

National Indian Gaming Commission
Philip N. Hogen, Chairman
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Government Organization Committee
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Good afternoon Chairman Torrico and members of the Committee.

My name is Phil Hogen, and I am a member of the Oglala Sioux tribe from South Dakota. I have chaired the National Indian Gaming Commission (NIGC) since December of 2002. Thank you for inviting me to discuss the impact of the *Colorado River Indian Tribes* court decision on the regulation of the tribal gaming industry nationwide and in particular in California.

For the past dozen years I have had the high privilege of working closely with Indian tribes throughout the United States. The tribal gaming industry has grown rapidly over that time with revenues of \$5.5 billion in 1995 growing to more than \$22.5 billion in 2005. These revenues are enabling tribal economic development and raising tribal standards of living as nothing else has done (Exhibit 1). I have watched tribes use gaming to escape the depths of poverty and social deprivation and offer – for the first time – a quality standard of living for their members.

Like many of my counterparts in the Federal family, before I began this work I had little reason to study or know much about the gambling industry, its history and development, and the challenges which face those responsible for regulating the industry.

I quickly discovered that California's neighbor, the State of Nevada, wrote the book with respect to the regulation of legalized gambling, and in many respects, it learned the hard way. Historically, casino gaming has been a target for illicit influences. It was not until Nevada established a strong, autonomous regulatory structure utilizing techniques such as full-time surveillance of the gaming operations that most potentialities for criminal involvement were eliminated from the gaming industry there. Only after creation of a gaming regulatory authority separate from the ownership and operations of the casinos

did oversight of the industry have an impact on criminal activity. Thereafter, significant progress was made into the identification and removal of individuals and entities intent upon exploitation and corruption.

Nevada's structures and procedures have become the model for effective gaming regulation throughout the United States. Nevada's regulatory efforts are focused in three areas: 1) ensuring the suitability of those engaged in gaming (licensing and background investigations), 2) ensuring the gaming proceeds flow to the intended beneficiaries (tracking money to assure taxes are paid and the owners and investors get the profits), and 3) ensuring the fairness of play (verifying that casinos don't cheat players and players don't cheat the casinos).

Although many factors contributed to corrupting influences in Nevada, one aspect stood out. At the time gaming was legalized in Nevada, the regulatory ability of the local governments tasked with oversight was compromised. These governments were in a rather deprived financial position and were also dependent on the potential revenues this growing gaming industry could provide. When regulatory authority shifted to the State this ceased to be an issue and effective oversight began. The Nevada experience demonstrates a critical structural fact of gaming regulation: as the government charged with regulation becomes increasingly dependent upon the profitability of the industry being regulated, the effectiveness of the regulatory effort may be increasingly challenged.

When Congress enacted the Indian Gaming Regulatory Act (IGRA) in 1988, it allocated the regulation of gaming activities to different entities depending on the class of gaming conducted. Clearly, Congress said that the tribes themselves should play the primary role in the regulation of all gaming. Tribal gaming exists in a structure whereby the lines of demarcation between ownership, operation and regulation can become unclear because of the nature of tribal governance. Perhaps out of concern for this situation Congress created and gave the NIGC an important oversight role.

We are here today as you consider the implementation of more sophisticated gaming, known as Class III or Las Vegas style gaming, which Congress said could only be conducted if a tribe and a state enter into a compact. Congress provided that tribes may play the primary role in this regulation, but, provision was made for those less directly linked to the operation to participate. IGRA was less explicit with respect to NIGC's oversight role of this Class III gaming.

In this process, it may be useful to look at how the structure of Class III gaming regulation has evolved since IGRA's enactment. Although Congress may have expected that there would be a dramatic change in the games tribes would offer, I think it is reasonable to assume that many expected tribal gaming would continue to be primarily Class II gaming, such as bingo, pull-tabs and non-house-banked card games. After 1988, when tribes and states began negotiating compacts for casinos with slot machines and house-banked card games, most states had little or no experience in regulating full-time casino operations. Michigan, for example, entered compacts with some tribes in 1993, but did not create its own Gaming Control Board or authorize commercial gaming until the end of 1996. Minnesota first signed compacts with tribes in 1990 and to this day has no non-Indian casinos within its borders.

