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## **Licensing**

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### **Introduction**

This chapter recommends a model approach for government licensure of the Internet gaming industry. Unlike some other areas of regulation, no best licensing practices exist. Each government must consider what is the best licensing structure to employ in light of its unique circumstances, such as its public policy, regulatory funding and resources, industry resources, and market size. All of these factors can influence the regulatory structure in general and licensing in particular.

A model approach, as opposed to best practices, provides a framework for what the government should consider in crafting and implementing a licensing system that best meets the government's goals and resources. The starting point for such approach is an understanding of the government's interest in licensing parties involved in the industry. This requires the government to identify public policies and policy goals by determining its position toward Internet gambling, what goals it hopes to achieve related to such gambling, and how regulation in general and licensing in particular can help achieve these goals. This is covered in section 1. Section 2 covers the economics of licensing. Governments need to understand the costs of imposing licensing and the non-licensing alternatives to achieving policy goals. Once the goals of licensing are determined and the costs understood, a structure needs to be put into place that considers who needs to be licensed, the level of licensing scrutiny to which they will be subject, and the standards and criteria under which they will be evaluated. Deciding who needs to be licensed requires an understanding of the parties involved in Internet gaming, their responsibilities and how they could impact government's achieving its policy goals. Section 3 addresses these issues.

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## Section 1 - Licensing and Public Policy

Licensing is a tool to achieve specific public policy goals by excluding persons from an industry, occupation or profession before their actions can compromise public policy. Licensing is not unique to Internet gaming. Governments often impose licensing requirements on various professions and occupations to protect the public. For example, lawyers, doctors, contractors and even beauticians have to go through some level of licensing scrutiny before they can offer their services.<sup>2</sup> Licensing is most valuable as a tool to shield the public from abuse where the person being licensed holds a special position of trust, the public is in a vulnerable position, regulatory violations are difficult to detect, and/or enforcement is of limited utility. For example, the public could easily be victimized by rigged games at the gaming sites. One scandal that plagued the online poker industry involved persons associated with the former owner of a poker site maintaining access to the system that allowed them to view other players' hands at the poker table. This method of cheating gave the cheaters a large advantage and resulted in players losing millions of dollars. Since these types of occurrences may be difficult to police through enforcement, licensing provides government with a tool to achieve policy goals, such as maintaining the honesty of the games by excluding dishonest persons from operating licensed gaming sites.

In this context, licensing is a prophylactic exercise. Some cases may exist where the applicant has such a sordid history or poor reputation that his or her mere association with the industry is inconsistent with policy goals. But, this is rare. Most often regulators use licensing to attempt to exclude unfit persons before they enter the gaming industry<sup>3</sup>. In this light, the primary purpose of licensing is to attempt to predict the behavior of the applicant for the license with the objective that only those qualified entities and individuals, i.e. those who do not pose a threat to the public, withstand licensing scrutiny.<sup>4</sup>

The foundation of gaming licensing is a determination of the government's public policy towards gambling generally and Internet gaming specifically. From this public policy, government can craft policy goals that it hopes to accomplish through regulation. Suppose that the only policy goals are to assure that the games offered on the regulated sites are fair and honest. The suitability review of applicants for an operator's license may not be limited to dishonesty, but may include assuring that applicants have sufficient competency to detect and prevent schemes by employees or third parties designed to cheat players. In this context, licensing would be designed to protect the public by requiring licensing of persons with responsibility that if not performed competently and honestly could compromise the honesty or fairness of the games. This, as an example, could include site owners, software architects and programmers, data and server centers and other persons with access to sensitive areas of the Internet

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<sup>2</sup> In re Application of Cason, 294 S.E.2d 520, 523 (Ga. 1982) (citing Penobscot Bar v. Kimball, 64 Me. 140, 146 (1875)).

<sup>3</sup> Through the course of the investigation and hearing, the process can educate the applicant of the standard expected of them as licensees.

<sup>4</sup> The process also allows the regulators to assess the applicant and where necessary place conditions on the granting of the license consummate with concerns that the regulators may have regarding future conduct and consequences for unsuitable future conduct.

gaming systems. It could include reviews of the applicant's honesty, experience, competency, or technology infrastructure. If the goals are expanded to assuring that player funds are protected, the scope of the licensing review may include the financial strength of the operator. Suppose further that government expands its policy goals to assure that the gaming markets are competitive to allow licensees to compete in world markets or to assure the lowest costs to players. In this case, the government needs to balance the cost and impact of licensing on competitive market conditions.

Absent an understanding of what the government wants to accomplish through regulation and licensing, regulators have no guidepost as to why they are requiring licensing. This can result in widely inconsistent actions by regulators who substitute their own beliefs or assumptions or those of their perceived constituency as to the goals and methods of regulation. This can create conflicts in approach to licensing between agencies, regulators, and even staff.

Once a government formulates a public policy toward Internet gambling, it must set and implement policy goals based on that policy. Implementation usually involves both adopting and enforcing laws designed to achieve policy goals. These laws can restrict, mediate or promote the activities of, or by, private parties.<sup>5</sup> Regulation is a common method of implementation. This is the process by which government achieves policy goals by restricting the choices of private parties.<sup>6</sup>

In the context of gambling, public policy most often focuses on either player protection or government protection, or a hybrid of these policies.

#### *Player Protection Policies and Goals*

Public policy that focuses on player protection has among its primary goals to assure that the games are fair and honest and players are secure in their transactions (deposits, payments, and transfers) and fiscally protected in their account balances.

Honesty refers to whether the site operator offers games whose chance elements are random. The concept of random is elusive and its precise meaning has long been debated among experts in the fields of probability, statistics and the philosophical sciences. A standard dictionary might define random in a general sense as "having no specific pattern or objective; haphazard," or "made, done, or happening without conscious decision." These same dictionaries also might provide a meaning in a more specific statistical sense such as "a phenomenon that does not produce the same outcome or consequences every time it occurs under identical circumstances," or "an event having a relative frequency of occurrence that approaches a stable limit as the number of observations of the event increases to infinity," or even "governed by or involving equal chances for each item." All of these definitions are lacking in some way for purposes of establishing necessary criteria for randomness in games of chance. Randomness in context of gaming is the observed unpredictability and absence of pattern in a set of elements or events that have definite probabilities of occurrence. In addition, each element or event must be independent, i.e., it must not be influenced by a previous element or event. For example, a slot machine is honest if the outcome of

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5 B. MITNICK, B., *THE POLITICAL ECONOMY OF REGULATION*, 8, 9 (1980).

6 *Id.* at 20.

each play is not predetermined or influenced beyond the established house advantage (or player's skill) in the gaming operator's or another player's favor.

A second aspect of honesty is whether influences outside of the established rules of the game influence the outcome. Take, as an example, community poker. The method of shuffling/distributing cards has to meet prescribed standards of randomness. But, beyond this, the game must be free of collusion between players and have controls to prevent players from gaining an advantage by having access to hole cards or unexposed cards in the deck. Like much of Internet gambling, detection of collusion is not a problem that can be solved exclusively by technology. HUDS (heads up displays) can provide operators with monitoring but interpretation of information that, like casino surveillance, is an art requiring training, competency and integrity.

Fairness deals with whether the operators are offering games that give the players a reasonable opportunity of winning. This is a form of price setting because game odds determine the cost that players have to pay to play (house banked) casino games and rake requirements determine the cost of playing (community pooled) poker. In a perfect economy, market forces would determine pricing because the players would have access to all the information necessary to determine the costs of playing and could choose the best price among multiple competitors. In house banked casino games, the cost of playing is reflected in the house advantage. In community games, it is the house commission such as the amount of the rake in poker. Most gaming markets are not perfect and regulators may attempt to ensure fairness by either requiring disclosure of game odds or setting the maximum price a casino can charge players for the gambling experience. The latter is reflected in jurisdictional minimum payback percentage requirements. Insuring a competitive market and full disclosure of odds information can meet the same policy goals as price setting as the competitive market is more efficient at setting a fair price than regulators.

Fairness in the online poker industry also may extend to other prohibitions. As an example, government may prevent the use of robotic tools (often called "bots"), which are software programs used by some participants in non-house banked games that use probability driven algorithms to attempt to derive a statistical advantage over most human players. Other examples as relating to poker may include allowing player collusion or allowing a player to have more than one seat at a poker table.

Player protection goals also extend to regulation of the industry to minimize undesirable social consequences. These social consequences can either be generally applied or focus on a specific sub-population that is considered worthy of special protection. One broader concept is the notion that gaming operators should not exploit the public by encouraging them to gamble, should not exploit players by encouraging them to gamble beyond their means, and should not convince players to wager more than they otherwise would without encouragement. These governments may adopt laws that prevent gaming operators from advertisement, offering incentives to gamble or conducting other activities that stimulate demand for more gambling. Broad prohibitions on advertising or incentives, however, are rare in the Internet gaming industry.

Other goals directed at the broader population are more common. These could include a general prohibition against the use of credit, operator or player set daily loss limits, maximum or player set playing times, display of time at play, or requirements that

sites or advertisements contain language regarding the dangers of problem gambling or access to problem gambling help lines.

Some player protection goals, such as excluding underage players, may relate to specific subgroups. Another group that is often given special consideration is problem players. A solution could range from mandatory exclusion of problem players either voluntarily or otherwise entered onto a list to having warnings or help line numbers published on the gaming site.

Finally, player protection can focus on protecting the player from other potential harms, most notably protection of player data and privacy that are derived from playing on the gaming site.

From a licensing perspective, unsuitable persons under the player protection goals could include those who would (a) cheat the players, (b) fail to take measures to prevent others, including employees or players, from cheating or taking advantage of others through the use of bots, by collusion or otherwise, (c) provide or permit games that are unfair, (d) fail to timely pay winnings or protect player funds, (e) evade regulations that discourage the stimulation of gaming demand or fail to implement mandated measures, or (f) violate or fail to take measures required by law or regulation that were designed to minimize social consequences.

#### *Government Protection Goals*

Governments may have a more selfish reason to prevent the involvement by persons who could, indirectly or directly, jeopardize the government's economic stake in the Internet gaming industry. While the player protection goals support regulation for the player, a government protection focus sets goals and provides regulation to protect the interests of the government. A similar analogy can be drawn to the restrictions that a bank may put on a business to which it lends money. If the bank lends a few hundred dollars to a borrower, a simple promissory might be a few pages long; however, if a bank lends a hundred million dollars, the loan documents may be hundreds of pages long. In both cases, while the bank wants to see both businesses succeed, it puts more restrictions on the second borrower because the bank's interest is greater.

Government protection goals often predominate where the government places a heavy reliance on the industry to meet tax expectations. Persons who can do direct harm to government interests include those who skim funds without paying taxes or are so incompetent that the government will lose tax revenues through employee or player theft or poor management. Governments also may have economic interests in the impact that a regulated industry may have in creating employment and encouraging economic development.

Another reason for the government's involvement through the government protection goals is to protect the industry from threats to its existence that would terminate the government's revenue stream or other economic benefits created by the industry. The gaming industry faces eradication if the public or public officials perceive it as too problematic for any number of reasons including that it is too intrusive, not subject to proper regulation, or is infiltrated by persons who are dishonest or associated with organized crime, have dubious reputations or otherwise taint the industry. For example, in the United States, a state government needs to ensure that if it permits

Internet gaming, that such business can be properly regulated to assure that persons physically located in other states that prohibit Internet gaming cannot access and play on the licensed sites. Failure to do so could result in federal prohibition to protect the interests of the states that prohibit online gambling or because of the negative publicity of state or federal criminal proceedings against licensed online operators that fail to respect jurisdictional prohibitions. Besides a federal threat, voters or legislators can change the law permitting Internet gaming. Gaming is different from most other industries because it is often perceived as a vice. Its very existence may be tenuous, as public perception of the benefits and burdens may change and influence the legality of the activity.

Besides the threat of legislative intervention, players collectively have the economic ability to impact the government's tax and economic interests by not playing with the regulated licensees under its control. For example, assuring the integrity of the games is important because the public must perceive that gambling is fair and honest before it will gamble. If one operator cheats, the public may believe or fear that the entire industry is dishonest. Additionally, the gaming industry can suffer credibility problems if the media exposes a site owner or operator as having criminal ties, regardless of whether the owner or operator otherwise complies with all regulations and acts ethically.

A third policy for governmental involvement is to assure that the gaming industry is conducted consistent with other government goals. For example, ensuring that the online gaming industry is not a conduit for money laundering is in its best interests. For example, Malta specifically looks to whether the applicant has followed practices to prevent money laundering and other suspicious activities before issuing Internet gaming licenses.

From a licensing perspective, unsuitable persons under government protection goals could include those who would (a) cheat the players, (b) fail to take measures to prevent others including employees or players from cheating, (c) provide or permit games that are unfair, (d) fail to pay winnings or protect player funds, (e) evade the payment of taxes, (f) associate with persons whose reputations can harm the industry, or (g) violate or fail to take measures to prevent violations of laws designed to protect the industry or the government's other interests.

### *Hybrid Systems*

Most frequently, governments do not strictly follow either the government protection or player protection goals, but instead blend aspects of both goal sets. For example, a jurisdiction could view the financial reward from gambling to generally be greater than the potential harm. These hybrid systems may try to reap the revenues from gambling, but minimize the harms, particularly to its citizens, by using regulation to regulate those aspects of the industry that do the most harm. If done properly, the government can assess the cost of the regulation (as reflected by the cost of implementation and loss of revenues) and compare the value to the cost of not regulating the matter at issue (costs to the government, the public or the players).

