Gaming Administrator began work with a formidable backlog. It should be noted that Bay 101 contested the validity of Title 16's licensing requirement and its key employees refused to cooperate with the Division in the licensing process. The 6th District Court of Appeals finally resolved the issue in a published opinion issued December 18, 2003, deciding that Title 16 was not preempted by the Gambling Control Act. The Court held that the City had concurrent jurisdiction over cardrooms with the State and that the City could impose more stringent local controls and conditions upon gambling than the minimum conditions imposed by the Gambling Control Act.

After Garden City, Inc. came out of bankruptcy in 2007 (the bankruptcy began in 1998 largely as a result of an unresolved dispute between the owner of the corporation, Eli Reinhard, and the landlord) the new business ownership let go many employees and embarked on a new business model that relied heavily on independent contractors to provide services that had been provided by employees of the cardroom. These changes resulted in an increase in key employee license applications and work permit applications for Garden City. It should also be noted that the turnover in employees and contractors at Garden City contributes significantly to the current backlog. In all, the current backlog is very likely the result of a historical backlog dating back to the early 2000's, based on the inadequacy of the auditing resources available to the DGC and the strict investigative requirements. Resolution of the backlog requires a structural work process change that takes into account many factors that protect the City's local regulation program.

It should also be stated that from 2002 to present, the DGC, working closely with the CAO, has been busy working on various lawsuits and settlement agreements that have further resulted in City Council approved regulatory improvements and changes. The settlement agreements approved by the City Council on March 24, 2009, which ended nearly eight years of legal challenges brought by the cardrooms to Title 16, included as a condition of the settlement a requirement that the cardrooms pay \$500,000 per cardroom for each of three fiscal years, 2009/2010-2011/2012, to non-profit organizations in order to address some of the social problems associated with problem gambling. This was an unprecedented action for both local regulation, and throughout the state of California, and marked the City Council's desire to put into place a more comprehensive approach for mitigating the social impacts of gambling. The City also negotiated an extensive revision of Title 16 with the two cardrooms during the settlement negotiations. The revised Title 16, which clarified and enhanced the scope, terms, conditions and procedures of regulation of cardrooms and funding sources, and made technical changes, was passed for publication on March 24, 2009 and adopted by the City Council on April 7, 2009.

3. Title 16 Overview and Core Principles & Background About the DGC

Title 16 Overview and Core Principles: Based on the above "bottom line" principles, historical criminal events, and local reform efforts, the City Council established a strong foundation of regulation of cardrooms. Spectrum Report observed that cardroom regulation is similar to the regulation of casinos and that the same types of activities likely to take place in cardrooms takes

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place in casinos.² Several of the key elements of effective gaming control that the Report recommended concerned licensing, specifically the Report states:

Strict licensing of those companies and individuals who participate in the cardroom industry should form the basis of regulation as they do in the casino industry. In just about every jurisdiction which has approved casino gaming, gaming activity is highly regulated. Public confidence and the overall integrity of the gaming industry requires such regulation and a concomitant commitment by government to use the tools gaming legislation provides.

The elements of effective gaming control include various operational controls and licensing of those companies and individuals privileged to participate in the industry. The goal of licensing is to ensure that only those companies and individuals who meet defined standards receive a license; organized crime is kept out of the ownership and operation of cardrooms; and otherwise unqualified companies and individuals are barred from licensure. (Id.)

As a matter of fundamental public policy, the City Council approved the aforementioned key elements as the foundation of the City's regulatory gaming program in the first three subsections of the statement of purpose of Title 16.02.010, the revised version of which reads as follows:

- A. Effective and comprehensive regulation of the practices, activities, *persons* and places associated with or involved in gaming in San José is essential for the protection of the public health, safety and welfare.
- B. The purpose of this Title and the Gaming Control Regulatory Program authorized by this Title is to maintain public confidence:
 - 1. In the integrity of Cardroom operations by requiring strict regulatory controls and enforcement practices to carefully monitor gaming activity at Cardrooms, and
 - 2. In the integrity of Nonprofit Organization Fundraisers held either in permitted San José Cardrooms or elsewhere in the City of San José by Eligible Nonprofit Organizations by requiring regulatory controls and enforcement practices pursuant to the requirements of State Gambling Law, The Gaming Control Regulatory Program and Title 16.
- C. The Gaming Control Regulatory Program is further designed to regulate the *persons*, locations and practices of permitted San José Cardrooms and Funding Sources.

The City also adopted Spectrum's other recommendations on licensing, which included licensing of the companies established to own, operate or manage the cardroom (the cardroom permit under Title 16), licensing for stock owners, key employees, landowners and financial sources for the cardrooms, and vendors (Survey and review of Cardroom Operations, August 1998, Page III-23). The Report provided the following analysis of the weakness of the Cardroom ordinance's registration requirement as it applied to key employees:

The licensing of these employees and the evaluation of their qualifications in conjunction with the licensing standards discussed herein would provide a vehicle to evaluate these potential employees and also provide a way in which to revoke licenses, if circumstances warrant. The present system of issuing work permits to all employees does not require the filing of a meaningful application form. Present background investigation(s) are essentially limited to a review of criminal records and does not allow the licensing officials to make a truly informed decision relative to licensure. (Page III-23).

The City also adopted the broad licensing standards, including affirmative criteria and disqualification criteria for licensing and the procedural recommendations regarding the burden of

² The major distinction between cardrooms and casinos is that in cardrooms the patrons play against each other, whereas in casinos the patrons play against the house (Survey and review of Cardroom Operations, August 1998, Page III-1). The Report went on to note that there is a universally accepted approach to effective regulation of casinos throughout the United States and submitted that these standards are applicable to cardrooms as well.