A review of compacts approved since 1989 shows that the more recent compacts often address the mechanics of the oversight and regulation of gaming quite specifically. Earlier compacts, however, many of which were entered into in perpetuity, do not address these issues at all. Further, the dispute resolution provisions in the compacts often employ cumbersome and time-consuming procedures such as mediation or arbitration that do not necessarily advance effective regulation.

It was in this environment that NIGC sought to enhance the regulation of a rapidly growing industry. The NIGC needed the appropriate tools to implement its oversight responsibilities. We lacked, however, a rulebook for the conduct of professional gaming operations and a yardstick by which the operation and regulation of tribal gaming could be measured. Some in Congress expressed concerns that uniform internal control

standards, which were by then common in other established gaming jurisdictions such as Nevada and New Jersey, were lacking in tribal gaming. The tribal gaming industry was also sensitive and responsive to these concerns and a joint National Indian Gaming Association (NIGA) – National Congress of American Indians (NCAI) task force recommended a model set of internal control standards.

In 1996, NIGC assembled a tribal advisory committee to assist us in drafting Minimum Internal Control Standards (MICS) applicable to Class II and Class III gaming. These standards were first proposed on August 11, 1998, and eventually became effective on February 4, 1999. With the adoption of the NIGC's MICS, all tribes were required to meet or exceed the standards therein, and the vast majority of the tribes acted to do so. The NIGC's approach during that time was to assist and educate tribes in this regard and not to be punitive. When shortcomings were encountered by NIGC at tribal operations, our assistance was offered and grace periods were established to permit operations to come into compliance.

It was also about this time that Congress, recognizing that the Indian gaming industry was growing rapidly and that NIGC's funding was inadequate to the task, amended IGRA to allow NIGC to assess fees on both Class II and III operations instead of only on Class II. The NIGC viewed this action, in part, as an endorsement of these added steps it had taken to impose its oversight Class III gaming.

I served as an Associate Commissioner of NIGC from 1995 until 1999, and I participated in the decision to adopt and implement the MICS. I have served as the Chairman since December of 2002. It is my confirmed view that the MICS were the most effective tool that our Federal oversight body had to ensure professionalism and integrity in tribal gaming. This was due to the strong efforts of tribes to meet and exceed the MICS and the inspections and audits that the NIGC conducted to ensure compliance. The NIGC MICS were embraced by state regulators and several adopted or incorporated the NIGC MICS or compliance therewith into tribal-state compacts.

Furthermore, for six years NIGC oversight of Class II and Class III gaming with the use of the MICS went quite smoothly. When necessary, NIGC revised its MICS with the assistance of tribal advisory committees. Each time, though, there were expressions of concern by tribes that NIGC was reaching beyond its jurisdiction under IGRA. The tribes argued that the regulation of Class III gaming was to be addressed in the tribal-state compacts, not by NIGC. We carefully considered these arguments but ultimately rejected them based on various mandates from Congress. At the time the MICS were adopted, of course, many tribal gaming operations and tribal regulatory bodies were already far ahead of the standards set forth in the MICS. Other tribes, however, had no such standards, and for the first time they had the necessary rule book by which to operate.

Overview of NIGC MICS

The MICS provide, in considerable detail, minimum standards that tribes must follow when conducting Class II and Class III gaming and are intended to represent accepted practices of the gaming industry. For example, the MICS prescribe a method for removing money from games and counting it so as best to prevent theft; they prescribe a method for the storage and use of playing cards so as best to prevent fraud and cheating; and they prescribe minimum resolutions and floor area coverage for casino surveillance cameras. The MICS ensure that gaming transactions are appropriately authorized, recognized and recorded. Attached is a copy of the MICS table of contents, which provides a more detailed overview of their comprehensive scope (Exhibit 2).