Because government and the player protection goals often overlap and most jurisdictions are hybrid systems, the basic structure of many licensing regimes for

gaming industries often are similar but sophisticated jurisdictions reflect nuanced differences in all aspects of regulation including licensing.

## **Section Two - Licensing and Economics**

Licensing would be fairly simple if jurisdictions could design licensing systems regardless of the cost to the government, those regulated and the market being regulated. This is not realistic because overly an burdensome licensing scheme can, in different ways, impact the government goals, the financial viability of the regulated industry and those who the regulations are intended to protect. Much of this is attributable to how regulation including licensing can impact market economics.

The theory of market economics specifies a number of basic conditions needed for a market to set prices efficiently. The greater the deviation from these conditions, the less efficient the market system becomes. A basic condition of efficient pricing is that markets must be competitive. Of all factors necessary to support a free market model, a key is the absence of barriers to entry.<sup>7</sup> Barriers to entry are factors that discourage entry into an industry by potential competitors and, thus, allow established firms to earn super-normal profits. Government restraints including licensing requirements are a barrier to entry that can prohibit the casino industry from being a competitive market.

The online gambling business does not have many natural barriers to entry. For example, online gaming is not necessarily a capital intensive venture. Likewise, gambling is fairly fungible, with the exception of the few propriety games. Similar dismissals of the other types of barriers to entry can be made with one major exception - government intervention including licensing.

Licensing as a government restraint will have economic costs. As an example, if licensing costs or requirements are too high, licensed gaming companies or vendors will gain protection from competition. The resulting monopoly and oligopoly markets create higher cost to the consumer, less innovation, lower service levels, and lower output. In the gaming industry, lower output means higher net profits on lower gross revenues. If a government bases tax rates on gross revenues, it will lower its overall tax return.

Moreover, barriers can hinder other government goals. Silicon Valley in Northern California, a world center for high tech companies, would not likely exist if start up

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<sup>7</sup>These barriers can take on a number of different forms. Barriers to entry include:

- A. Extreme or significant capital requirements resulting from scale effects.
- B. The existence of patents or copyrights.
- C. Scarcity of or control over a necessary resource.
- D. Excessive skill or knowledge requirements.
- E. Social, cultural, or religious taboos.
- F. Absolute cost advantages, i.e. advantages possessed by established firms who are able to sustain a lower average total cost than new entrants irrespective of size of output.
- G. Large initial capital requirements.
- H. Product differentiation, either natural or artificial, such as advertising.
- I. Retaliation or pre-emptive actions.
- J. Vertical integration, i.e. requiring entry at two or more levels.
- K. Governmental restraints.

companies with great ideas and little capital had licensing barriers. If a government has a goal to attract new technology companies and resulting employment through the legalization of Internet gambling, these goals can be frustrated by licensing barriers that keep start up or thinly capitalized companies from entering the market.

On the other hand, if licensing is too lenient, then the industry may suffer if a scandal develops that harms the industry's reputation or if the scandal results in legislation to prohibit legal gambling. Likewise, player protection goals may seek to insure that the players get the fairest price when they play with a licensed online site. If licensing results in oligopoly or monopoly pricing, this translates to games that are less fair to the players. Consistent with government protection goals, the proper balance between licensing and barriers to entry is crucial.

A market can become a monopoly or oligopoly or competitive from explicit licensing restraints, e.g. state law may dictate there only is one or a finite number of site operators or system providers. Under the Nevada regulations, as an example, only existing Nevada casino licensees will be eligible to become licensed Internet gambling operators. There are certain other requirements, depending on the location of the establishment within the state, that require existing licensees to have either a resort-hotel, a certain number of rooms or seats or have held a license for at least five years. Likewise, California has proposed legislation that would restrict licenses for site operators to certain tribes, card rooms and race tracks and limit the number of licensed systems providers that could service these site operators. If the federal government passes legislation, it will likely restrict operators' licenses to casinos, Indian tribes, racetracks and card rooms. Each of these decisions could impact a competitive market by allowing those fortunate to qualify for a license to reap greater than competitive returns. Any restriction on who may obtain a license will create some level of entry barrier.

The law may not dictate the number of site operators, but will influence whether a given market becomes a monopoly, oligopoly or competitive. Barriers need not be explicit but can result from cost, risk, time, opportunity costs or reputation. For example, costs can also result from excessive technology requirements. Another example is where a government requires a substantial investment to qualify for a license. California legislation creates a vignette by requiring non-refundable deposits against the operator's tax liabilities in the amount of \$30 million. Any minimum investment requirement will create some level of entry barrier. Even if California allowed an unlimited number of licenses, this would constitute a significant barrier to entry. Such legislation may make investment attractive for the first entrant who can make monopoly profits and, perhaps, even a few other entrants. At some point, however, potential competitors will not be willing to enter the market because the potential profits do not justify the capital costs.

Besides cost, the licensing system employed by a state will influence the number of competitors. In a perfect competitive system, competitors will enter the market if the existing entrants are making extraordinary profits. How quickly or easily they can enter the market is greatly influenced by licensing. Existing competitors will have an advantage if the licensing process creates an enormous barrier. Licensing can create barriers to entry in five major ways. First, it can add uncertainty and risk to the decision on whether to enter a market if regulators regularly deny licenses to applicants. All things equal, a company will devote its resources to a market where it can more likely



obtain a license. Second, the length of time that a licensing investigation takes may create a barrier. Companies that want to enter a market do so based on the current economics of that market. If licensing takes a substantial amount of time, the company must forecast the economics for when it may obtain its license. This adds risk to the decision to enter the market. Moreover, the time and effort required in the licensing process are an opportunity cost as such effort could be directed into creating or expanding existing markets. For example, in Malta, the Lotteries and Gaming Authority (LGA), which is the public regulatory body responsible for regulating gaming in Malta, takes about two to three months to investigate an applicant and issue a license. This expeditious handling of license applications allows the prospective licensees to plan deployment and marketing strategies. More problematic is where licensing can take a year and or more. Third is the cost of licensing. A potential entrant will consider the cost of licensing to decide if its money will generate a higher return in this market or business as opposed to another. Fourth is the burden that the licensing places on the applicant's resources including the efforts of officers, directors, and staff needed to complete applications and successfully navigate the licensing process. Finally, the licensing process may cause social stigma and embarrassment to a potential entrant. This may discourage some companies, especially diversified companies, whose embarrassing news could hurt its other businesses.

These barriers can be particularly problematic as they relate to providers of goods or services. In one case involving an emerging casino jurisdiction, their regulations mirrored those of a larger casino jurisdiction that required licensure for companies that manufactured chips and tokens. Because the cost of licensing exceeded the value of any contract to supply chips based on current market prices, no company applied for a license. Had a company stepped forward and obtained a license, it could have effectively charged rates up to the point where the casino would have effectively given a substantial portion of its table game profits just to purchase chips needed to offer the games. In the interactive gaming world, this can occur with service providers or software providers like site security or payment processors. Posed as a question, will the largest and potentially the best providers of a service or software that have broader application than Internet gaming invest the effort, time and cost of licensing if other markets exist for its product without such barriers?

Where reasonably efficient proactive standards and enforcement can achieve public goals, they are generally preferred to licensing for two reasons. First, enforcement can provide a more certain and measureable result. Licensing attempts to predict behavior where standards and enforcement control behavior. Protecting player funds is an example. Licensing tries to predict whether a future licensee having control over player funds is likely to divert them for other purposes. Requiring licensees to physically segregate player funds under the control of a trusted third party allows the regulator to control the funds. Second, reasonable standards and enforcement may not create the same level of barrier to entry as licensing.

This does not mean that barriers to entry are not justified in many instances. For example, requiring that applicants have minimum reserves to assure that player's deposits are protected is a barrier to entry because it may prevent less financially endowed companies from entering the market but is a barrier that may be justified in jurisdictions that have a strong public policy to protect players.

Governments need to understand the costs of imposing barriers to assess their value versus the benefits that they hope to achieve through implementation of those barriers. Simply, the most efficient regulation is one that accomplishes key policy goals with the least impact on a free market economy

### **Section 3 - Licensing Fundamentals**

Differences between licensing systems are based on five major factors: breadth, depth, level of review, criteria and standards of the licensing process.

*Breadth* means the extent to which a government requires persons or entities associated with the gaming industry to obtain a license. For example, does a company that provides payment processing solutions for Internet gaming sites have to obtain a license?

*Depth of licensing* means the extent to which government requires persons within a licensable entity to undergo an individual investigation. This could require that certain officers, directors, shareholders and employees associated with an entity that applies for a gaming license must file individual disclosures and undergo a background investigation.

*Level of review* refers to the intensity of the investigative process. A low-level review might include simple checks with law enforcement agencies to learn whether the applicant has an arrest record. A high-level review may entail the regulatory agency training special agents to conduct a complete and independent review of the applicant, including both background and finances.

*Criteria* are those matters that the government considers in granting licenses. These can include character, honesty, criminal history, association with criminals, financial ability and business competency.

*Standards* are the minimum attributes that applicants should meet to qualify for licensing. These refer to how rigid the regulators will be in applying the criteria. For example, under the same set of facts, an applicant may obtain a license in one jurisdiction, but not another. Such a case would occur if one jurisdiction requires the applicant to meet a higher standard of conduct than another.

### **Breadth of Licensing**

The Internet gaming ecosphere has many participants. Besides the owner and operator of the Internet gaming site, others such as suppliers and service providers may serve integral roles in the creation and operation of an Internet gaming site.

Government needs to determine which participants within the Internet gaming ecosphere need to obtain gaming licenses. These participants can roughly be divided into major subsets based on relationships to the gambling site operator.

The first major subset includes those with an economic interest in the success of the site such as owners or investors, those who receive a percentage of profits and some creditors.

A second major subset is comprised of key *gaming* software and system providers. This subset can include suppliers that provide anything from a full turn key gaming solutions, which include the back end non-gaming software otherwise known as the system software, to providing a portion of the gaming layer, which include game subsystems or individual game content. In this respect, gaming sites can be modular. One supplier may provide the gaming system or subsystem and multiple suppliers can provide games or gaming subsystems. Manufacturers of gaming sub-system include sports betting and exchange systems, casino gaming, poker software, and bingo software. Game content suppliers can provide software for front end game play that may be exhibited in browser software, mobile or other applications. These vendors may or may not provide the back end non-gaming software otherwise known as the system software.

A third major subset contains contracted *non-gaming* service and software providers. This is divided into two categories: software providers and service providers. Non-gaming service providers include payment processors, fraud prevention, customer service, domain name acquisition and management, affiliate management, bonus and loyalty management, network and chat management, hosting services, age and location verification, site optimization, and others. Non-gaming software providers include system software providers and those whose products integrate into back-end gaming platforms to perform such functions as account management, affiliate and agent software, CMS/CRM tools, fraud and security tools, registration platforms, integrated cashier, centralized reporting tools, bonus and loyalty tools, network management tools and site optimization tools.

A fourth subset is network specific services including data and server centers and site security.

A fifth subset is people resources such as affiliates, marketing partners and other marketing resources.

## **1. Those Having a Direct Economic Interest in Success of the Business.**

### **A. Owners**

Owners hold the rights to conduct the Internet business. Owners may either operate the gaming site or hire a service provider to run the gaming site on their behalf. While owners, who are not operators, do not have direct contact with the software or with customers, they may have considerable influence over the website and share in gaming profits. Land-based casino jurisdictions generally require that casino owners be licensed.

Under the player protection goals, licensing of the owner is consistent with policy goals. The owner has direct influence over the honesty and fairness of the gaming operations as well as control over player funds. The owner also has the financial responsibility and ability to implement all the necessary systems and procedures to assure that players are protected from third party cheating, privacy violations and data theft. Owners also have primary responsibility for implementation of compliance systems and programs designed to meet problem gambling and other regulatory requirements.

Under the government protection goals, the government also is concerned about both the potential influence that an owner has over the operation and the public's perception of having unsuitable persons in ownership (if the public knows who owns the domain name or any part of the online business). In transparent licensing settings, the owner is the most visible person to the public as these licensing jurisdictions typically require adequate disclosure of the ownership of the site. The Internet gaming space, however, has a history of owners hiding behind brands or even behind proxies. In some cases, the players and the general public are unable to pierce this privacy screen and determine who owns or operates the site. Therefore, in any case, under both government protection or player protection goals, owners should be given highest licensing priority.

### *B. Persons Entitled to Revenue or Profits*

Persons entitled to profits are parties that bargain goods, services or capital for a percentage of the gaming profits or revenue. In an online gaming environment, such profits will mainly be a percentage of revenues derived from player losses or rake. This is a sensitive area for gaming regulators because ownership interest can be easily disguised as a participatory interest in the gaming operation. The potential for abuse has led to some states, like Nevada, and some Internet gaming regulations to have an absolute rule that anyone sharing in a percentage of gaming revenues be licensed. For example, Antigua requires suppliers to be licensed if they receive a percentage of gaming revenues.<sup>8</sup> This rule has the advantage of certainty and ease of application.

Still, many profit participation agreements in the Internet gaming space are both legitimate, consistent with existing Internet marketing practices and arms length. A good example of a party that might be entitled to revenue share includes the owners of websites that drive traffic to the gaming site. Such affiliate marketing is widely used in the online retail space where companies that sell books, electronics and clothing pay a percentage of each sale to the operator of the site that referred the customer to the site. Other persons who provide other property or services in which they bargain for some of the profits may include those who provide equipment, software, financing or management.