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proof and licensing hearings set out in the Spectrum Report (Survey and review of Cardroom Operations, August 1998, Pages III-24 – 27) (See generally Chapters 16.32 and 16.36 of Title 16). Spectrum also recommended that other employees be required to apply for and receive work permits, and the City adopted this recommendation as well with respect to gambling enterprise employees. Notably, Spectrum also recommended that vendors be monitored and licensed. The revised Title 16 provides for this in a new provision requiring approval of vendors.

Background about the DGC: The State investigative and review process is based on a dual review/approval process by the State Division of Gaming Control and the State Gambling Control Commission. In San Jose, these two functions are the responsibility of the DGC. The DGC is the administrative and enforcement unit which ensures that this oversight occurs as mandated by the City Council in Title 16. Specifically, the responsibilities of the DGC are as follows:

- Enforce Title 16 and State Gambling Laws and promulgate and enforce regulations necessary to implement the requirements and fulfill the policies of Title 16;
- Conduct operation and financial audits and reviews of Cardrooms;
- Administrative inspection of the Cardroom premises;
- Conduct investigations (including, but not limited to investigations of complaints from patrons and employees);
- Monitor the "Observed Patron Monitoring Requirements Regulation" for compliance;
- Perform criminal and civil background investigation of license applicants;
- Perform financial analysis applicants for stockowner, key employee, funding source and other gaming licenses;
- Perform investigation of renewal applicants;
- Preparation of a final recommendation and report to the Chief of Police regarding all gaming license applications and renewal applications and appear in licensing hearings;
- Review and approve all work permit applications and provide assistance to cardroom employees as they submit their work permit applications;
- Collect all appropriate fees associated with the work permit and gaming license application and establish a City (via Finance Department) account for the individual;
- Issue appropriate cardroom identification cards to employees and contractors for their specific jobs;
- Preparation of notices regarding all work permit denials, suspensions or revocations and appear before work permit administrative hearings; and,
- Initiate and participate in Regulatory Action proceedings against Cardroom Permittees and Licensees.

It is the Administration's fundamental philosophy that any change to local regulation that is initiated for the purpose of effectiveness and efficiency, specifically where the State of California's processes would replace local processes, including licensing and work permitting, should be weighed very heavily against the backdrop of potential loss of enforcement and local control in the City's cardrooms. To demonstrate the significance of advancing change in a heavily regulated industry, where thorough and complete analysis is needed, the Administration is providing a snapshot of investigations launched during the course of this Audit to demonstrate the risk to the City (Attachment B for more detailed information), and that these investigations are not unusual rather reflective of normal activity:

⁴ The use of temporary licenses has allowed for the City to accommodate the cardroom businesses while still maintaining the ability to undergo due diligence in the background investigative process. More recently, the Division administratively added a procedure that allows for due process for Temporary License holders prior to any final decision to suspend or revoke a Temporary License. (Please note in this regard that the City has only attempted to revoke one Temporary License in the 10 year history of Title 16.) The City Attorney's Office at the direction of Council is drafting an amendment to Title 16 to codify this procedure.

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Table 1: Summary of Investigations During the Audit (Open Cases)

Type	Summary
Deny/Revocation License	<ul style="list-style-type: none">▪ Applicant lied about his/her arrest record▪ Key Employee allowed a problem gambler to gamble and cash in gaming chips after learning the employee was gambling in violation of the State Gambling Control Act. The Key Employee in question then lied to investigators during the investigation.
Revocation Work Permit	<ul style="list-style-type: none">▪ Permittee stole:<ul style="list-style-type: none">▪ Money from a poker game and deposited it on his/her tray while on duty▪ Gaming chips while on duty▪ Money from the cashier cage and booked into jail for embezzlement▪ Permittee illegally arranged cards so that co-conspirators would know the sequence of the cards. Approximately \$27,000 was stolen and individuals were arrested and charged.
Administrative Investigations	<ul style="list-style-type: none">▪ Key Employee:<ul style="list-style-type: none">▪ Reinstated a "Self Restricted Patron" in violation of the State Gambling Control Act. Only the State has the authority to reinstate a self restricted person.▪ Did not timely report cheating.
Underage Patrons	Multiple employees allowed underage patrons to gamble at one of the cardrooms on three separate occasions. In at least one instance, the minor was served alcohol and consumed it while gambling.
Stimulation Play	Both cardrooms allowed "Stimulation of Play prohibition" by allowing the Funding Sources to reimburse money to the players for table fee payment purposes.

Regulatory Costs: The Audit states that the cost of regulating cardrooms in San Jose is higher than all but one California jurisdiction. It should also be noted that in the 1997 San Jose Mercury News Article, *Odd in Trouble*, the two San Jose Cardrooms were acknowledged as making the most money per table of the 10 largest clubs in the State of California. Evaluating the cost of regulation based on fees alone does not adequately acknowledge that the City's regulatory model is based on Nevada and New Jersey, and thus comparisons to California cardrooms is somewhat incomplete. Nevertheless, the Administration does believe that there are several approaches for analyzing the appropriate cost of regulation, some of which are based on an evaluation of: Fees (e.g., Table Fees); Taxes (e.g., that include regulatory costs); cost of regulation as compared to total cardroom revenues; and, cardroom's contribution to a jurisdiction's General Fund.

As noted later in this report, the DGC is operated on a cost recovery basis and is supported by the Cardroom Table Fee generated by the two cardrooms. The Cardroom Table Fee is calculated based on the annual cost of managing the DGC, and includes the total cost of the staff (including central service cost allocations) and the related non-personal costs associated with the DGC operation. It is difficult to compare costs across jurisdictions, as all of them have different regulatory methodologies; but, it should be noted that the fiscal relationship between a cardroom and jurisdiction often shape the regulatory model. For example, California Attorney General Bill Lockyer, requested that a report be developed to provide an overview of gambling in California, including social and economic impacts and findings and recommendations. This report highlights the inefficiencies of the State Division of Gambling Control as well as the Gambling Control Commission, and further states:

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Some cities are particularly dependent on cardroom revenues as a major source of municipal funds. Cities such as Commerce, Bell Gardens, Colma, Hawaiian Gardens, Gardena, and San Pablo depend on local cardrooms for a significant portion of their income. This dependence has raised questions as to whether these cities can adequately regulate club operations, as they are in essence a "municipal partner." (Page 111)

Changes to regulation, licensure and work permits, must appropriately ensure that the City maintains the independent integrity of its regulatory function while achieving the desired efficiencies.