The NIGC employed three methods of monitoring tribal compliance with the MICS. First, tribes were required to engage an independent certified public accountant to perform Agreed Upon Procedures annually and evaluate each gaming operation's compliance with the MICS. The results were provided to the tribe and the NIGC within 120 days of the gaming operation's fiscal year end. Second, NIGC investigators and auditors visited tribal gaming facilities on a regular basis and spot check tribal compliance. Third, NIGC auditors conducted a comprehensive MICS audit at a number of tribal facilities each year. The audits identified instances where tribes were not in

compliance with specific MICS, and the NIGC then worked with the operation to correct deficiencies.

I have presented testimony to committees of the United States Congress attempting to set forth NIGC's considerable experience in monitoring the operation and regulation of tribal gaming generally and compliance with the NIGC MICS in particular. Rather than attempting to restate our experience and concerns in that regard, attached is a copy of my statement to the Senate Indian Affairs Committee at a hearing held on September 21, 2005 (Exhibit 3). Therein I have gone into considerable detail with respect to the extent and nature of non-compliance with the standards that our oversight disclosed.

Colorado River Indian Tribes Case

In early 2001, NIGC attempted to audit a Class II and III gaming operation owned by the Colorado River Indian Tribes (CRIT). CRIT refused to give NIGC access to its Class III gaming records. The NIGC Chairman responded with a notice of violation and civil fine. CRIT appealed, but the Commission upheld the Chairman's actions. On appeal, the District Court for the District of Columbia granted summary judgment in favor of CRIT, finding that IGRA does not confer upon NIGC the authority to issue or enforce MICS for Class III gaming. The District Court found that while IGRA grants NIGC authority over certain aspects of Class III gaming, MICS are not among them.

On October 20, 2006, the U.S. Court of Appeals for the District of Columbia ruled that the NIGC lacks the statutory authority to issue MICS for Class III gaming operations. The decision affirmed the summary judgment granted by the District Court.

What, then, are the implications for the regulation of Class III gaming in the wake of the CRIT ruling, which displaces what had become the established presence of NIGC in the segment of tribal gaming which accounts for nearly 90% of the over \$22 billion in gross gaming revenues?

Typical gaming regulatory activities are structured to emphasize preemptive action. In this preemptive role, tribal regulators screen individuals and organizations that will be responsible for conducting gaming activity. They also screen any external entities with which their managers will be interacting. They verify the functionality of gaming equipment and perform audits of their gaming operations' internal control systems to confirm policies and procedures are consistent with established industry best practices.

NIGC MICS - Pre-CRIT:

It is my belief that the lack of effective internal control systems will inevitably lead to internal control irregularities which will disadvantage tribal members and the gaming public. For MICS to have a meaningful impact there must be a reliable method of monitoring to measure compliance.

MICS audits must have a comprehensive scope because an organization's internal controls represent an interactive set of procedures in which the control of risk in one area may be influenced by controls residing in other areas of the overall regulation. The NIGC audit program examined the previous year's activities along with real-time testing, inquiries and observations, and all gaming-related documents and activities are examined. Such scope and testing is necessary to sift the isolated incident of noncompliance from pervasive control weakness.

The comprehensive nature of the audit process and the scope of the remedial actions typically produce two fundamental changes in how business is conducted by the gaming property. First, management becomes better informed regarding accepted industry practice and acquires a better appreciation for the need for effective internal control systems. Second, the tribal gaming regulatory authority acquires a heightened level of importance within the hierarchy of governmental departments. Although enforcement actions are occasionally necessary, NIGC is acutely aware that the success of its regulatory oversight depends to a large degree upon voluntary compliance.