An absolute rule against sharing in gaming revenue disturbs the natural economy of Internet commerce by attempting to capture these affiliates in the licensing net. The effects, however, can be twofold. First, sites and suppliers may alter their economic relationships based on formulas that are less reflective of the actual value of their services. For example, the value of a player referred by an affiliate is best measured by the player's losses. If this cannot be done because of licensing barriers, a different and probably less efficient formula for compensation will have to be derived between the operators and affiliates. Second, fewer affiliates or suppliers may be attracted to the market and competitive pricing may be impacted.

A focus on the licensing of those sharing in profits has greater application in jurisdictions that tend toward government protection goals because of the sensitivity that the reputation of the industry can be damaged if those sharing in revenues are found to be persons of disrepute or notorious reputation.

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<sup>8</sup> Antigua & Barbuda Internet gaming and Interactive Wagering Regulations

Jurisdictions that tend toward the player protection goals are more concerned with the ability of the actor to influence operations based on their relationship to the gaming operator. For example, an affiliate marketer who receives a minute fractional percentage of the revenue from a gaming site is of less concern than a person that has financed the entire operation. To effectively deal with the different types of persons that receive a percentage of revenue, the government needs to create subcategories of persons subject to licensing by either discretionary or objective criteria. Objective criteria could be a dollar amount or a percentage amount that triggers some form of licensing. For example, a person that licenses a game patent and receives a percentage of the net revenues of that game may not have to undergo licensing, but a private person that finances the Internet gaming site and receives 20% of net profits may have to obtain a license. The reason is that a person who receives a small percentage of the revenue of one game is unlikely to have any significant influence over the site's operation. This allows for the creation and promotion of new game content that is based on the real value of the game to the gaming site.

In addition, relaxed standards may exist for persons sharing in overall revenues based on the nature of the transaction. An example of this may be where the sharing in the revenues is by a finance company, and the transaction is typical of financing in broader context.

Discretionary criteria allow the regulator the discretion to require licensing of anyone receiving a percentage of revenue based on consideration of a variety of factors including the percentage amount, the sensitivity of the role played, whether the arrangement is arms length, the threat posed by association with the person or other factors.<sup>9</sup>

### *C. Lenders/Creditors*

Lenders/Creditors are common parties to most business agreements. Most typical are those who lend money to the owners to finance the Internet business. They include, however, suppliers of software and/or vendors who sell equipment credit.

Four considerations surround the degree of regulatory scrutiny accorded creditors. First, creditors that lend money or provide financing expect a return on their money commensurate with the costs and risks involved in the transaction. Second, the initial cost of capital may decrease if the lender has the potential to share in the revenues. Third, as the amount lent or financed increases, so does the creditor's vested interest in the success of and potential influence over the business. Fourth, unsuitable persons may use the guise of being lenders or creditors to extract moneys beyond market interest rates from the gaming operations. Regulation must balance the first consideration against the latter two.

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<sup>9</sup> While covered in the section on level of review, regulators may decide to divide this group into smaller groups for purposes of tiering them for licensing review. One distinction can be based on the total revenue paid to a person. For example, are substantial regulatory concerns invoked if a poker teaching site is paid a nominal monthly fee of a few thousand dollars based on a revenue share for recommending and referring players to a licensed poker site? Having different levels of licensing (or none at all) based on cumulative annual payments to vendors and suppliers is common in the gaming industry.

Full licensing helps assure that loans are not used to hide ownership in gaming operations and that a party having potential influence over a gaming site is suitable. Requiring full licensing of all creditors, however, raises costs and creates barriers that may deter many legitimate lenders. This policy may result in higher borrowing costs to gaming operators as competition is diminished and lenders pass on the investigation costs to borrowers. Likewise, vendors of equipment and goods may not be willing to provide goods on credit if it requires them to bear the expense of licensing. The latter may be particularly acute in jurisdictions where the potential revenue from Internet gambling operations is not sufficient to attract major lenders.

Short of full licensing for all creditors, regulators can exempt certain creditors from licensing scrutiny. One possible exemption focuses on the difference between commercial and noncommercial creditors. There are four major types of commercial creditors: (1) banks or savings and loans regulated by the government, (2) national insurance companies, (3) government-regulated pension or retirement funds, and (4) foreign-regulated banking institutions. Exempting commercial creditors from licensing is based on the idea that other government agencies regulate these lenders. These institutions would not likely violate controls prohibiting their involvement in gaming operations because it could jeopardize their other licenses. Moreover, because they are in the business of lending money, they spread their risk over many loans. Therefore, these institutions are less likely to feel compelled to influence gaming operations to protect their investment in the loan to the gaming operators. Finally, the initial structuring of a loan with a commercial creditor is unlikely to be a scam under which the lender is actually an equity participant.

A second possible exemption is based on the materiality of the transaction. This exemption recognizes that many transactions by noncommercial creditors are done in the ordinary course of business. This may include suppliers that ship their product, bill the gaming operator and expect payment within a certain time. Requiring the operator to prepay all suppliers or pay on delivery would place a burden on the gaming operators. Therefore, a standard can be set that exempts creditors below a certain dollar threshold from having to obtain a license. For example, creditors owed more than a certain amount may have to register with the regulators, and only those over a higher amount must obtain a license.

A third possible exemption may be for transactions that are not secured by gaming assets, such as gaming receipts and gaming stock. This would recognize that lenders with certain security pose the greatest regulatory concern. These creditors have a substantial remedy against the gaming operator for failure to pay its debt. As such, a secured creditor of a financially distressed gaming operator can exercise much greater control over the gaming operator than an unsecured creditor. This also can be addressed by requiring registration of secured interests, and giving them greater scrutiny than unsecured transactions. Another option is to require approval of secured transactions, but not necessarily a licensing investigation of the creditor. A third option is to require prior approval for the secured creditor to foreclose on a security interest in gaming equipment, gaming receipts or stock.

Instead of granting broad exemptions, regulators may require the gaming operator to report all credit transactions. After reviewing the reports, the regulators

would then have the discretion to require the creditor to file an application and undergo licensing. This allows the regulators to maintain control over the transaction with only minimal interference with the financial markets. The mere possibility of having to obtain a license might result in some lenders refusing to serve the gaming industry, but will not be as significant an obstacle as mandatory licenses. Moreover, regulators can allay many concerns of potential lenders by judiciously exercising their discretion only when serious concerns arise.

## **2. Key Game Suppliers**

### *A. Operators - Hosted Service Providers*

A white label product or service is a product or service produced by one company that other companies rebrand (or “skins”) to make it appear as if they made it. White label service providers are Hosted Service Providers (also called an xSP). These “turnkey” solutions are in essence a combination of Internet functions including gaming and non-gaming applications (Software as a Service), infrastructure, customer service, player hosts, web design and maintenance, regulatory oversight, security, monitoring, storage, and hosting email. Typically, the customer can brand the site by providing art and audio that the white label provider integrates into the site. The customer is then responsible for marketing the site. Hosted service providers can provide different degrees of customization or permit the customer to assume responsibility for some aspects of the site.

Hosted service providers rely on economies of scale and operate on a business to business model, delivering the same software and services to several customers, who may not have the cost or expertise to operate their own Internet gaming service. As an example, in places like Nevada, where only casinos can offer Internet gaming, smaller casinos can also take advantage of liquidity that a larger network can provide to its customers. When offering community based games, like poker, this assures the player has a variety of available games and limits and, when offering house banked games, it allows for a wider array of games.

Hosted service providers also should be given the highest priority in the breadth because of their importance to controlling the systems that assure the honesty and fairness of the games, protection of player funds and the other goals of both the players and government protection goals. From a government protection perspective, while the profile of the hosted service provider may not, in many circumstances, be as visible as the actual owners, scandals or issues at such a level are still likely to significantly taint the industry.

### *B. Gaming Software Provider and Manufacturers of Internet Gaming Systems*

Just as manufacturers of slot machines and other gaming devices are crucial in the operational ability of traditional casinos, manufacturers of gaming software are essential for an online gaming operation. Because such suppliers produce the machinery or code, suppliers can create flaws in the machine or imbed bad code which can compromise the honesty or fairness of the games. The online gaming operation and the government regulators need to depend not only on the integrity of the software, but on the technical ability of the operator or software maker to prevent future breaches of security. Many governments specifically require software providers to obtain licenses.

For example, in Alderney, an “associate” needs to be licensed. While “associate” might seem like it means “a business partner,” the definition of an associate includes a software contractor that designs the code.<sup>10</sup> Alderney’s laws, in particular, have a wide breadth as they relate to what the jurisdiction perceives as a function most critical to player protection. In contrast, Antigua only requires key personnel to be licensed, which do not include suppliers such as software contractors. In fact, suppliers need to be licensed only if they receive a percentage of gaming revenues.<sup>11</sup>

The extent to which a jurisdiction requires licensing of software providers may depend on several factors. Foremost is the expertise and technical and financial capability of the jurisdiction to test and certify software to the standards required by the regulations. Licensing becomes more important to the extent that the regulators do not have the money, expertise or technical resources to assure integrity of the games through testing and enforcement. A sophisticated gaming laboratory is expensive; more than the entire regulatory budget in many places. Jurisdictions without a testing laboratory may use private testing companies to fill the void. Either method may comfort the regulators that the quality of design and operation of the gaming sites and its myriad of functions meets government standards. Even with a state-of-the-art laboratory, however, some aspects of Internet gaming sites are so complex that unscrupulous persons can still gaff (insert methods to cheat) them without detection. Regulators therefore must rely to some extent on the manufacturer’s integrity to assure that the gaming sites and the games thereon are fair and honest.

Another issue is the history of the software. Other non-licensed developers may have touched the code in the past. Software is a living breathing entity and code is rarely derived from the ground up. Moreover, with dynamic and distributed teams, governments cannot guarantee the code has only been handled by licensed resources. Therefore, the government needs to rely more heavily on accountability of the licensed operator or systems architect and potentially the test labs to be accountable for the safety of the integrated code in its current and future configurations.

A subset of game software providers is the core of many game systems, the random number generator. This is the software algorithm that generates a sequence of numbers or symbols that lack any pattern, or appear to a testable degree to mimic a random event. Malta and other legislations typically certify a number of RNG producers and require licensees to use only a certified random number generator.

### ***3. Non-Gaming Related Services and Software.***

#### ***A. Application Service Providers.***

An application service provider (ASP) is an Internet based business service. The ASP typically provides software application, operates and maintains the servers, and offers the Internet service over web browsers, mobile devices or otherwise. Even a gaming company that intends to own and operate its own Internet gaming site contracts

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<sup>10</sup> Alderney eGambling Regulations, 2009

<sup>11</sup> Antigua & Barbuda Internet gaming and Interactive Wagering Regulations



certain services to third party ASPs for services such as payment processing, geo-location, age and identification verification or customer relations management. The reason for such integration with third party services can be that the Internet site lacks expertise in a particular service area or that the costs are much less expense to contract for the service than to provide it directly. In most cases, ASP is not specific to the Internet gaming industry but provides the service generally to Internet retailers and others conducting commerce over the Internet. They have the ability to spread costs over thousand of customers and can garner much greater experience and provide more robust and tested services. Risk, however, exists in integrating some services including the possible loss of control of corporate data and potential security risks.

The extent to which ASPs fall within the breadth of licensing should depend on the type of service being provided.

### *1. Payment Processors*

Internet gaming sites can process payments directly with their bank, called the merchant bank. In this case, the site will apply for and obtain a merchant account. This allows the site to accept credit cards/debit cards, and other forms of payment cards online based on the card not present (CNP) transaction principals. A payment processor typically is a third party company appointed by a merchant to handle credit card transactions for merchant-acquiring banks. Most payment processors act as "middleman" where the player pays the processor, which in turn pays the site less a processing fee. Besides securely transferring the money between the various bank accounts, the payment processor can provide other services including anti-fraud and anti-money laundering measures, discussed below. The use of ewallet structure versus an aggregate accounting structure presents different software bookkeeping and controls. Ewallets, as an example, tie to a user's social security number. Nevertheless, fraud and anti-money laundering controls are typically written into the software system layer.

Advantages to using a payment processor can include increased security, fraud prevention, and less cost in system infrastructure (such as purchasing or developing a payment gateway). A large payment processor may allow the gaming site operator to leverage credit card merchant facilities with multiple premier banking institutions with preapproved mainstream payment mechanisms such as major credit cards and ewallets.

Payment processors are unrelated to most of the major policy goals regardless of the focus on player or government protection. For example, a payment processor has no opportunity to cheat the player or impact the honesty or fairness of the games offered on the site. Payment processors may, however, handle player payments and receipts. In this process, some payment processors may have temporary custody of player funds. The policy goal consistent with both the player and government protection is to assure that these funds are adequately protected. This can be done in several ways short of requiring licensing of the payment processors. The first way is to require the owner to have reserves in place even for funds in temporary possession of the payment processor. If this is done, even if the payment processor absconded with the funds, the players would be protected. While the operator ultimately takes the

responsibility for these funds, this is no different than the commercial risk that an operator takes in the normal course of business. Operators are not the type of vulnerable class that licensing seeks to protect. A second method would be to require the payment processor to bond or otherwise insure the moneys in their possession. A third method is to regulate the accounts that the payment processor is using to assure that they are properly restricted. This can include procedures and approvals for segregation of players' funds outside of operators' control with control shared by two or more trusted third parties including the payment processor, regulated financial institutions, and regulated escrow agents or insured certified accountants. In any of these cases, enforcement mechanisms may better assure that policy goals are met, than to interfere with market competition by creation of barriers to entry through licensing.

Besides the security of the player's funds, the government may have legitimate concerns as to whether the payment processor can adequately protect player data since they receive and retain sensitive information about players and their financial accounts, data breaches could substantially harm players. This may be partially addressed by technical standards or reference to third party compliance. For example, major credit card companies adopted PCI (Payment Card Industry) compliance standards for financial institutions and merchants that secure customer's personal data when using a credit card to make payments or fund an account. Malta requires that all payment processors be PCI compliant.