ANALYSIS

The Audit contains two findings and six recommendations; the Administration agrees with five and is neutral on Recommendation #1. This section of the report provides responses that integrate the perspectives of the CMO, CAO and the SJPD. As noted, the responses are preliminary in nature and are based on the need for more exploration and evaluation of the various recommendations as well as the consultant's review of the recommendations within the broader context of the aforementioned factors. Staff will provide a report on the status of further analysis in the fall 2010 timeframe.

Recommendation #1: Retain the City's licensing of cardroom owners, and propose amendments to Title 16 to require and rely solely on the State's key employee license for issuing a San Jose key employee license thereby reducing the DGC's workload while preserving the City's ability to impose limitations and conditions on these licenses including the ability to retract the license based on the key employee's violations of Title 16. These revisions should apply to all new, pending, and incomplete license investigations. (Priority 3)

The Administration is reserving judgment/final conclusions on this recommendation and would view it as an option that would require further evaluation. Further, the Audit is silent on the licensing and/or work permitting of funding sources and/or third independent contractors which is another category that the City needs to address as part of its broader evaluation of redesigning its licensing processes. According to California Research Bureau, *Gambling in the Golden State* (May 2006), the following is noted about its findings regarding state regulation:

Gambling is government-regulated. Governments determine which kinds of gambling are permitted, where gambling establishments may locate, their size, who may own them, who may work for them, who may sell them supplies and what games they can offer. In effect, governments grant monopolies to themselves (state lotteries) and limit other gambling operations through regulation (Indian casinos, race tracks, card clubs), providing a valuable asset to a relatively few enterprises.

Governments regulate gambling in part to reduce its negative impacts on society. In order for a regulatory scheme to be effective, it must have the resources and structure to effectively monitor and investigate potential problems. California's regulatory structure mixes responsibilities among a number of entities—the Lottery Commission, the California Horse Racing Board, the California Gambling Control Commission, the Division of Gambling Control in the Department of Justice, the Office of Problem Gambling in the Department of Alcohol and Drug Programs, and the Governor. This divided structure makes it hard for the state to develop and implement a unified regulatory policy. Equally as important, the state's regulatory agencies do not have sufficient resources to fully staff their responsibilities. (Page 2)

The bulk of the Division's resources are directed towards its licenses responsibilities, leaving it short of investigative and enforcement staff. (Page 39)

Recommendations to the Commission are based on findings made by both the Division and Commission staff:

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The Commission is handicapped by a relatively small staff and by unclear language in the 1999 compact regarding this authority to inspect and audit casinos. The commission has 46 employees and a budget of \$8.3 million (FY 2005 – 2006) to monitor the states \$5.78 billion Indian gaming industry and 86 card rooms. It has fallen behind on audits of Indian casinos and has a backlog of casino employees and vendor license reviews.

The state's Gambling Control Act declares in § 19802(c) that the legislature should "...sufficiently fund a full-time commission and law enforcement capability with responsibilities commensurate with the expanded scope of gambling." Interviews with officials in the state's regulatory bodies suggest that neither the Division nor the Commission have sufficient staff resources to fulfill their statutory obligations to regulate, investigate and enforce state gambling laws. California's agencies that regulate gambling have fewer resources relative to their responsibilities that those provided by other major gambling states. (Page 40)

In developing a response to Recommendation #1, staff acknowledged three preliminary options:

1. Rely solely on the State for Key Employee Licensing.
2. Maintain Investigation Function, but Redesign the DGC's process to one that that is more efficient.
3. Develop a hybrid model that relies on sharing of information between the City and the State.

The options need to consider the various issues noted, and for this reason, the Administration respectfully requests additional time to evaluate the options available for moving forward (See Attachment C). The Administration is cautious that State oversight and regulation would be much like the oversight and regulation provided by the California Department of Alcoholic Beverage Control (ABC) over alcoholic beverage licensees in San Jose, which does not have the investigative resources needed to adequately monitor compliance with and enforce State alcoholic beverage control laws in San Jose's bars, nightclubs, package liquor stores and other businesses subject to licensing by ABC. If the City were to stop licensing key employees and requiring city issued work permits for persons holding gambling enterprise employee positions at cardrooms, the City would have to wait on the State to enforce its licenses and work permits without recourse to enforcing Title 16 by initiating disciplinary proceedings on the basis of City issued licenses and work permits. It should be emphasized as well that the State as a general rule does not have the resources to enforce local gaming laws and regulations, so we could not look to the State to assist in enforcing Title 16 through State disciplinary procedures on state issued licenses and work permits. Even if the City maintained a City issued key employee but relied solely on the State issued key employee license, the City would be in a difficult position to justify the addition of anything but generic conditions to a license if it has not performed its own licensing investigation and developed its own factual record to justify specific individualized terms and conditions based upon a licensing investigation.