NIGC MICS - Post-CRIT:

Since the CRIT decision in December 2006, the NIGC has virtually abandoned all efforts to measure compliance with the MICS in Class III gaming. I am concerned that removing the risk of an NIGC audit may result in a deterioration of the quality of overall tribal gaming regulation. The findings of approximately sixty compliance audits performed since the MICS were adopted have demonstrated that the majority of audited operations were not in compliance with industry best practices. Experience has shown that when comprehensive oversight is removed, the allocation of tribal resources moves away from regulation to grow the bottom line.

Currently, the resources of NIGC have been redirected towards investigating allegations of misconduct. Essentially, instead of acting preemptively to deter integrity violations, NIGC staff is now acting in a reactive posture. With each passing day that the question of NIGC authority remains unresolved, the consequence of ineffective internal control systems becomes more problematic.

The future of Indian gaming regulation

I am of the opinion that the integrity of the regulation of tribal gaming is less secure now than before the CRIT ruling. I believe that the Indian gaming industry would be better served if IGRA were amended to clarify that NIGC has the authority for MICS oversight.

I want to be clear that I do not think there is any danger that immediate calamity will befall the industry or the gaming public. With or without the mandate of Federal regulations, most tribes will continue to do a high-quality job of regulating the gaming on their Indian lands and will devote adequate resources to that task, keeping the necessary separation between the management and operation of the facilities and their regulation. Some tribes had not achieved consistently effective internal controls before NIGC promulgated the MICS. If they did so afterwards, it was because of NIGC's efforts. The paramount reason for this was not that the MICS were Federal requirements but rather that they were good business. They protect tribal assets and revenues and instill greater confidence in the customers that all is secure and everyone gets a fair shake.

Indian Gaming in California

Since the beginning of this year I have had the pleasure of welcoming Norm DesRosiers as an NIGC Associate Commissioner. Working with Norm has given me greater confidence in the quality of California's tribal regulation. When Secretary Kempthorne nominated Norm to serve on the NIGC, Norm was Executive Director of the Viejas Tribal Gaming Commission, which oversees a large, well-run gaming facility in Southern California. Norm knows first-hand the challenges that all-day, every-day, on-the-floor gaming regulators face, and he has been a leader developing secure, efficient tools that tribes may use to maintain the integrity of the operation and regulation of their gaming facilities. When selected for his post on the Commission, Norm was serving as the Chair of the National Tribal Gaming Commissioner/Regulators Association and had built that organization into a vital, broad-based network of tribal regulators throughout the country, representing all of the vast diversity which exists in Indian gaming.

Every day Norm DesRosiers contributes invaluable insight regarding the challenges gaming regulation faces and the solutions it employs to address them. This insight is proving invaluable as we seek to achieve our mission. I know that not all tribal regulators in California possess Norm's experience and insight, but I think his service exemplifies the seriousness with which California tribes approach their regulatory tasks and the professionalism which can be attained at that level, and I am comforted by that.

While I expect it can be risky to generalize, I think that the five tribes whose compacts are now before you are leaders among tribes nationally in the resources they devote to the regulation of their gaming, and as I have observed it, it would appear that they utilize those regulatory resources effectively. Given the scrutiny which is attending the State of California's consideration of these compacts, at this time, I think that the risk that this would change in the future is not significant.

My optimism in this regard is greatest in the near term, however. I reiterate that I feel the model existing before the D.C. Circuit invalidated the NIGC MICS' application to Class III gaming was most useful, that a Congressional enactment to restore it is desirable, and

that perhaps such action would allay a number of concerns this Committee may have in connection with the proposed compacts.

Further, it is important to bear in mind that although the CRIT decision removed a vital piece of NIGC's hands-on oversight, NIGC continues to have significant responsibilities with respect to Class III gaming activity. The Commission has the authority to issue civil fines or closure orders against any tribal gaming operator or management contractor that violates the terms of IGRA, NIGC's implementing regulations, approved tribal ordinances, or tribal-state gaming compacts. The IGRA further requires that the Chairman approve all Class III management contracts. To that end, the Commission may impose fines or closure orders when a company manages without an approved contract.