Finally, payment processors have responsibilities not to knowingly or negligently serve as conduits for money laundering or bank fraud. Payment processors have a legal responsibility to assure that the transactions are not misidentified to the processing banks as non-gaming transactions to circumvent the bank's internal policies not to process gaming transactions even where legal.<sup>12</sup>

Payment processors are contrasted to payment gateways. A payment gateway merely facilitates the transfer of information between the Internet gaming site and the players bank, called the issuing bank. A key function of a payment gateway is encryption. A payment gateway uses SSL 128-bit encoding technology to encrypt and decrypt all the information including credit card numbers and other account information. The payment gateway processor validates the card account details provided and authorizes the payment amount, and the card issuer transfers the funds directly from the player's card balance at the acquiring bank into the Internet gambling site's account balance at its bank.

Payment gateways should have low priority because they have no direct contact with any policy goals regardless of the focus on the government or player protection.

## *2. Fraud Prevention*

*Fraud prevention* is fraud screening techniques designed to maximize the efficiency of the *payment verification* process and is often conducted by the

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<sup>12</sup> The FDIC issued a Financial Institution Letter on the risk of payment processors. FIL-3-2012.

payment processor as a function of the services that they provide to the online sites. These techniques can involve address verification (comparing the address information provided by the player against the billing address information that the issuer has on record for the account), card verification methods (to ensure that the person submitting the transaction is in possession of the actual card), comparison of data in positive and negative files (OFAC list lookups or 'black-list' lookups) and the conducting of risk analysis based on IP address, country of origin and velocity pattern analysis. In most cases, the provider that offers fraud prevention services does not decide whether to accept or reject a transaction; rather if the fraud criteria set by the operator and administered by the service provider indicates an exception, the transaction is referred to the operator for resolution. In such cases, the service provider is further removed from responsibility for decisions that could impact revenues and hence, less important to achievement of policy goals.

### *3. Site Security*

*Site security* is a very broad concept and can entail many aspects including network management, site redundancy, firewalls, intrusion detection, intrusion prevention, hacking, social engineering, anti-virus, anti-Trojan, anti-worm, physical security, a secure uncrackable RNG and disaster recovery. Certain forms of hacking such as Denial of Service attacks, that cannot cripple a brick-and-mortar casino, would prevent an Internet gaming operation from operating and can cause serious damage to an Internet-based gaming operation. This can be a concern for jurisdictions that focus on government protection goals as it can impact tax revenues and the public perception of the sufficiency of the regulations. Moreover, compromised site security could allow hackers to steal personal player data or impact the fairness or honesty of the games. Thus, site security is an important aspect of regulatory oversight.

Regulators looking at the licensing aspect of site security will need to take a holistic approach. Site security is important to all Internet commerce from small businesses to multi-billion dollar banking institutions. The methods that each uses to protect their sites can and often are state of the art solutions. Creating barriers to entry through extensive licensing for security service and software providers to the gaming sites may prevent many larger providers to forego servicing the industry. This may result in the gaming sites being less secure as they may be denied access to state of the art security services and software needed to ensure the security of the site from hackers and other external threats. Many of these third party services and solutions are more appropriately the subject of technical standards and regulatory enforcement as opposed to licensing.

Nevertheless, overall security for the site is a critical regulatory function whether performed by the operator or a third party service provider. Most often overall responsibility for site security lies with the licensed operator or service provider and proper suitability review during the course of their license investigation may be warranted. Specifically, licensing investigators may look at

the potential operator's past security experience and previous track record with security breaches.

#### *4. Age and Identification Verification*

Age and Identification verification refers to systems or services used by Internet gaming sites to confirm that the users attempting to access their website are who they claim to be and are of the age required by law to participate in gaming. This service involves tracking and logging of identification and age verification. Age and identification verification providers also interface with age and identification databases provided by fourth party providers including other governments.

#### *5. Location verification*

Location verification refers to systems or services sites use to confirm that the users are physically located in a jurisdiction where they are permitted to play and where the site is permitted to accept players. This service involves tracking and logging of identification and age verification.

Like age and identification verification systems, age verification solutions are widely available and used in a variety of existing online businesses. For example, both age and location verification is important for Internet sales of alcohol and tobacco products as well as age-restricted materials. Allowing Internet gaming sites to use existing technologies without placing substantial licensing barriers to providers assures that the most technically advanced technology is always available to the operator. This is particularly important for lawful compliance with the laws of other jurisdictions. The need to require licensing of age and location verification is further mitigated where the regulators set reasonable standards for the age or location verification systems or services including privacy protections and the parameters for determining who is deemed of proper age and location made by the operator both at the automated systems level and in dealing with exceptions.

#### *6. Bonus and Loyalty Management and other Marketing Services*

*Bonus and loyalty management* software and services allow the Internet site to measure customer feedback and allocate resources including bonuses based on customer loyalty. The systems include customer loyalty metrics that measure individual and aggregate customer loyalty, ongoing customer feedback, and systems to categorize and apply strategies including bonusing based on the data and feedback.

To the extent that third party service providers can access player data or can interface with game systems, the regulators may impose regulatory oversight. To the extent that these concerns can be addressed through technology standards, the need to invoke licensing or registration may be mitigated. Where third parties do not have access to systems or player data, responsibilities can legitimately lie exclusively with the licensed operator.

## *B. Internet Hosting Services*

An Internet hosting service allows individuals and organizations to make their website accessible to players. Web hosts are companies that provide space on a server owned or leased for use by clients, as well as providing Internet connectivity, typically in a data center. Web hosts also can provide data center space and connectivity to the Internet for servers owned by the operator of the site but physically located in the web host's data center, called co-location. Here, the user owns the server; the hosting company provides physical space that the server takes up and takes care of the server. The co-location provider may provide little to no support directly for their client's machine, providing only secured facilities, an environmental control system, uninterruptable power supplies, battery backups, alternative energy sources such as diesel generators, and Internet access. Hosting services play two important roles of concern to regulators - security of the site servers and uninterrupted service. The ability of a hosting center to provide uninterrupted service can be reviewed against objective criteria. For example, private certification of a data center is made based on the level of capability of the data center, with the highest tier (4) being the most robust and least likely to have interrupted service. The physical security of the data centers is not rated by private certification. They can vary from insecure to meeting highest standards for critical government and banking servers. In most cases, however, governments can easily verify the security of a hosting facility and assess whether it meets minimum perceived standards for alarms, surveillance, security personnel, access control and other standards. As governments are more likely to want licensees to use the most secure and robust data centers as opposed to self-housing their servers, they may want to regulate the use of third party co-location data centers by technical standards and enforcement than by licensing.

Data centers for physical hosting also are closely associated with the Internet Service Providers that maintain and supply the connection between the site servers and the Internet. Between the data center and the ISP, a possibility exists for the interception of online gaming transactions for malicious purposes. This, however, is better addressed through technical standards, audit requirements, and policies that require limitations on physical server access.

A newer category of hosting services is virtual or "cloud" services. While the flexibility and scalability is very attractive to Internet gaming operators, the ability to ensure integrity and security of the servers, applications, and data is currently non-existent. For this reason, cloud-based data centers are not a feasible solution, but it may be worth mentioning because of their growing importance to the Internet as a whole.

## *C. Independent Marketing Agents, Affiliates and Other Referral Websites, Agents, and Virtual Hosts.*

Search engines, e-mail, website syndication and marketing affiliates have long played an important role in driving customers to Internet gaming sites. Several common methods exist to compensate these third party companies including revenue sharing or pay per sale (PPS), cost per action (CPA), and cost per click (CPC) or cost per mille

(CPM). As the name suggests, pay-per-click advertising means that the advertisers put the gaming operation's advertisements on many websites to gain potential clients.

Affiliates are focused websites that have business arrangements with the gaming operation in which the affiliates agree to connect their users to the gaming website. For example, a gaming news website that directs its members to the casino would be considered an affiliate. In return, the affiliates are compensated for their referral. The gaming operation pays the affiliate once a prospective gaming customer clicks on the advertisement and is directed to the gaming operation's website. CPA arrangements typically pay the affiliate (a) a flat fee for each registered player, (b) a flat fee for each registered player who makes a deposit, (c) a percentage of the gross revenue of a player or a combination of (a) plus (c) or (b) plus (c).

Some gaming sites earn more than 70% of their revenue from affiliate referrals. In the realm of Internet gaming, affiliate websites perform the roles that junket representatives and hosts perform in traditional casinos. Affiliates do not know or have access to the revenues that a gaming operation generates. The only connection that affiliates have with the gaming operations of the gaming website is when affiliates are paid a percent of actual gaming revenues.

Regardless of the policy focus on the government or the player, the use of affiliates poses certain concerns.<sup>13</sup> Unlike casino employees, affiliates act independently of the gaming site. This creates less accountability to corporate codes of ethics and internal controls. For example, affiliates can serve as "barkers" whose sole goal is to drive traffic to the gaming sites. This can be done by the use of false or misleading advertisements or offers. For example, a site may pose as an independent consumer review of online gaming sites, but in fact give false positive reports and ratings only to those sites that pay them bounties. Moreover, the affiliates can operate beyond the jurisdiction of the regulators.

Site operators must adopt corporate policies if they want to control affiliate behaviors. Regulators can shift the responsibility to maintain regulatory controls over the affiliates to the site operators through mandatory policies and practices that can be reviewed and measured by regulators if desired. Moreover, technologies exist to help control affiliates. Governments can implement "crawler" software that can collect data on the marketing activities of the affiliates of their licensees. If violations of advertising standards are detected, then the regulators can force the termination of the affiliate relations or take other corrective action. This, however, is reactive as opposed to proactive.

Advertisers are generally more isolated from gaming revenues and the gaming operations. The largest groups of online advertisers include search engines and social media websites. Rather than affiliates who might be paid an estimated or actual percent of gaming revenues, advertisers in the online world are generally paid per click. As such, they pose little regulatory risk.

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<sup>13</sup> Under the most conservative players protection goals, the use of affiliates to promote gaming activities could be prohibited as it stimulates demand.

#### *D. Operation and People Services*

*Other services* such as customer service, domain name acquisition and management, affiliate management, network and chat management, affiliate and marketing campaign management, customer support workflow systems, CRM/bulk email communication services and site optimization are not critical to the basic concerns of either the player or the government protection goals. Regulators may want to understand the interface of these systems with more critical system functions and, in particular, access to customer data. Only where technical requirements cannot adequately protect the critical systems should consideration be given to requiring registration or licensure of providers.

#### *E. Non-Gaming Software Providers*

Products integrated into back-end gaming platforms perform such functions as account management, affiliate and agent software, CMS/CRM tools, fraud and security tools, registration platforms, integrated cashier, centralized reporting tools, bonus and loyalty tools, network management tools and site optimization tools.

### **Depth of Licensing**

When a government requires a license to engage in an occupation related to gaming, the entity that must apply and obtain the license often is not an individual. For example, the owners of most Nevada casinos are publicly traded corporations. Depth of licensing refers to which persons associated with the applicant-entity must file an application and obtain a license.

To attain any type of approval, it is first necessary to determine which parties associated with the applicant need to be licensed. Jurisdictions around the world have varied requirements as to which individuals within or associated with an applicant need to be licensed. These requirements are mostly based on the relationship between the party required to be licensed and the applicant-gaming operation. For example, in the Isle of Man, for the business' gaming license to come into force, a designated official of the company must first be approved by the Commissioners.<sup>14</sup> Thus, the depth of who needs to be licensed requires an analysis of the involvement of parties in the management and operations of the online gaming operation. Many jurisdictions, however, require much depth in terms of who needs to be licensed.

Most owners, operators, suppliers and vendors for Internet gaming sites will be some form of business entity, usually a corporation. A corporation is an artificial person or legal entity that the government authorizes to conduct business. The principal benefits of a corporation over other forms of business enterprises are limited liability of equity owners (known as shareholders), transferability of interest, and continuity of existence.

Structures for corporations differ between countries, but usually involve officers, directors, shareholders, and employees. Shareholders are persons or entities that hold equity, as represented by shares, in a company. Shares entitle the holders to control the

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<sup>14</sup> Isle of Man Online Gambling Regulation Act, 2001

corporation through voting for the board of directors. In the discretion of the board of directors, shareholders are entitled to earnings through current or accumulated dividends and to pro-rata distribution of assets upon liquidation.<sup>15</sup> Shareholders typically elect directors who manage the corporation through the corporate officers. Officers are corporate agents, and have management responsibilities that the board of directors delegates to them.

Depth of licensing for corporations concerns which directors, shareholders, officers and employees must undergo licensing scrutiny. Similar considerations are needed for other business formations, such as general and limited partnerships, trusts, joint ventures, limited liability companies, and joint stock associations.

### **Officers/Key Employees**

Gaming executives have the responsibility of overseeing the gaming operations. One gaming executive that is particularly critical to the operations of the Internet gaming operation and the well being of the gaming operation is the Chief Executive Officer (CEO). The CEO manages all of the online gaming operations, ensures efficiency of the website, and establishes internal policies and rules governing the website's operations. Sometimes, an online gaming portal may divide the CEO's responsibility into two – while the CEO would have the roles of managing the business aspect of the gaming operation, an employee with specialized technical skills, known as the Chief Technology Officer (CTO) would manage the site itself. Among the CTO's responsibilities are to ensure that the site is always accessible, that it is secure, that it can sustain the necessary traffic, and that the software and hardware implemented meet regulatory and internal standards. Other important technical persons include the chief architect and chief systems administrator. The "system administrators" are important to site security. They can govern everything from safety of the operating system to new builds of software (versions). The Chief Financial Officer (CFO) is typically responsible for managing the financial risks of the corporation, budgeting and financial planning, record-keeping, financial reporting and data analysis. Some companies in heavily regulated areas, like gaming, designate a special C-Level position for a Chief Compliance Officer or CCO. These persons are responsible for compliance at all levels of the organization.