Recommendation #2: Abide by the Title 16 guideline that license investigations should be completed within 180 days and develop clear written guidelines for when investigations can extend beyond 180 days. These revisions should apply to all new, pending, and incomplete license investigations. (Priority 3)

The Administration agrees with this recommendation to develop clear written guidelines for investigations that extend beyond the 180 days. Specifically, Title 16 notes, "*To the extent practicable, the Administrator shall act on all applications within 180 days of the date of receipt of a completed application and applicable fees except as extended pursuant to Subsection D.*" Subsection D states that if the investigation cannot be concluded within 180 days after the receipt of a completed application and applicable fees, the Gaming Administrator shall inform the

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applicant in writing of the status of the investigation and shall also provide the applicant with the date on which the investigation may reasonably be expected to be concluded. To ensure that applicants are fully aware of the licensing process, and to what extent the applicant's cooperation is expected, as well as cooperation from independent parties such as banks and other gaming regulatory agencies, the DGC meets with each license applicant at the beginning of each investigation to discuss the process, including a discussion of when an application is considered complete, including a description of the financial information that would be requested and analyzed in order to complete the licensing investigation. In the event the investigation cannot be completed within 180 days, the applicant is notified and an anticipated completion date is provided. If the delay is caused by the applicant, or for lack of or delay of receipt of information from a third party, the matter is documented and maintained.

The City's 180 day processing benchmark is consistent with the State Gambling Control Commission Regulations, Title 4. Similar to Title 16, the State has a statement in its Title 4 that *"To the extent practicable, all applications shall be acted upon within 180 calendar days of submission of a completed application."* The State Code of Regulations provides for a broader interpretation of the statutory period, and makes clear that the 180 day processing period does not begin until the application is complete and all necessary documentation is received. Per State Gambling Control Commission Regulation, Title 4 California Code of Regulations Section 12343, the State has 330 day timeline built into its procedure for the issuance of a gaming license. This is based on a dual review/approval process by the State Division of Gaming Control and the State Gambling Control Commission. Department of Justice (DOJ) has 180 days to complete the investigation and may extend this processing time; the Gambling Commission has 120 to grant or deny the application based on the DOJ's review, and an additional 30 days is allotted if the Commission needs additional time to review the application. In San Jose's case, these two functions are the responsibility of the DGC. This processing time, coupled with the existing 12-month backlog of licenses, could mean a potential 2 year timeframe for State processing of licenses. Thus, any of the options that the Administration presents to Council in the future as proposed under Recommendation #1, would inherently accept the State's backlog, and would most likely result in longer than the 180 day stated benchmark in Title 16.⁴

Recommendation #3: To better manage its backlog of pending license investigations, redesign its background investigations to: a) provide clearer guidance on the desired scope of the DGC licensing process, b) be more limited in scope, and c) track and report the status and cost of these pending and incomplete license investigations through the Annual Report to the City Council. These revisions should apply to all new, pending, and incomplete license investigations. (Priority 3)

The Administration generally agrees with this recommendation that the backlog of pending license investigations needs to be better managed. In June 2009, staff developed MBA #28 as an option to redesign the DGC to make it more efficient and effective specifically with respect to issuing licenses and work permits. In September 2009, the Administration proposed restructuring the DGC again so as to allow for reliance on license fees and deposits and the use of this provision rather than reliance exclusively on the table fees to finance itself. These two efforts clearly demonstrate that the Administration has made attempts over the past year to address the backlog, become more efficient, and to maintain the effectiveness of local regulation.

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From a historical perspective, when Title 16 was first adopted in 1999, applicants who had been working in the cardroom business were given provisional key employee licenses and those that came in after 1999 have been issued temporary key employee licenses. With either a provisional or temporary key employee license, applicants may begin work while their respective background investigation is being performed. Hence, the City has always had and will always have a backlog of gaming license applications so long as individuals are allowed to work before a regular gaming license is issued. In investigative background work, a backlog is inherently present and it is important to minimize the number of backlogged applications along with ensuring that work processes are developed in a manner are efficient and not unduly burdensome. It is worth restating that when the Gaming Administrator was hired in 2002, there existed a backlog of 37 gaming license applications. Due to the fact that Title 16 of the San Jose Municipal Code requires that every gaming license must be renewed [once every three years], plus the tremendous turnover of key employees (21 licenses at one cardroom and four at the other cardroom) due to termination, withdrawals, promotions, outside contractors wishing to operate businesses inside Garden City, the DGC has been unable to keep up with the work load.

The DGC's normal practice has been to review an applicant's documentation for a period between five and seven years to determine the person's financial integrity and responsibilities in connection with the suitability examination. In the event additional testing is deemed required, the review can in fact extend to 10 years or beyond. Of the eight investigative files reviewed by the City Auditor's office, only one investigation went back 10 years for reasons consistent with public policy, two went back five years, two went back six years and two went back seven years. Two were not begun because the owners were "grandfathered" with stockownership licenses when Title 16 was adopted in 1999, but were not issued Stockowner license certificates until March 24, 2010.

Recommendation #4: Implement procedures to track time and costs of each licensing review, provide an itemized accounting to each applicant at the end of each review, and include the per applicant cost in the Annual Report to City Council. (Priority 2)

Staff agrees with this recommendation. This recommendation was proposed in the September 2009 staff report and the DGC already has the equipment and web-based time sheet management portal to implement this recommendation. The use of this time sheet system would track the time that DGC staff has expended on each and every investigation and the applicant will be billed based on actual cost recovery. Lastly, in the revised Title 16, the language of Section 16.32.100 was amended after negotiation with the cardrooms in order to ensure that implementation of this work process approach was possible. This recommendation will be implemented as a feature of any new process developed by the Administration.

Recommendation #5: Liquidate the two encumbrances in the DGC's fund and use the funds to offset DGC costs. (Priority 2)

Staff agrees with the recommendation to liquidate the encumbrance in the DGC fund, but will be using a portion of those funds for the above mentioned consultant services. The DGC is operated on a cost recovery basis and is supported by the Cardroom Table Fee generated by the two cardrooms. The Cardroom Table Fee is calculated based on the annual cost of managing the

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DGC, and includes the total cost of the staff (including central service cost allocations) and the related non-personal costs associated with the DGC operation. The central service costs are allocated based on rates from the cost allocation plans developed by the City's Finance Department utilizing the same methodology used throughout the City's organization and consistent with cost allocation plan methodologies developed under the current guidance of the US Office of Management and Budget (OMB) Circular A-87, Cost Principles for State, Local and Indian Tribal Governments.