Additionally each tribe must enact a gaming ordinance and have it approved by the NIGC Chairman before gaming may commence. Class II and III ordinances must require that:

- net gaming revenues are used as outlined in IGRA;
- the tribe has the sole proprietary interest in the gaming activity;
- the tribe annually has an outside entity conduct a financial audit of its gaming operations and provides a copy of that audit to the NIGC;
- all contracts related to gaming operations that are over \$25,000 annually are subject to independent audits;
- each gaming facility is constructed, maintained and operated in a manner that adequately protects the environment, public health, and safety;
- there is an adequate system for background investigations of primary management officials and key employees (including suitability criteria) and that oversight of such officials and their management is conducted on an ongoing basis; and
- NIGC is notified of the issuance of licenses and the results of background checks;
- net revenues are used to make per capita payments only when done in compliance with a revenue allocation plan approved by the Secretary of the Interior.

If these requirements are not included in the ordinance, the NIGC Chairman can disapprove the ordinance. More importantly, when the ordinance is approved, a tribe's failure to abide by the ordinance can be subject to a civil fine or closure order issued by the Chairman.

While many of these authorities go beyond the immediate operational gaming aspects of tribal gaming, they demonstrate that NIGC is by no means now disinterested in Class III gaming activity.

A number of these ongoing powers of NIGC might provide a means of attaining some of the protections the NIGC MICS provided. For example, adherence to minimum internal control standards would not be an inappropriate provision for inclusion in a tribal gaming ordinance. If so included, in monitoring ordinance compliance, NIGC might similarly monitor compliance with the MICS. There would, no doubt, be shortcomings to this approach, such as a likely lack of standardization and the ability of tribes to amend their ordinances and escape NIGC scrutiny, but further consideration might be warranted. At the end of the day, of course, the idea would need to be read together with the Courts' mandates in the CRIT decision, which could limit the effectiveness of this option.

Similarly, NIGC has a mandate to consider enforcement action for violation of tribal-State compacts. Therefore, incorporating internal control standards into compacts themselves could facilitate NIGC entry into the area, although the jurisdiction and authority of the several participants in such an arrangement would need to be carefully structured and agreed to by all concerned. The reservations I expressed above relating to ordinances would likewise apply here.

It has also been suggested that the NIGC create a voluntary compliance program whereby tribes, although not otherwise legally required to meet NIGC MICS, voluntarily agree to submit to their application and to NIGC sanctions for non-compliance. While such an approach would be superior to no outside standards or oversight, a voluntary arrangement, likely terminable at will, might not be a proper footing for a MICS regime. Again, compatibility with the CRIT holdings would merit close examination.

Given the sea change brought to NIGC's oversight of tribal gaming by the CRIT decision, no doubt creativity will be useful and all available methods of enhancing the security of tribal assets and the integrity of tribal gaming operations, consistent with IGRA are worthy of consideration.

Conclusion

For the many reasons stated above and the continued dramatic growth in Indian gaming, it seems abundantly clear that Indian gaming needs broad and effective oversight in order to continue benefiting Indian communities. Unfortunately, viewed nationally, the future without the NIGC's Class III MICS will be a time of some uncertainty and doubt.

While many tribes will maintain strong controls, others will not. Operations without effective internal controls and oversight will once again become obvious targets for the unscrupulous. Those tribes, and their members, will lose millions of dollars and will often not realize that it has happened until years later.

We can expect that the CRIT decision will continue to serve as the basis for disagreements with some tribes over the NIGC's Class III authority. In the meantime, the Federal government will continue to seek a legislative clarification to resolve those disagreements. The NIGC will continue to update its MICS pending that legislative clarification to assure that tribal-state compacts and Secretarial procedures that incorporated the NIGC MICS will stay up to date.

I hope that these views will be useful to your Committee as you endeavor to accommodate compacted arrangements which prove positive for California's gaming Tribes and the State of California.