Since executives have access to nearly all of the gaming operation's financial information and have the ability to manipulate the data, they are the group most susceptible to regulatory sensitivity and intensive licensing review. Regulation can designate these individuals in different ways. For example, the Kahnawake, a Mohawk Territory in Canada, require licensure by designating the titles of key officers that must be licensed including the CEO, CFO, COO, CTO and Office Manager.<sup>16</sup> In Malta, the regulators require licensure of the directors of the company, who must be Maltese residents. Others designate who needs to file based on the functionality as opposed to title. For example, the United Kingdom requires that key personnel be licensed, but defines key personnel based on function rather than title and includes anyone responsible for the overall strategy of gaming operations, financial planning, control,

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<sup>15</sup> H. Henn & J. Alexander, *CORPORATIONS*, HORN BOOK SERIES, 396 (1983).

<sup>16</sup> Kahnawake Regulations Concerning Internet gaming



budgeting, marketing, commercial development, regulatory compliance, IT provision, and gaming related security.<sup>17</sup> Still others rely on compensation as the trigger for licensure by either setting a compensation amount that triggers licensure or simply requiring a fixed number of the most highly compensated executives to file an application.

## **Other Employees**

### *1. Hardware and Software Technicians*

Software engineers, also known as computer programmers, are among the most numerous employees of an online gaming operation. Led by a chief software engineer, the role of software engineers is to write computer code that will impact every aspect of the website. The most common types of code that the engineers focus on direct the randomness/probability of casino games, the movement of money between accounts, and proper reporting. Although this group might seem as if it can severely impact gaming operations, software engineers are not deeply involved while the gaming operation is functional. Prior to regulation of the industry, however, programmers who wrote the code often were tasked to assure that it ran properly. This allowed those programmers access to the servers at such a level that they could easily inject malicious code, and affect outcomes. Policies, if not laws, should require segregation of software developers from the system administrators so as not to create licensing or security issues.

The programmers' role of writing code is undertaken offline and is verified by multiple parties, internal and external, before the software is implemented in a live setting. Governments need to understand their own resources and the limitations of testing strategies even by independent testing facilities. While controls over the software can be implemented to ensure that the computer code is fully functional and that no avenues exist for the programmers to insert malicious code that would change probabilities or transfer funds to incorrect accounts, these cannot be accomplished with absolute guarantees. The degree of assurance is dependent on many factors including the quality of the standards, the quality of the manufacturers internal testing and controls, the competence and capability of the testing agency, and the degree and sophistication of the government's oversight of the industry. Once the software is implemented into the operations, except for follow up releases and bug fixes, the technical operations personnel take over the role of managing the software.

While serving a different function, database engineers and database administrators also are key technical personnel having access to the data within the Internet gaming system databases.

Technicians for Internet gaming companies have different roles, some of which have greater regularity sensitivity and their responsibilities can impact key policy goals such as the honesty or fairness of the games, the securing of player funds and the protection of player identification and personal data. Gaming regulators should require a skills and responsibility matrix that identifies all technical employees within the

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<sup>17</sup> Great Britain Gambling Commission; <http://www.gamblingcommission.gov.uk>

organization along with their qualifications such as education, certifications, and work experience.

The regulators make require technicians with the greatest regulatory exposure to obtain some form of license. The determination of which technical personnel present the greatest risk is complex in this environment. Each deployment of an approved system will have its own characteristics due to how the system is configured and architected. This can be influenced by factors such as the network infrastructure, organizational structure, and internal control system. Regulators can require a submission prior to installation of these systems to provide transparency into the site's operation.<sup>18</sup> Along with this submission, the regulators can require the site operator to provide a user access listing that identifies all persons with access to the system. Besides providing the regulators with a guide to how the system is being operated if they want to perform a pre-deployment or post-deployment inspection of the system, the submission provides information on the personnel that have access to sensitive areas of the system and the nature of that access. This information can be used to determine who should have to obtain a work card or other license.

## *2. Technical Support and Operations Personnel*

In the ecommerce world, technical support staff is often broken into levels. L3 personnel would be highly technical personnel including system administrators and support engineers. Key individuals in this group are discussed above. L2 personnel would have some knowledge of technology but much less than L3 personnel and generally support L1 personnel. L1 personnel are not very tech savvy but interface with the customers. Most important for purposes of regulatory licensing is not the level but the functionality and access assumed by each level of technology support staff. For example, *technical operations personnel* are a subgroup of technical support that is unique to Internet gaming. This group is responsible for ensuring that the website is operational and that it is secure. A major role of technical operations personnel is to monitor the website and ensure that it is safe for players, that there is no cheating, and that the integrity of the gaming operation is not compromised.

As a general rule, non-executive members of this group should be subject to very clear and restrictive procedures and control standards, such as prohibitions against changing game outcomes. Some technical operations personnel, however, may be given access and have the ability to move funds into or out of client accounts, to monitor and change game outcomes, to contact clients regarding their accounts, and to access the funds of the gaming operation to settle amounts in dispute. Where such sensitive functions are granted to individuals, they must be accompanied by stringent controls and some level of licensing review.

## *3. Customer Support*

*Customer support*, in any business, is meant to interact with customers and solve any issues facing them. In Internet gaming, some common roles of customer service

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<sup>18</sup> An example of this in the context of land based operations is a directive from the Nevada Gaming Control Board for approval of system based games, system supported games, or mobile gaming systems.  
[http://www.gaming.nv.gov/industry\\_ltrs/industry\\_ltr\\_328.pdf](http://www.gaming.nv.gov/industry_ltrs/industry_ltr_328.pdf).

include providing information about the website to potential clients, having knowledge of the games offered, and settling client disputes with the gaming operator. In the long-run, effective customer support can help the website achieve the status as user-friendly, which will certainly help the business. To perform effectively, customer service needs access to information that might be sensitive.

To solve some of the more sensitive customer issues, such as those involving funds, customer support may need access sensitive information regarding the customer, customer funds and bank accounts. Furthermore, to settle disputes, customer support may be able to move a limited amount of funds either to or from player accounts. Much of this may depend on whether payment processing is outsourced and whether the data is available only to the payment processor. Although this group has access to sensitive customer information, the regulatory need to require strict licensing of the group is not high because the actions of customer support can be traced and, if necessary, reversed. Additionally, much of the information that is available to customer support is on a read only basis, which means that customer service employees can view, but not change, the information. Nevertheless, depending on the functionality and access accorded to customer support governments may consider some form of licensing for customer support such as employee registration or work cards.

#### *4. Fraud and Surveillance*

The *fraud and surveillance* department of an online gaming operation seeks to prevent players from cheating either the gaming operation or other players. The department, led by the director of surveillance, monitors games and their outcomes in order to determine the probability of players using software to cheat the gaming operation. By looking at the risk/returns of many games, the fraud department can prevent players from banning together and bilking other players out of money. Another key function of the fraud and surveillance department is to prevent fraudulent forms of payment. As identity theft and credit card fraud rise, the burden on the department to verify payments rises so that the gaming operation and other players can be awarded their winnings.

The fraud and surveillance departments may be integrated into information technology departments of some Internet gaming companies. This is because many of the methods used to detect fraud and collusion involve data analysis within the system's databases. Many times, the same algorithms used to identify key patterns and trends for marketing purposes are also used to detect cheating and collusion.

Along with the functions of a traditional casino, such as monitoring games to prevent collusion among players, the online frontier imposes many additional duties on the fraud and surveillance department. For example, the department monitors the website for collusion, chip dumping and robotic programs. The fraud and surveillance department also ensures that the users of the site are real persons.

The main tool that the department has to prevent players from cheating is exclusion. Just as traditional casinos can remove players from the property, the fraud and surveillance department of an online gaming operation can exclude a player from participating in the website's operations. Generally the department has read only access. Thus, while the director of surveillance has access to information that would

make him critical in gaming operations, the access is not one that can be used to manipulate gaming data.

### *5. Marketing Employees*

The marketing department of a gaming operation is responsible for the creation and implementation of a marketing strategy to drive traffic to and promote the gaming operation. A gaming marketing director leads the marketing department and works with affiliates and advertisers to seek more customers. Some key roles of the marketing director include developing promotions, installing rewards programs, and ensuring that the image of the gaming operation is upheld in the media. The marketing director is also responsible for ensuring that all marketing strategies and all interactions with affiliates, advertisers, and potential customers comply with all relevant gaming statutes and regulations.

In Internet gaming, the marketing employees of a gaming operation are responsible for some unique tasks. For example, the marketing department of an online business has to monitor online activity targeting the gaming operation. Search engine optimization, social media marketing, and banner advertisements on websites are some of the common functions that an online gaming operation's marketing department performs. All such roles, while not directly related to the gaming operations, indirectly influence the revenues of the gaming operation.

Internal marketing employees pose fewer problems than affiliates because they are subject to corporate codes of ethics and internal controls. Because they are employees, gaming site operators have greater interest and control over their actions.

### *6. Finance and Accounting*

The finance department of a gaming operation, led by the Chief Financial Officer (CFO), makes financing decisions such as issuing debt, ensuring compliance with regulation, and monitoring projects to generate positive cash flows for the gaming operation. The accounting department is led by the gaming operation controller. It is the duty of the controller to reconcile accounting transactions, enforce internal controls, approve the general ledger, and work with the internal audit department to monitor money flows. Together, the finance and accounting departments maintain the gaming operation's financial records, prepare licenses and tax forms, and balance the gaming operation's books.

Although the two departments seem to have access to much of the gaming operation's financial records and bank accounts, the access is very limited. The employees of the two departments can view the financial information, but generally cannot alter the data. Furthermore, internal policies are in place to prevent the employees from transferring any of the gaming operation's funds into other accounts. Thus, the departments are not too sensitive to the actual operations of the gaming operation. Their post-gaming operation roles of journaling entries, reporting results, etc. do not make them too susceptible to gaming licensing regulation.

### *7. Internal Audit*

The role of the *internal audit* department is to analyze and verify the gaming operation's transactions to ensure that they meet the established regulatory and internal

guidelines. Internal auditors, led by the director, also determine if the various gaming departments are following accounting rules, custodial policies, and control procedures. While internal auditors are focused on the workings of gaming departments, audit clerks audit revenue generating areas. Audit clerks verify the accuracy of revenue and expenditure figures, correct discrepancies, audit online balances, and prepare reports about daily operations. The internal audit department seeks to verify information post-event and so it is not directly involved in the daily operations of the gaming site.

#### ***8. Non-Gaming Employees***

A website needs to hire employees for non-gaming purposes. For example, a website could have employees that manage its servers and decide which types of games to offer players. Such roles are isolated from the actual game play and therefore need not be licensed.

Notable exceptions are computer information service employees. As gaming operations become more computer-based, the staff dedicated to the maintenance of these systems increases. A gaming operation can have many different sensitive computer systems, including player tracking systems, slot tracking systems, debit card systems, marker issuance and collection systems, bingo and keno systems, accounting systems, and sports and horse race totalizers.

Except for certain computer service employees, non-gaming operation employees generally are of the lowest regulatory priority. Effective implementation of internal control systems should adequately protect gaming operator assets from potential theft by non-gaming employees. Regulators, however, may wish to treat computer service employees, particularly those with access to software, at a higher level of regulatory priority, perhaps as gaming employees.

#### **Directors**

Directors have a duty to the corporation to use their best judgment in deciding and executing corporate policy. Their duties include (1) selecting officers and setting officer salary and compensation, (2) making major policy decisions, and (3) deciding major financial matters, including dividends and financing. Directors often are described as inside or outside directors. An "inside" director is a board member who is an employee, officer or significant shareholder in the company. An "outside" director is not an employee, significant shareholder, does not have operational responsibilities and is considered independent of management. Outside directors can be selected because of their general business or specific industry knowledge or experience. As a result, outside directors are often viewed as having objective informed opinions regarding the company's decisions, health and operations and bring diverse experience to the company's decision-making processes.

Governments often only require inside directors to obtain licenses. In Nevada, as an example, only outside directors of public and certain private companies have to file licensing applications. They include the chairman of the board, those holding greater than one percent of any class of voting securities, those serving on the executive committee or any comparable committee with authority over the casino activities, those who are also gaming employees, and those who regulators determine supervise gaming activities. This is a reasoned approach because outside directors are independent of the

company and have less opportunity to impact daily management or operations most subject to regulatory sensitivities. Moreover, as independent directors are most often paid based on fixed criteria such as a monthly or meeting fee, they are less subject to financial or other pressures that could lead to compromising regulatory integrity. Finally, a goal of selecting outside directors is to have the most qualified persons to serve in that position. The pool of eligible outside directors would likely be significantly smaller if licensing were a prerequisite.

### **Shareholders**

All forms of business entities that a license applicant may use include the concept of equity ownership. In corporations, the most common form of business entity, equity is held by shareholders. A corporation can be either public or private. A publicly-traded company is a corporation whose stock is traded on a public market. An attractive feature of being a publicly-traded corporation is the ability to raise capital through a public offering. Most often, a public offering occurs when the company sells either stock or debt instruments to the public through brokers. Public company stock is attractive to investors because it usually provides liquidity. If a person buys the stock, he can usually sell it in the public market by simply contacting his broker.