While the original encumbrance totaled \$161,655 in FY 2008-2009, as mentioned in the Audit, the current balance of the two encumbrances is now \$100,394. This is because staff used \$61,260 to purchase equipment to set up the DGC structure to process work permits in an effort to restructure the licensing and permitting process for gaming, following conversation and conceptual agreement with the proposed structure (See MBA #28 and City Council Staff Report, September 9, 2009, Item 8.1).

Recommendation #6: (1) Propose revisions to Title 16 to discontinue the City's permitting function and accept State-issued portable gaming work permits, or (2) Process work permits within the DGC.

If the Administration chooses to process work permits within the DGC we also recommend that: a) the DGC continue to streamline and develop a work permitting approval and renewal process that strictly abides by the Title 16 guide to issue work permits within 20 working days, and b) the Administration to analyze the cost recovery status of work permit fees. (Priority 3)

Staff agrees with part (b) of this recommendation, and accepts the 20 working days as a benchmark to issue work permits provided that the submitted application is completely in order. The Administration is interested in developing performance measures to track the DGC's ability to issue work permits within this timeframe and identify trends regarding the lack of ability to meet this benchmark. Work Permits are generally processed through the Department's Permits Unit and cardroom applicants have experienced a backlog due to the workload of the Permits Unit.⁵ Prior to July 2009, an applicant for a work permit would have waited approximately 60 days to meet with a member of the Permits Unit for an initial appointment and to start the background process, which subsequently causes delays in the issuance of a work permit and ability for the applicant to work. Since April 2009, the City has developed a "One Stop Permit" service delivery approach on pre-advertised dates, which eliminated the backlog by July 2009. The expedited approach for issuing work permits has provided valuable information for implementing a new service delivery model in the DGC, rather than the Permits Unit. In order to proceed with full and permanent implementation of this streamlined approach, the City would require some time to implement a new structure for just the work permit functions in order to reallocate staffing resources and recalculate the various permits and fees affected by shifting staff work load from the SJPD Permits Unit to the DGC.

⁵ The Permits Unit oversees permitting for various functions, such as: taxis, peddler, ambulance operators, amusement devices, bingo halls, concealable firearms, event promoters, flower vendors, massage parlors, ice cream vendors, funeral escorts, etc.

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CONCLUSION

Sound and effective public policy is the underpinning of cardroom regulation which sets the basic standards for controlling cardroom activity and ensuring a safe local gaming industry. When the City Council recently reformed local regulation, the Spectrum Report identified key fundamental principles which are still very much relevant today, and which were preserved during discussion of the Cardroom Ballot Measure. One of the fundamental methods used to preserve the integrity of cardrooms is a comprehensive licensing and regulatory program. The City's past and current events underscore the importance of maintaining local control of the individuals that are permitted the privilege of working in the City's cardroom industry.

There is a complete commitment to address the concerns related to cycle-time to complete licenses and work permits and to reduce the backlog of license applications; however, this interest needs to be thoughtful, measures, and well-paced to maintain the local regulatory interests. With the recent cooperative spirit that the Administration and cardrooms worked under to address some workplan items and advance a successful Cardroom Ballot Measure, I request that the City Council allow me the time and space needed to continue this work and evaluate the options, to strengthen the City's processes to issue Cardroom licenses and work permits.



DEBRA FIGONE
City Manager

Attachments (3):

- A. Expanded History of Gaming in San Jose
- B. Summary of Investigations During the Audit
- C. Audit Recommendation 1: Discussion of Preliminary Options

ATTACHMENT A

Expanded History of Gaming in San Jose

As stated, current regulation, as codified in Title 16, is in part a result of historical events related to crime and corruption at/in San Jose cardrooms, various lawsuits and settlement agreements. Below is an expanded history of gaming in San Jose that has directly shaped the current state of regulation and public policy.

In 1963, there were 15 cardroom permits in the City, and the City allowed only 7 in the downtown area. The 1963 ordinance also prohibited any person from being an owner in more than one cardroom permit. In 1964, the City Council revised the cardroom ordinance again to reduce the total number of permits to 13. By 1972 only 9 Cardroom Permits were authorized in the City, and only 6 were authorized in the downtown.

In 1978, the City Council passed an ordinance that reduced the number of authorized cardrooms to five in San Jose. The ordinance imposed new regulations on cardrooms, including a prohibition on incorporation, restrictions on ownership, registration of employees and agents, regulations prohibiting the cardrooms from providing financial or other inducements to play cards or to eat and drink at cardrooms. Additionally, the games that could be played at cardrooms were specified by name in the ordinance for many years. The 1978 ordinance limited the games that could be played to draw poker, lowball and panguingue, and prohibited all games of chance.

In late 1989, Texas Hold'em Poker was added to the list of authorized games. In the 1992 revision of the Cardroom ordinance, the City Council adopted a procedure to authorize games by resolution, and that list contained 21 games.

Until 1995, by City Council action, the provisions of the Municipal Code which served to regulate cardrooms in the City contained an "amortization" provision that reduced the number of permitted cardrooms in San Jose whenever any outstanding permit was surrendered, revoked or terminated by operation of law for any reason. By 1995, only three cardrooms existed in the City.

In June 1996, the City Council amended the Cardroom ordinance by adding a set of limitations and restrictions on the expansion of gambling that would require voter approval for any expansion of gambling. These provisions became Chapter 16.04 in Title 16 and authorized the voters to approve any changes with respect to gaming expansion. The public policy goal from this action was to limit gaming expansion to a level in which voters would likely support.

In February 1997, the City Council amended its Campaign Contribution Ordinance and included a provision, Section 12.060260 that prohibited cardrooms, cardroom owners, officers of a cardroom, key management employees, a spouse of a cardroom owner or a spouse of a cardroom officer from making contributions to local political campaigns. This provision had been recommended by the CAO and the SJPD in a memorandum considered by the City Council with it amended the Cardroom ordinance in June 1996 to add the voter approval requirement for any expansion of gambling. The public policy goal from this action was to ensure that politicians were not fiscally dependent on cardroom contributions and to prohibit actual or perceived political influence.

The Cardroom ordinance that existed immediately prior to the 1999 enactment of Title 16, Chapter 6.22 of the Municipal Code, provided for regulation of cardrooms through a Cardroom Permit requirement, and regulation of owners and employees through a registration requirement, with an additional regulation of stock ownership transfers through a stock transfer approval procedure. These procedures were the precursors of the work permit requirement and Cardroom license requirements (including key employee, and stock ownership licensing) that exist today under Title 16.

It should also be noted that the City Council had already enacted into Chapter 6.22 a number of operating regulations that regulated the conduct of cardrooms, their employees, the conduct of patrons, and restrictions on gambling, including the current voter approval chapter (which was lifted verbatim from Chapter 6.22 and put into Chapter 16.04 of Title 16). Chapter 6.22 also had a warrantless inspection of premises provision that was as broad in scope as the warrantless inspection provision in Title 16. Other examples of provisions taken directly by the City Council from Chapter 6.22 and placed into Title 16 include:

- Restrictions to Permissible Game
- Restricted Betting Limits
- Prohibition of Stimulation of Play
- Prohibition on House Lending
- Prohibition on Blank Checks
- Prohibition on House Credit
- Restrictions on Patron Deposit Accounts
- Requirement to Produce an Annual Crime Report
- Voting Requirement for the Expansion of Gambling

Some of the major regulatory controls that Chapter 6.22 lacked were minimum internal control and accounting regulations to control the various functions and operations of the cardrooms, regulation making authority for SJPD licensing for key employees, stock owners, financial sources, funding sources (third party providers of proposition player services) and formal standards for licensing to better ensure against criminal and corrupt elements assuming positions as managers or owners of cardrooms, and elements such as having patron security plans that are required under the Gambling Control Act.

The City Council's actions to establish a strong regulatory presence are based on significant criminal activity in San Jose's history. Below is a table that provides a summary of some significant criminal and regulatory actions in San Jose during the past 20 years that have shaped the current state of regulation.

Table 3: Significant Criminal and Regulatory Actions

Year	Actions	Regulatory Actions/Outcome
1987	<p>Indictments of Garden City, Inc., its owners, and various managers and other employees for skimming revenue from the corporation as part of a conspiracy to cheat and defraud the State of California, conspiracy to cheat and defraud Garden City's landlord, tax fraud, conspiracy to violate State and City campaign contribution disclosure laws, grand theft, attempted grand theft, and perjury. This resulted in:</p> <ul style="list-style-type: none"> ▪ Approximately \$4,000,000 in understated cardroom revenues over an eight year period beginning in 1977; ▪ Grand theft; ▪ Political contribution laundering; and, ▪ Conspiracy to cheat and defraud the State of California and the landlord. 	<p>A true bill charging stockholders and non-stockholders with a variety of tax code violations, grand theft and other charges. Some of the actions which are described in the indictment caused the revenues of the cardroom to be understated. The purpose of some of the activities was to avoid the payment of taxes to the State.</p> <p>Federal taxes, penalties, and interest amounting to approximately \$10,000,000 to \$12,000,000 for the corporation and the individual shareholder defendants. State of California collected \$800,000 against the corporation for taxes in a jeopardy assessment against the corporation in 1987.</p> <p><i>(Note: In 1995, the City Council took action that required voter approval for the expansion of gaming)</i></p>
1992	<p>Police Chief Louis Cobarruviaz issued a notice of decision imposing a \$93,500 administrative penalty on Sutter's Place, Inc. and a suspension of its cardroom permit for 108 days based upon violations of the cardroom ordinance and California Business and Professions Code by employees of Sutter's Place and the corporation. The cardroom ordinance violations ranged from:</p> <ul style="list-style-type: none"> ▪ Failure to display required identification while on the cardroom premises; ▪ Employees playing with personal money; ▪ Use of proposition players to stimulate play; ▪ Playing prohibited card games; ▪ Under-age minor on the premises; and, ▪ Allowing an obviously intoxicated person to play cards. 	<p>The corporation entered a "no contest" plea on a total of 51 misdemeanor counts of violations of the City's cardroom ordinance. The Court imposed a total criminal fine on the corporation of \$10,560.00.</p> <p>Three employees pled no contest to violation of the State of California's Business and Professions Code of furnishing alcohol to an intoxicated person. Seven cardroom employees pleaded non contest to State and City misdemeanor charges.</p>
1993	<p>All stockholders of Garden City, the corporation itself, and a number of management and other employees pled to various felony and misdemeanor charges including profit skimming from Garden City, Inc.</p>	<p>The Chief of Police imposed a monetary penalty in the amount of \$5,000,000.00 on Garden City, Inc. for the felony case, and \$80,000.00 for acts committed by employees in Municipal Court cases. All the shareholders in Garden City, Inc. had to completely divest themselves of all stock in Garden City, Inc.</p> <p><i>(Note: In 1997, the City Council took action that prohibited cardrooms, cardroom owners, officers of a cardroom, key management employees, a spouse of a cardroom owner or a spouse of a cardroom officer from making contributions to local political campaigns.)</i></p>
1997	<p>With growing community concern for safety and social impacts of gaming in San Jose, the San Jose Mercury Newspaper ran a series of articles that reported on:</p>	<p>See <i>San Jose Regulatory Reform Section</i> below.</p>