Besides their benefits, allowing publicly traded corporations to own and operate gaming operations poses regulatory issues. As a practical matter, a publicly-traded corporation cannot be licensed if all its shareholders must be licensed. A public company can have thousands of shares traded daily. Therefore, if a jurisdiction wants to encourage publicly-traded corporations to invest in its gaming industry, it must allow licensing without each shareholder having to obtain a license.

Waiving licensing requirements for some shareholders, however, may allow unsuitable persons to buy shares and have an ownership interest in the gaming companies. This may not pose substantial problems if the person owns a few shares out of millions, but can create regulatory issues if the person owns a significant percentage of the stock. Public perception problems may occur where the media exposes that a notorious criminal has major holdings in a publicly-traded gaming company. Moreover, regulatory problems may occur where the person's holdings allow him to exert influence or control over the corporation.

Jurisdictions that want publicly traded corporations must balance these regulatory concerns with market realities. They can do this by setting thresholds at which shareholders in publicly traded corporations must apply for and obtain a gaming license. In the United States, these levels are commonly set at 5%, 10%, or 15%. As an example, the applicant to name every shareholder and provide a curriculum vitae of every shareholder that holds more than 5% of the company. These levels are often tied to government reporting or filing requirements when a shareholder acquires beneficial interest of greater than a certain amount. Some places, such as Nevada and New Jersey, allow institutional investors to hold over 10%. Institutional investors are entities such as banks, insurance companies, registered investment companies, advisors and employee benefit or pension funds. Falling within this category are mutual fund companies that often control and invest billions of dollars for their clients. In Nevada, the regulators set a maximum limit (25%) that an institutional investor may hold without

obtaining a license. Under both systems, the institutional investor must show it is holding the stock for investment purposes only.

Some jurisdictions do not distinguish between private and public companies and set levels for shareholder licensing based solely on percentage of ownership. For example, Kahnawake requires the suitability of each individual who owns more than 10% of outstanding shares, while Antigua sets the bar at 5%. Little reason exists to distinguish private and public companies in this respect. The reasons that some jurisdictions do make a distinction are more based on history. These were jurisdictions that have licensed gaming since before the advent of public gaming companies. They made general exceptions to the requirement that all shareholders had to be licensed to allow public companies to enter the industry. This limited relaxation of regulatory oversight was deemed an acceptable tradeoff to the benefits brought by public company investment. The requirements were not relaxed for private companies. Even Nevada, however, has since relaxed requirements that all shareholders of private companies must obtain a license.

### **Levels of Review**

Levels of reviews in regulatory systems use “tiered” licensing. Tiered licensing involves categorizing every group of individuals or entities that are associated with the gaming industry into two or more tiers. Each tier is then subject to a different level of licensing scrutiny. For example, regulators may decide to extend the breadth of licensing to both owners and gaming employees. The level of review, however, might be different. Owners may have to undergo a thorough investigation that requires the regulators to spend months reviewing all aspects of the owner’s life, while the review of the gaming employees is a check of their police records. These checks take on several forms depending on the jurisdiction. In Malta, the licensing authorities review personal background information, financial information, participation in illegal activities, and criminal records to determine whether the owner can be licensed.<sup>19</sup> Key personnel face similar stringent requirements and a check of their police records. In the United Kingdom, the licensing authorities analyze personal details, civil litigation history, prior gaming industry and general business history, competencies, references, and prior bankruptcies to determine the ability of key personnel to be licensed.<sup>20</sup> Similarly, Panamanian authorities consider criminal records, suitable references, and general national employment regulations to determine levels of review.<sup>21</sup> From an economic perspective, these tiers can be seen as different sized barriers; high scrutiny is a substantial barrier to entry and low scrutiny is a low barrier to entry.

The most expensive and intrusive investigation is a full licensing investigation. It is a comprehensive independent review of the applicant’s financial history and personal background. Full investigations are expensive because the government investigators review primary source materials. For example, rather than relying on an acquittal as a determination of innocence, government investigators may reinvestigate the incident.

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<sup>19</sup> Malta Remote Gaming Regulations

<sup>20</sup> Great Britain Gambling Commission; <http://www.gamblingcommission.gov.uk>

<sup>21</sup> Panama Online Gaming Act of 12 Nov. 2002

They will seek to learn if other evidence, perhaps that was not admissible in the criminal proceeding, might suggest guilt. In a financial context, investigators may not rely on tax returns, but instead analyze cash-flow by reviewing actual deposits and withdrawals to figure out both net worth and source of funds. These investigations are expensive and time consuming.

Partial investigation involves reviewing only limited areas on each application. Instead of a field background investigation, the regulators may conduct only a computer review of federal, state, and local police data banks. If the review does not reveal any arrests, convictions or investigations of the applicant, the regulators may issue a license. Partial investigations provide less protection to the government. A partial investigation usually is only a check for negative criminal history, reviewing responses from the applicant's references, and sometimes a personal interview.<sup>22</sup> Partial investigations have two disadvantages. They may not provide enough information or personal contact with the individual to provide a basis for accurate prediction of future conduct. Moreover, the cursory investigation with an insufficiency of information verification often yields questionable information.<sup>23</sup> Nevertheless, a partial investigation provides some benefits. Most notably, it may inhibit persons with extensive criminal histories from obtaining employment in the online gaming business. Moreover, regulators may obtain useful derogatory information on applicants from third parties that may lead to denial of the applicant despite the absence of a negative criminal record.

Limited licenses are common with gaming employees. In this case, the extent of the partial investigation can be tiered, with key employees being subjected to higher review than lower-level employees. Similarly, the licenses issued can restrict the person's activities very specifically, such as an internal auditor only, or by category, such as in New Jersey, which issues different licenses to key gaming employees, regular gaming employees, and non-gaming employees.<sup>24</sup> To differentiate types of licenses, jurisdictions may use different terminology, such as a work "permit" or "card" for the licensing of gaming and non-gaming employees.

Nevada derived a formal tiering structure for Internet gaming service providers by identifying three classes and conducting a different level of investigation for each class. Class 1 service providers are those who (a) manage, administer or control wagers that are initiated, received or made on an interactive gaming system; (b) manage, administer or control the games with which wagers that are initiated, received or made on an interactive gaming system are associated; (c) maintain or operate the software or hardware of an interactive gaming system; (d) receive payments based on earnings or profits from a game, or (e) any other applicant for a service provider license who the regulators believe should have a Class 1 license. Applicants for Class 1 licenses have to undergo the most stringent investigations. Class 2 services providers are any other service provider that the regulators deem as having a critical role with the gaming site's operation. These service providers have to undergo a more cursory review. Any person

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<sup>22</sup> Deborah L. Rhode, *supra* note 2. at 512.

<sup>23</sup> *Id.*

<sup>24</sup> See generally Nicholas Casiello, Jr., New Jersey, in *INTERNATIONAL CASINO LAW, SECOND EDITION* (Cabot, et al., eds.) (1993).



who is a service provider other than a Class 1 or Class 2 is a Class 3 service provider. A Class 3 license is a probationary license more akin to a registration, and includes anyone who acts as a marketing affiliate for an operator of interactive gaming.<sup>25</sup> Accordingly, a “marketing affiliate” is a type of interactive gaming service provider who provides:

- (i) information regarding persons to an operator of interactive gaming via a database or customer list; or
- (ii) person who provides the trademarks, trade names, service marks or similar intellectual property under which an operator of interactive gaming identifies its interactive gaming system to patrons.

The term “marketing affiliate” is intended to capture persons that share customer databases with operators, or companies that intend to license their brands to operators.

To determine a level of review, however, placing service providers and employees in different tiers is important.

Placing a group into a particular tier requires consideration of four major factors. First is the relationship between the group under consideration and public policy goals. For example, if the principal governmental policy is to assure the honesty of the game, the most obvious persons who need to obtain licenses are the game operators or the software suppliers or programmers. Likewise, if governmental policy attempts to prevent gaming profits from going to criminals who may use them to fund criminal operations, then the breadth must extend to persons sharing in profits from the games.

A second factor is the degree of risk that a group poses to accomplishing a key public policy goals.

Another consideration is capability and budget. Placing all groups into a mandatory licensing tier with full investigations will require a substantial government commitment of trained personnel to conduct the investigations or rely on third party investigations whose quality is difficult to maintain. Therefore, a government often place groups into the tiers on a priority basis. Usually, the top priorities are owners and operators, followed by persons sharing in profits, distributors, manufacturers, and key employees. The government then assigns different levels of licensing scrutiny to each tier taking into account the budget and capacity of its investigative division.

A fourth consideration is the economic impact of requiring licenses of certain groups. As discussed later in this chapter, requiring licensure may discourage persons from applying because they are unwilling to devote the time, pay the cost, or suffer the embarrassment of the licensing process.

## **Criteria**

Gaming regulators can consider many different criteria in assessing an application for a gaming license. Criteria can be of a fixed or discretionary nature. Fixed criteria are quantifiable ones that an applicant either meets or does not. Fixed criteria

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<sup>25</sup> NGC Reg. 5.240(3).

can include whether person has not been convicted of a felony (South Dakota) or ensuring that a person has not been convicted of any crime involving gambling, prostitution, or sale of alcohol to a minor (Mississippi).

Discretionary criteria are minimum qualifications that are not subject to quantification, but are based on the discretion of the gaming regulators.

Great Britain requires that the person is likely to comply with the gaming controls, each of which merits special discussion. The most common discretionary criteria involve good character, associations, management capabilities, and financial abilities.

### *Good Character*

Statutes and regulations often require regulators to consider "good moral character" as a factor in screening applicants for professional and other vocational licenses involving a high degree of public trust. In Alderney, as an example, gaming commissioners will examine the applicant's character. Besides privileged licenses such as gaming, it is often a criterion in considering whether to grant a professional license, such as accounting, law or medicine. Despite its common use, the term has limited practical utility because it is difficult to define and apply. The major problem with using "good moral character" as a criterion is the inherent subjectivity involved when judging another's character.<sup>26</sup>

Deciding a person's qualification to hold a gaming license based on the person's character is merely a total grant of discretion to the regulators. "Good" character, as opposed to "bad" character, lacks useful definition. What is good or bad is ultimately based on the individual perceptions of the person making the judgment. What is "good" or "bad" to a Baptist minister or a Bronx numbers operator will differ greatly. The former might find any applicant for, or holder of, a gaming license to be of "bad" character because of his choice of profession. In this context, the concepts of good and bad vary based on the political, social, religious, and psychological orientation of the regulator.

Judicial attempts to define the phrase and give concrete standards to the term "good character" are infrequent and unhelpful. One leading case that attempts to define the term is *Konigsberg v. State Bar of California*.<sup>27</sup> In that case, the State Bar denied an applicant admission because of "questionable moral character" based on the applicant having made certain political statements. The Court, discussing the definition of "good moral character" stated that:

The term, by itself, is unusually ambiguous. It can be defined in an almost unlimited number of ways for any definition will necessarily reflect the attitudes, experiences, and prejudices of the definer. Such a vague qualification, which is easily adapted to fit personal views and predilections, can be a dangerous instrument for arbitrary and discriminatory denial. ...<sup>28</sup>

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<sup>26</sup> Rhode, *supra* note 392. at 529.

<sup>27</sup> 353 U.S. 252 (1957).

<sup>28</sup> *Id.* at 262-63.

Other courts have struggled with the same ambiguities. The Arizona Supreme Court, ten years after *Konigsberg*, conceded that “the concept of good moral character escapes definition in the abstract,” and held that each case must be judged on its own merits in an *ad hoc* determination.<sup>29</sup> Thus, the conclusion that the individual has good moral character and, therefore, is fit, or conversely, has bad moral character and is not fit, is a subjective opinion only reached by comparing the individual to one’s personal concept of what is moral or immoral.

Other courts’ attempts to define “good moral character” usually resulted in defining a vague, highly subjective phrase with more vague and highly subjective phrases.

For example, the North Carolina Supreme Court defined “good moral character” as:

something more than an absence of bad character. ... It means that he must have conducted himself as a man of upright character ordinarily would, should, or does. Such character expresses itself not in negatives, nor in following the line of least resistance, but quite often in the will to do the unpleasant thing if it is right, and the resolve not to do the pleasant thing if it is wrong.<sup>30</sup>

The Arizona Court adopted, as a means of determining bad moral character, a test that inquires “whether that behavior truly portrays an inherent and fixed quality of character of an unsavory, dishonest, debased, and corrupt nature.”<sup>31</sup>

The overall standard in this area was stated by the United States Supreme Court.<sup>32</sup> In that case, an applicant for admission to the Bar was rejected for questionable moral character because of his membership in the Communist Party. The Court reversed, stating that:

[A] state can require high standards of qualification, such as good moral character or proficiency in its law, before it admits an applicant to the Bar, but any qualification *must have a rational connection* with the applicant’s fitness or capacity to practice law.<sup>33</sup>

The Court found that membership in the Communist Party alone was not rationally related to one’s ability to practice law, and ordered the applicant to be admitted. Applying this in a context other than the practice of law, any “good moral character” requirement would have to be rationally connected to the qualities and abilities needed to engage in that particular occupation.

A second approach that courts take in attempting to interpret “good character” is to engage in judicial interpretation of the goals of licensing. For example, the United

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29 Application of Klahr, 433 P.2d 977, 979 (Ariz. 1967).