	<ul style="list-style-type: none"> ▪ Cardrooms dodging the City's \$200 betting limit allowing high-stakes gambling; ▪ Problem gambling within Asian American community; ▪ Crime associated with cardroom activity; and, ▪ Cardrooms serving as recruitment hub for brothel patrons. <p>Source: San Jose Mercury News— <i>Odds in Trouble</i>, March 9, 1997; <i>As They See It</i>, March 9, 1997; <i>Asian Games Fuel Card Club Explosion</i>, April 20, 1997; <i>Shooting Ends Gambling Outing in S.J.</i>, June 25, 1997; <i>Why Valley is Prime Target for Trafficking</i>, September 21, 1997.</p>	
2000	<p>168 count indictments were brought by a grand jury charging 55 defendants with felonies associated with activities at San Jose cardrooms. The charges included:</p> <ul style="list-style-type: none"> ▪ Loan sharking; ▪ Extortion; ▪ Witness intimidation; ▪ Sale of crack cocaine; ▪ Felonious assault; ▪ Credit card fraud by mail theft; ▪ Counterfeit check passing; ▪ Forgery; and, ▪ Perjury. 	<p>28 defendants had pleaded guilty or no contest to 70 felonies and 6 misdemeanors by September 2000, and those defendants were ordered to stay away from gambling establishments as a term of probation. One defendant, a manager at Bay 101, stipulated to entry of a final judgment to pay the District Attorney's Office \$90,000, including a sum of \$10,000 in civil penalties and \$80,000 for the costs of the investigation and entry of a permanent injunction barring him from all gambling establishments in the State of California, with the exception of 6 southern counties.</p>

ATTACHMENT B

Summary of Investigations During the Audit

- **Deny/Revocation License** (case open) -Work Permittee filed a Key Employee license application but lied on the application regarding an arrest record.
- **Revocation Work Permit** (case open)-Work Permittee stole money from a pot of a poker game and deposited the money in her work tray while on duty.
- **Revocation Work Permit** (case open) -Work Permittee stole approximately \$400 in gaming chips from the cardroom while on duty.
- **Revocation Work Permit** (case open) – Work Permittee stole money from the cardroom cashier cage. This individual was booked into jail for embezzlement.
- **Revocation Work Permit (case open)** -Work Permittee illegally arranged cards in a Baccarat game so that co-conspirators know what sequence of cards will be played. Large bets were made accordingly and approx. \$27,000 was stolen from a Third Party Proposition Player Services. The Work Permittee and a co-conspirator were arrested and charged.
- **Administrative Investigation (case open)** – Key Employee reinstated a “Self Restricted Patron” in violation of the State Gambling Control Act. Only the State has the authority to reinstate a self restricted person.
Administrative Investigation (case open) - Key Employee did not timely report a patron cheating on a California/Asian game after the incident was brought to his attention. Title 16 requires that crimes must be reported immediately.
- **Three Separate Underage Patron Investigations** (cases open) -Multiple employees allowed underage patrons to gamble at one of the cardrooms on three separate occasions. In at least one instance where a minor patron was served with alcohol and consuming the alcohol while gambling.
- **Denial of Key Employee License** (case open) -Key Employee allowed a problem gambler to gamble and cash in gaming chips after learning the employee was gambling in violation of the State Gambling Control Act. The Key Employee in question then lied to investigators during the investigation.
- **Stimulation of Play** (Closed case) -Warning letter to the Third Party Provider of Proposition Player Services of both cardroom regarding their respective violation of Title 16 “Stimulation of Play prohibition” by reimbursing money to the players for table fee payment purposes.
- **Working without a Work Permit** (Closed case) -Warning letter to an outsourced contractor regarding working without a work permit.

ATTACHMENT C

Audit Recommendation 1: Discussion of Preliminary Options

Option 1 - Relying on the State for Key Employee Licensing: After a preliminary evaluation by the Administration and the CAO, the City is not prepared to forego its own background investigative process and accept the State's background investigation without further analysis. The work permit and licensing provisions in Title 16 are central to the first declaration of legislative purpose stated by the City Council in the first section of Title 16 *"Effective and comprehensive regulation of the practices, activities, persons and places associated with or involved in gaming in San Jose is essential for the protection of the public health, safety and welfare. The Gaming Control Regulatory Program is further designated to regulate the persons, locations and practices of permitted San Jose Cardrooms and Funding Sources."*

Ceding entirely the City's investigative review and licensing and permitting to the State will fundamentally change the nature of Title 16 and the City's system of regulatory controls over cardrooms. Local licensing for key employees and work permits for all gambling enterprise employees is needed in order to ensure that cardroom employees have a direct personal responsibility for compliance with Title 16, its regulations as well as with State Gambling Law, and with other relevant law (e.g., federal law regarding money laundering). Without local permitting and licensing, and the possibility that the City can take disciplinary action for failure to cooperate with the Division and comply with Title 16 and its regulations, employees and contractors lose much of the incentive they have to voluntarily comply with local regulations and with the DGC when it conducts audits, reviews, and investigations.

It is important to acknowledge that the system of regulatory controls in place only work with the willing cooperation of managers and employees who voluntarily comply with Title 16's regulatory requirements and self-report suspicious, criminal and corrupt activities to the Division. Self-regulation and reporting can only work well if individual employees can be held accountable for their failure to adhere to the rules and to report suspected violations by other employees. Even if the City only cedes background investigations leading to licensing to the State, but still issues a City key employee license based solely on the State's decision to issue a State key employee license, this option would severely hinder the City's ability to place individualized terms and conditions on licenses, which require the support of a factual record that can only be developed if the City performs the background investigation. Also, the City loses the ability to deny a license to a person it believes does not comply with local standards for licensing if it leaves the investigation and decision-making authority with the State to determine who will be licensed.

Gambling in the Golden State report highlighted the inefficiencies of the State Division of Gambling Control as well as the Gambling Control Commission. Interviews with officials in the State's regulatory bodies suggested that neither the Division nor the Commission have sufficient staff resources to fulfill their statutory obligations to regulate, investigate and enforce state gambling laws; making note that local governments are responsible for enforcing gambling laws in cardrooms. This information, along with the State's reported a 12-month licensing backlog, has led staff to believe that moving to a system where the City relies solely on the State for its key employee licensing would not result in additional efficiencies or a desired outcome.

In June 2009, the State Audits and Evaluations Office released a performance review of the California Gambling Control Commission. The scope included a review of the Licensing Division to determine compliance with applicable laws, regulations, policies and procedures; and a review of application processing procedures to determine if the procedures resulted in a backlog of unprocessed applications. In summary, the results determined that the Licensing Division can do more to monitor license application and work permit processing to ensure better compliance with regulations and procedures. It should be noted that the revised Title 16, in Parts 6 and 7 of Chapter 16.32, requires the licensing of Funding Sources, key employees for managerial employees of the Funding Source, and work permits for other employees who work on the cardroom floor. *Currently the State only requires registration, not licensing of Funding Sources*⁵.

An additional difference between State and the City's regulation is that the State does not have a formal legal mechanism for identifying and requiring key employee licenses and work permits for persons who are independent contractors, but who hold key employee or gambling enterprise employee positions at cardrooms. This issue has arisen with respect to Garden City. Very shortly after the new owners of Garden City assumed control of the corporation in 2007, the corporation began outsourcing many positions to independent contractors. In order to maintain Title 16's system of integrated controls over gaming, the Division promulgated emergency regulations to require licensing for contractors holding key employee positions and contractors holding gambling enterprise employee positions. After negotiation with the cardrooms as part of the settlement of the cardroom litigation, the revised Title 16 codified the emergency regulations into Section 16.20.010 of Chapter 16.20. The other provision in that chapter, Section 16.20.020, placed further restrictions on the outsourcing of important positions in cardrooms in order to prevent the evasion of Title 16's system of regulatory controls and the further burdening of the Division's licensing and work permitting functions.

Option 2 - Maintain Investigation Function, but Redesign the DGC's Process to One That that is More Efficient: This option maintains the status quo in terms of the City maintaining a background investigation role and licensing and work permitting function; however, it does call for redesigning the DGC's process to one that is more efficient. In June 2009, staff developed MBA #28 which detailed a redesign plan for the DGC to address the licensing and work permit backlog. In September 2009, the Administration proposed restructuring the DGC to allow for reliance on license fees and deposits and the use of this provision rather than reliance exclusively on the table fees to finance itself. Both structures were discussed with the cardrooms and, to different degrees, were agreed upon conceptually for advancing to the City Council for consideration; however, the proposals were dropped to develop a more comprehensive workplan based on cardroom business growth concerns. More detail is provided under Recommendation #3 later in this report, but in summary, the Gaming Administrator suggests that using a five year benchmark may reasonably achieve the objective as set out under the Gaming Control Regulatory Program, so long as the extent of the investigation may be extended based on certain criteria to

⁵ Under State Gambling Law, the Funding Sources are independent contractors who provide banking services for the California (Asian) games. It is our understanding that the scope of the City Auditor's Report and recommendations is not intended to affect the provisions of the revised Title 16 regarding licensing of Funding Sources and licensing and work permitting for their employees, and the Audit itself is silent regarding recommendations for the cardroom Funding Sources.

trigger additional review. This preliminary input can be further refined, and informed, by a gaming consultant that can merge our in-house expertise with other best practices.

Option 3 - Develop a hybrid model that relies on sharing of information between the City and the State: The Administration would like to explore and evaluate the possibility of working with the State to share information that would help alleviate some of the work performed by the DGC. In order to proceed, the City would need to better understand the State's requirements and/or methodologies for investigations to issue a Key Employee License.

The SJPD has recently been in contact with the Bureau Chief of the California Department of Justice, Bureau of Gambling Control, and wishes to continue discussions to better understand what type of background investigations the State undertakes to overlay this with the type of background investigations the City requires, toward a goal of eliminating duplicative processes and redesigning a more efficient process. Discussions with the State at this point have been positive, but have been too preliminary to determine whether it will be possible to arrive at a written agreement for sharing investigative information. The Gambling Control Act (Act) does not require or specifically authorize the release of information held by the Bureau or the Commission to local regulatory or law enforcement authorities. There are a number of obstacles in the Act itself to meaningful sharing of information held by the Bureau or the Commission to local regulatory or law enforcement authorities. The above scenarios assume that the state is interested in an agreement.

The Act does not require the Bureau of Gambling Control to share with the City any information that it receives from or concerning a license applicant. The Act is structured more or less as a one way street to require local authorities to provide information to the Bureau. The Act, Business and Professions Code Section 19829, requires local law enforcement agencies to disclose all information obtained during the course of any substantial investigation or prosecution of any person if it appears that a violation of any law related to gambling has occurred. There is no parallel provision in the Act that requires the State to share information to local authorities. Likewise, the Act, Business and Professions Code Section 19828(c), prohibits the Bureau from disclosing confidential or privileged information without the prior written consent of the holder of the privilege or a court order after timely notice of the proceedings has been given to the holder of the privilege. Even assuming that the Bureau were interested in considering an information sharing agreement, there will be many situations where the holder of the privilege is not the Bureau and the Bureau would not be in a position to require the holder of the privilege to give his or her consent to disclosure of that information to the City. This would affect the ability of the City to access personal information collected by the State, especially personal financial information, and information that is privileged under the Evidence Code where the State is not the holder of the privilege. The Act, Business and Professions Code Section 19821, also prohibits Gambling Commissioners, and their employees and officials from disclosing confidential records or information to any person not authorized by law to receive it.