30 In Re Farmer, 131 S.E. 661, 663 (N.C. 1926).

31 Application of Klahr, 433 P.2d at 979 (citing In re Monaghan, 222 A.2d 665, 671 (Vt. 1966)).

32 Schware v. Board of Bar Examiners of the State of New Mexico, 353 U.S. 232 (1957).

33 Id. at 239

States Supreme Court, interpreting California decisions on bar admissions stated that the practical definition of “good moral character” tended to be stated in terms of an absence of proven acts that raise substantial doubts about the applicant's honesty, fairness, and respect for the rights of others and for the laws of the state and nation.<sup>34</sup> Here, the courts apply relevancy by deciding what good attributes are for licensing in the profession being considered, and decide that good character equates to those attributes. This definition has been adopted by several other states.<sup>35</sup> While this is a reasonable approach by courts that are faced with a standard-less criteria, from a policy perspective, establishing more concrete criteria in the first instance is preferable.

Another problem with using “good character” as a criterion is attempting to define an individual as good or bad. The concept of character necessitates a review of all the person's traits. Character, by definition, is “the pattern of behavior or personality found in an individual.”<sup>36</sup>

Noted one commentator:

One problem of sorting people into two categories -- those of good moral character and those who are not -- is that most people range across the dividing line. Many, if not most, people are usually of good moral character, but not always; are frequently honest, but once in a while untrustworthy; are often loyal, but sometimes unfaithful; will be generally competent, but occasionally careless; and so on. They range along a continuum, usually acting above minimum standards, but at times falling below.<sup>37</sup>

Defining “good” behavior based on a single event in a person's life may, or may not, be justified depending on the nature of the event. If the person sold confidential government information to enemies of this country, that would probably meet most persons' criteria of “bad” character based on a single event. But, what about other single events. Take, for example, an applicant who had been arrested for a single instance of child abuse, agreed to counseling, and had the charges dismissed. A regulator who had been abused as a child might view this single instance as disqualifying while another might not.

Another problem with “good character” as a criterion is that regulators and investigators usually give little credence to “good” acts, but concentrate on trying to prove bad character. Thus, a person has “good moral character” if there are no proven instances where the individual showed “bad moral character.” A definitional difficulty arises because reasonable people can differ about what conduct would raise substantial doubts about one's moral character.<sup>38</sup> Defining a positive (“good moral character”) by the

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34 Konigsberg, *supra* note \_\_\_, at 263.

35 See, e.g., *In re Florida Board of Bar Examiners*, 373 So. 2d 890 (Fla. 1979); *Reese v. Board of Commissioners of the Alabama State Bar*, 379, So. 2d 564 (Ala. 1980); BLACK'S LAW DICTIONARY, 693 (6th ed. 1990).

36 WEBSTER'S NEW WORLD DICTIONARY 125 (Second Concise Edition (1976)).

37 McDowell, *supra* note 394, at 323.

38 Rhode, *supra* note 392. at 530.

absence of a negative (“bad moral character”) is unhelpful unless there are standards provided to determine when the negative exists.

Generally, conduct evidencing “bad moral character” (in a Bar admissions context) is “[c]onduct evidencing dishonesty, disrespect for law, disregard for financial obligations, or psychological instability.”<sup>39</sup> Conduct that is most damaging to one’s character is conduct evidencing “moral turpitude,” another standard open to varying interpretations.<sup>40</sup> Moral turpitude is an act or behavior which gravely violates moral sentiment or accepted moral standards of the community.<sup>41</sup> It is present in some criminal offenses, but not all.<sup>42</sup> Thus “moral turpitude” is similar in definition to “good moral character” with the same definitional inadequacies. According to one commentator, “[f]or purposes of Bar discipline, the ‘moral turpitude’ criteria does nothing to refine the inquiry, but merely removes it one step from its announced concern—fitness for legal practice.”<sup>43</sup>

### *Integrity, Honesty and Truthfulness*

*Integrity, honesty, and truthfulness* are three concepts that licensing statutes use as criteria to assess an applicant’s suitability for a license. For example, in the Isle of Man, the commissioners will grant a license only if the company is under the control of person(s) of integrity. Under Kahnawake law, besides character, the commission reviews the applicant’s honesty and integrity by taking into consideration: personal, professional, and business associations, history of criminal convictions, history of civil litigation, credit history, bankruptcies, and personal and professional references.

While related, these concepts of integrity, honesty and truthfulness have different meanings. Truthfulness means simply to tell the truth. Truthfulness is only one component of honesty. One can be truthful, but dishonest. It is dishonest to use true facts and not disclose other facts in order to create a false impression.<sup>44</sup> For example, a person who was arrested by state police, can truthfully state that he was never arrested by city police. If, however, he responded to a question as to whether the applicant has a criminal record by stating he had never been arrested by the city police, it would be dishonest.

Similarly, honesty is only one component of integrity. “The word ‘integrity,’ means soundness of moral principal and character, as shown by one’s dealing with others in the making and performance of contracts. . . .”<sup>45</sup> A person can be honest, but lack integrity if, for example, he knowingly takes advantage of people in his business dealings.

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39 *Id.* at 532.

40 *Id.* at 551.

41 BLACK’S LAW DICTIONARY, 1009 (6th ed. 1990).

42 *Id.*

43 Rhode, *supra* note 392. at 552

44 *Wiggins v. State of Texas*, 778 S.W.2d 877, 889 (Tex. App. 1989).

45 *In Re Bauquier’s Estate*, 88 Cal. 302, 26 p. 178, 532 (\_\_\_\_).

Integrity is a complex concept that involves commitments to a personal priority of moral principles. These principals can include honesty, family, friendship, religion, honor, country, or fairness. Persons prioritize these commitments such that it is acceptable to violate some commitments in order to honor others. For example, most people believe that it is acceptable to lie if necessary to protect another from harm or injustice.

Integrity means to uphold these commitments for the right reasons in the face of temptation or challenge.<sup>46</sup> For regulators to attempt to test a person's integrity, they would have to understand the person's personal priorities, and then decide whether the person is consistently true to these commitments and their priority. This is an impossible task in a neutral setting, but becomes even more problematic because the regulators' sense of personal priorities might be different from the applicant's.

Integrity might be inconsistent with regulatory policy based on the priority of the applicant's commitments. For example, suppose the applicant values personal friendship highly. Unfortunately, he has been friends from childhood with a person who is of a notorious reputation. The regulators demand licensees not to associate with such persons, but the applicant's personal integrity places his personal commitment to friendship above the dictates of regulation. The applicant, to maintain his integrity, would continue to maintain his friendship. This may make him unsuitable to hold a gaming license. Therefore, regulators must be adept at defining which commitments are most important to good regulation, and to testing the person's behavior against those commitments.

Commitments that are important to meeting regulatory objectives differ between regulatory goals. Fairness and respect are more important to protecting the player than the government. Both government and player protection goals place importance on honesty. Government protection goals place greater emphasis on complying with law.

As a licensing criterion, "honesty" is generally preferable to truthfulness or integrity. Regulators want applicants and licensees to not only tell the truth, but to convey accurate impressions by full disclosure. Therefore, "honesty" as a criterion is preferable to truthfulness. While conceptually "integrity" appears preferable to "honesty," it suffers because of its difficulty in application. Attempting to decide a person's personal priorities and testing his behavior against those priorities is difficult, if not impossible.

With that being said, how useful is "honesty" as a criterion? Shakespeare wrote, in *Hamlet*, "Ay sir, to be honest, as this world goes, is to be one man picked out of ten thousand."<sup>47</sup> Thomas Fuller conveyed a similar thought when he wrote, "He that resolves to deal with none but honest men must leave off dealing."<sup>48</sup> The sentiments that both men convey is that no matter how committed to honesty a person may be, few, if any, people can claim to be completely honest in all their dealings.

When applying the "honesty" criterion, regulators must apply a materiality standard. An applicant is unlikely to be denied a license if he told his son that he could

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46 Lynne McFall, *Integrity*, *Ethics* 5, 9 (October 1987).

47 WILLIAM SHAKESPEARE: *HAMLET* act 2, sc.2.

48 THOMAS FULLER, *GNOMOLOGIA*.

not take him fishing because he had to work, when, in fact, he was going to a football game. Two general rules emerge. First, that the honesty criterion generally is reviewed in a business, as opposed to a personal, relationship. This is justified because the purpose of licensing is to predict the behavior of the applicant as a gaming licensee. Therefore, his behavior in other business relationships is more germane to the inquiry than his personal relationships.

Second, honesty in business conduct becomes more relevant with the importance of the transaction. For example, it may be of minor materiality that an applicant, in order to cut short a telephone conversation, may have lied by telling the salesman that he recently bought the product being offered. The materiality increases dramatically if the applicant misrepresents the value of inventory to convince a lender to loan money to his business.

### *Competency/Management Abilities*

Operating a gaming site takes special knowledge and skills. Regulators may have concerns that otherwise honest persons might frustrate governmental goals if the operators cannot properly manage their gaming operations. For example, poor managers may not recognize when dishonest software programmers install gaff in computer programs to cheat players or steal from the site. This may frustrate a primary governmental goal that the gaming operation ensures that all games are honest. Similarly, professional cheaters and dishonest employees can more easily steal from gaming operations with poor management. This may frustrate the governmental goals to collect taxes on all revenues derived from gaming operations. Therefore, some jurisdictions, like Kahnawake, require applicants to have the appropriate services, skills, and technical knowledge to provide online services.

Testing for adequate management skills varies depending on the complexity of the applicant's organization and the gaming operation. The former addresses the nature of the applicant. If it is a large diverse public company, regulators generally do not expect the chairperson of the board of directors to have operational experience. Instead, the emphasis is on the management structure established for the gaming operations. Regulators often require applicants to provide organizational charts designating the persons in each position, their responsibilities, and lines of authority. These are then tested against standards of depth, *i.e.*, is there enough management coverage? Are all key management areas covered? Are responsibilities properly segregated? Does the person have adequate knowledge and experience?

In contrast, to management competency, regulators should investigate and consider technical competence as Internet gambling presents new challenges. Internet gaming software can be incredibly complicated and prone to the same security vulnerabilities that challenge the largest internet companies such as Facebook, Google, and Amazon. Having the competency to assure the security of the site is necessary for different policy goals such as assuring the honesty and fairness of the games, that player funds and data are secured and that the site has uninterrupted service. While traditional gaming has become more technologically complex, Internet gambling is unique in that governments are dealing with certifying information technology that is creating an internet-enabled channel in a regulated and secure environment. A gaming commission may need a devoted software architect to decide if an operator is

technically competent to manage and operate an Internet gaming site, if their architecture is sound and their hardware and software is well written. Relying simply on post-licensing system certification may not be sufficient if the operator has purchased or licensed the software from a third party and has no practical or technological resources to operate the site. This could be equivalent to allowing a child to drive a Porsche without a driver's license.

To assure competency, the regulators first need to understand the skill sets that a site operator needs to possess to competently operate the system. These skills can include, among other things, site security, server maintenance and software support. Once the skill sets are defined, the applicant's competency to meet these minimum expectation needs to be reviewed. This can be accomplished by requiring the applicant to provide a skills matrix of all key technical personnel with a description of their qualifications including education, specialized training, experience and skill levels. The regulators can then review the matrix to assure that all critical skills are being addressed with responsible personnel that at least facially have the competency to meet regulatory expectations.

### *Financial Abilities*

A government may have varying degrees of concern with the financial ability of an applicant for a gaming license to succeed. In a monopoly or small oligopoly situation, the government may have a strong interest in assuring that the prospective gaming operator is properly financed. For example, the Isle of Man requires the applicant company to have adequate financial means available to conduct online gaming. Similarly, Alderney gaming commissioners review the applicant's current financial position and background. Malta is more focused on the applicant's ability to maintain the minimum required reserve by law.

In a competitive economy, the government may not have concerns regarding if a new gaming operation's economic viability to provide adequate assurances are in place protecting player's funds and/or government tax revenues. Market forces in a competitive economy often are the best judge of what is viable. If this is done by the government, the market may lose a potential competitor that could succeed by introducing innovations or creating new markets. If the regulators question the viability of an operation, there may be some legitimate concerns. For example, will the operator go to some unsuitable source to get money if times turn tough or will it try to create profits by cheating players? These concerns can be addressed by careful monitoring of the operator and requiring submission of periodic reports.

A closure may not hurt a competitive economy. Instead, it often helps the economy. Suppose a market can only support five gaming sites when there are six. The most marginal site has some market share. If the sixth site closes, this market share would go to the other five sites. With the sixth site open, the other five sites are less healthy because they earn less. They are also less attractive to lenders and investors. When the sixth site closes, the other sites quickly absorb their capacity and become healthier. Usually the site that fails is the one that is the least competitive because it is under financed, has an inferior product, or is overpriced.



### *Compliance With Law*

Malta regulators look to whether the applicant is untainted with illegality. An applicant's compliance with all laws covering its business is material to the granting of a gaming license. One function of the licensing process is to predict whether, if granted a license, the applicant will comply with all gaming laws and regulations. Strict compliance with these laws and regulations is essential to achieving the policy goals underlying them. Nothing is more predictive of future compliance with business laws and regulations than a review of past compliance in the same context.

Like application of the "honesty" criterion, some instances of noncompliance may be less material than others. Less material noncompliance might include matters that not involve dishonesty, are civil violations, involve negligence, occurred many years ago, were isolated incidences, corrective action was taken before criminal action, were self reported or were minor compared to size of business. More material incidents of noncompliance include matters involving dishonesty, criminal violation (particularly felonies), matters involving illegal gambling, intentional or reckless acts, recent acts, repetitive acts, were denied or an attempt was made to hide the violations.

Jurisdictions like the United States that are late in entering the Internet gaming industry will be faced with a difficult decision as to whether Internet operators that have directly or indirectly (through their licensee) accepted US players are ineligible for a license. No precedent exists as to whether this is or is not a disqualifying factor to obtain a license. Some jurisdictions laws and regulations do not have rigid criteria for determining suitability. For example, conviction of a felony or an offense involving gambling may be a disqualifying factor and pose an insurmountable hurdle for those companies with criminal convictions as it is in some states. Other jurisdictions follow more flexible standards. There, regulators will have to make a qualitative decision based on all factors as to whether the persons or company are suitable. Compliance is an importance aspect of that review. Compliance is much more than whether the company has violated or not violated the law, but whether it has institutional controls for assuring compliance with all laws. This is not only compliance with United States and state laws, but also with foreign laws. This ultimately might evolve into an inquiry into compliance with the laws of foreign countries, specifically whether the company has made compliance efforts to review and comply with the laws of all the jurisdictions where they accept wagers.

Much has been discussed about whether an October 16, 2006 date, when the Unlawful Internet Gaming Enforcement Act ("UIGEA") went into effect, should be a determining date. The thought goes that after that date, site operators knew that accepting US play was unlawful. The recent California legislation proposes a December date, indicating that some animosity should have extended past the October 16<sup>th</sup> date. This approach is too simplistic. For example, even if we assume that UIGEA was the first federal statute that clearly marked that accepting US play on poker or game of chance might be illegal, it may be less relevant to those companies that accepted sports wagers. In 2002, Jay Cohen's conviction for accepting US play on sports wagering was upheld. A question arises, therefore, as whether 2002 is perhaps a better date for those that accepted sports wagers. In addition, these foreign operators may have additional issues with state laws such as Nevada Revised Statute 465.092 that prohibits a person

who is not licensed in Nevada from accepting or receiving a wager over the Internet from a person located in Nevada. This law has been in place since 1997. Moreover, inquiry is not likely to be limited to gaming laws. Focus may shift to compliance with US and state tax reporting and payment.

### *Manner Of Doing Business*

Different people have different manners of doing business. While some are reconciliatory, and successfully resolve most disputes without the need for litigation, others are adversarial and regularly litigate most disputes. The adversarial type may create disputes to delay payment, and seek favorable settlement by threatening or bringing a lawsuit. In dealing with regulators, the reconciliatory type is cooperative, and agrees on appropriate behavior. The adversarial type challenges the authority of the regulators and ties up regulatory resources in court challenges.

Reconciliatory types make better gaming licensees. They are more willing to conform their behavior to the expectations of the regulators. By not challenging the regulatory authority through litigation, regulatory costs are reduced. On the other hand, adversarial types may provide an important check on regulators. If no licensee challenges regulatory actions that exceeded the regulator's authority or are inconsistent with legislative policy, public policy goals might be frustrated without the knowledge of either the legislature or the chief executive. In addition, citizens in most societies have the right to seek judicial redress of grievances. Negatively judging an applicant because of the exercise of legal rights would appear unjust.

In any circumstance, however, where an applicant abuses the legal system, regulators may justifiably consider this in assessing suitability for a license. Two methods of abuse are using litigation for delay or advancing frivolous claims to coerce settlement.

### *Criminal History and Prior Convictions*

Several jurisdictions that regulate online gaming including Malta, Kahnawake (convictions), United Kingdom, and Panama, investigate the applicants' criminal history, background or records. Given that regulators necessarily must focus on past actions to determine moral character, especially past criminal actions, what type of history should disqualify someone from obtaining a license? A jurisdiction may take two approaches. First, the jurisdiction may use a fixed criterion that anyone convicted of a felony, a crime involving gambling or a crime involving "moral turpitude" is ineligible for a gaming license. A second approach would be to allow the introduction of a criminal conviction as evidence of the person's suitability, but not consider other evidence to decide overall suitability. Under this view conviction of a crime creates a presumption of unsuitability and shifts the burden on the applicant to rebut the presumption by showing rehabilitation.<sup>49</sup> In the case of *In re Application of Cason*, the Georgia Court stated that this rebuttal must be by clear and convincing evidence.<sup>50</sup> The Court went on to state that for Bar fitness purposes, the applicant must reestablish his or her reputation by

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49 Maureen M. Carr, The Effect of Prior Criminal Conduct on the Admission to Practice Law: The Move to More Flexible Admission Standards, 8 GEO. J. LEGAL ETHICS, 367, 383 (1995).

50 *In re Cason*, 294 S.E.2d at 522.

showing a return to a “useful and constructive place in society.”<sup>51</sup> This cannot be evidenced by merely paying a fine or serving time, but must be evidenced by affirmative action, such as community service, occupation, or religion.<sup>52</sup> This “test,” allows licensing committees considerable leeway in determining eligibility based upon their own subjective attitudes. Still, it does little to establish that a person who has committed crimes in the past will not commit them again in the future.

Under the discretionary approach, no definitive tests are available to decide whether a person with a history or incidence of past criminal activities can earn a gaming license. In some instances, convicted criminals may receive gaming licenses. Similarly, the gaming authorities may deny licenses to persons never convicted of a crime, but who failed to show a lack of involvement in criminal activities. Gaming regulators may consider several facts in assessing whether to deny an application based on prior criminal activities. These include:

- The nature of the crime; criminal activities involving moral turpitude, such as thievery or embezzlement, are very significant;
- Mitigating or extenuating circumstances;
- Proximity in time of the criminal activity;
- Age at time of the criminal activity;
- A pattern or high frequency of criminal activity; and
- The applicant’s honesty and forthrightness in revealing the past criminal activity to gaming investigators.

Some past crimes committed by an applicant may have no relation to their ability in some particular occupations. For example, a person convicted of child molestation 15 years ago is probably unfit to be licensed to operate a child care center, but it does not follow that the same person is not “morally” suitable to operate a gaming operation. There is no rational connection between the two, and the fact that the person was convicted of child molestation in the past provides a poor basis for predicting that the person is morally incapable of operating a fair gaming operation.

#### *Associations With Unsuitable Persons*

If gaming licensees have friendships with persons of notorious backgrounds, the public may believe that the unsuitable persons have an interest in, or influence over, the gaming operations. A person’s willingness to associate with persons of poor reputation also may call into question his own character.

The problem with the concept of association is definitional. One court noted “the word ‘associate’ is not of uniform meaning but is vague in its connotation.”<sup>53</sup> For example, do incidental contacts with known criminals constitute association? What

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<sup>51</sup> Id.

<sup>52</sup> Id.

<sup>53</sup> *Weir v. United States*, 92 F.2d 634, 114 A.L.R. 481 (7th Cir. Ind., Oct. 21, 1937) (No. 6243, 6245, 6248, 6250, 6252, 6253), cert. denied by *Weir v. United States*, 302 U.S. 761, 58 S.Ct. 368, 82 L. Ed. 590 (U.S. Ind., Dec. 20, 1937) (No. 585).

about involuntary contacts? What if the applicant had no knowledge of the other person's unsuitability?

Some courts define associations to be more than incidental contacts with unsuitable persons. In interpreting a regulation prohibiting police officers from "associating" with criminals, one court held that the term means more than "incidental contacts" between police officers and known criminals.<sup>54</sup> The issue in another case was whether a parolee violated his parole by "associating" with undesirable persons.<sup>55</sup> The court defined association as "to join often, in a close relationship as a partner, fellow worker, colleague, friend, companion, or ally."

The New Jersey Supreme Court held that unknowing associations are not a basis for a finding of unsuitability by gaming regulators.<sup>56</sup> The Court stated, however, that after an applicant is aware of the unsuitability of an association, the failure to dissociate is a knowing association. In that case, the New Jersey Casino Control Commission decided that the founder of a casino company was unsuitable. Among the Commission's reasons was a recurring and enduring relationship with an individual who allegedly had ties to organized crime. The applicant sought judicial review. In upholding the agency decision, the Court noted that it is "not critical of a proposition denouncing guilt adjudication predicated solely on unknowing or otherwise innocent association and is sensitive to the difficulties defending against such a premise." Here, only volitional relationships predicated upon a concerted action should subject the applicant to increased scrutiny.

While difficult to define, the concept of unsuitable "associations," should focus on the following:

- Nature and intensity of the relationship. Facts considered include: (1) type of relationship; *i.e.*, business or friendship; (2) knowledge of the second person's unsuitability; (3) whether the relationship was voluntary; (4) frequency or involvement of the relationship; and (5) the applicant's attitude after becoming aware of the concern by gaming authorities with the relationship;
- The influence or control over the applicant by the other person;
- The nature of the concern about the second person and how that concern poses a threat to the public interest; and
- The number of questionable relationships.

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54 *Sponick v. City of Detroit Police Dept.*, 49 Mich. App. 162, 211 N.W.2d 674 (Mich. App., Aug. 29, 1973) (No. 15396-15398).

55 *State v. Morales*, 137 Ariz. 67, 668 P.2d 910 (Ariz. App., Feb. 8, 1983) (No. 2 CA-CR 2821).

56 *In Re Boardwalk Regency Casino License Application*, 90 N.J. 301, 447 A.2d 1335 (1982).

### *Conduct During the Investigation*

Statutes or regulations generally require applicants to make full and true disclosure of all information requested by the regulatory agents during the investigation.<sup>57</sup>

The applicant's conduct during the investigation may become relevant to his suitability for many reasons. If the applicant attempts to hide or mischaracterize a past transgression, the regulators may question the applicant's current credibility. If the applicant is not cooperative, the regulators may question whether the applicant will adopt such an attitude when it comes to compliance with the controls. If the applicant keeps disorganized and incomplete financial and personal records, the regulators may question the applicant's ability to account properly for taxes.

### **Standards of Proof**

In licensing matters, the burden of proof is usually on the applicant. This is logical because the applicant has the most direct access to that information on which the regulators may decide his suitability. If the applicant cannot produce this evidence, then it probably does not exist. Similarly, the burden of persuading the regulators of the applicant's suitability should be on the applicant.

A party that has the burden of proof must, at a minimum, present evidence to support the requested decision. For example, if an applicant has the burden of proving his suitability, then the applicant must provide at least enough evidence to allow the regulators to decide whether the applicant is suitable. In matters such as licensing, the burden of proof may also insinuate the burden to persuade the regulators of the applicant's suitability.

Regulators decide factual matters by weighing the evidence and making a decision. But, not all decisions are made by stacking evidence on different sides of the scale and choosing the side with the most substantial evidence. Decision-makers have different ways to "weigh" evidence. Perhaps the most commonly known are "beyond a reasonable doubt," and "the preponderance of evidence." The former emanates from the standard used in criminal trials. Here, the amount of evidence supporting a particular decision should be substantial so as to eliminate any reasonable doubt that a contrary conclusion could be reached.

The common standard for a civil trial is a preponderance of the evidence. This is the "scale of justice" test. It requires the decision-maker to look at the evidence and decide which of different conclusions is more likely to be true. Suppose, for example, a player dispute arises over whether the player placed a wager on a roulette table before or after the dealer called for no further bets. The decision-maker may hear contradictory testimony from many persons, including the player and the dealer. The decision-maker must then decide which was more likely to have occurred. Having received this conclusion (a finding of fact), the decision-maker would then apply the law (that no contract of wager was formed).

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<sup>57</sup> See, e.g., Nev. Rev. Stat. §463.339.

Another standard is “clear and convincing evidence.” This standard calls for the party with the burden of proof to provide “clear and convincing evidence” to support the requested decision. This standard is higher than a preponderance of the evidence, but less than “beyond a reasonable doubt.”

An even higher burden than “beyond a reasonable doubt” would be to prove a matter “beyond any doubt.” If an applicant for a gaming license must prove his suitability “beyond any doubt,” he has a substantial burden. If the investigation revealed any evidence that raised any doubt as to his suitability, then the agency should deny the application. For example, suppose the applicant was convicted of shoplifting while a college student, but had no other criminal transgressions. This instance alone might create doubt as to his suitability, but may not rise to the level of reasonable doubt.

The highest burden is when the applicant must prove no evidence exists that he is unsuitable to hold a license. This is an unrealistic standard because virtually every person has some incidences in the course of a lifetime that would provide negative evidence. In most cases, however, they are minor and should not disqualify the person from holding a license.

Given discretion to either grant or deny a license, regulators must assess the evidence in a given application against standards. These can be defined or left to the intuition of the regulators. For example, the regulators may be given a statutory directive to deny an application if the regulators have any reason to believe that the person does not qualify. This standard would result in fewer licenses being approved compared to a standard that would require the regulators to grant a license based on a preponderance of the evidence. In other words, if the regulators weigh the evidence for and against the applicant, the decision to grant a license will be based on which side has more weight. For example, suppose a person was convicted twenty years ago of theft, and a licensing criterion is honesty. Obviously, theft involves dishonesty. Therefore, the theft is evidence of the person’s lack of honesty. If regulators are compelled to deny a license when any evidence exists to suggest that the applicant does not qualify, the person would be denied a license. Suppose, further, that the person has led an exemplary life since that conviction for taking the cement sleeping bear mascot from a motel’s lawn as a college prank. Under the preponderance standard, he would probably obtain a license.

Standards of proof can vary depending on the state’s public policy. Under both the player and government protection goals, the government has a strong interest in assuring that unsuitable persons are not involved in the gaming industry. In these circumstances, the standard of proof should exceed that of a preponderance of the evidence. The level to which this standard rises depends on the intensity of government’s policy. If the government insists on and enforces a “clear and convincing” standard, it will have a high efficiency rate, *i.e.* it will likely succeed in keeping out nearly all criminal elements. It also will create a moderate barrier to entry.<sup>58</sup> As the government increases the level of the standard of proof, the less likely it is that criminal elements will infiltrate the gaming industry, but the barriers to entry will increase.