Complying with State Gaming Regulations*

By: Paul M. Miller and Michelle C. Roberts

Investment advisers acquiring securities of publicly traded companies that have state gaming licenses often become subject to state gaming regulations as a result of the acquisition of these securities. Because state gaming regulations vary by state, investment advisers acquiring securities of publicly traded gaming companies may be subject to a variety of regulatory obligations. While a comprehensive survey of these regulatory obligations is beyond the scope of this article, this article highlights key considerations an investment adviser should keep in mind when acquiring or contemplating the acquisition of securities of publicly traded gaming companies. The article concludes by spotlighting Nevada's gaming requirements in view of the presence of a significant number of gaming entities in Nevada.

Identifying the Applicable State Gaming Regulations

As a first step in its compliance efforts, an investment adviser acquiring the securities of a publicly traded gaming company should identify those states where the gaming company maintains a gaming license. The adviser should also identify the type of gaming license maintained by the company.

Most publicly traded gaming companies include disclosure in their Form 10Ks that identifies both the states in which the companies maintain a gaming license and the type or types of gaming licenses held by the companies. A typical Form 10K for one of these companies includes a section titled "Regulation and Licensing" or contains a description of governmental regulations affecting the company. In some instances, these sections include a detailed discussion of the state gaming requirements that apply to institutional investors (e.g., registered investment advisers). In addition, many publicly traded gaming companies include information about their gaming licenses and relevant gaming regulations on their websites.

Once an investment adviser has identified the states whose gaming regulations may apply and the type of license held by the gaming company, the adviser should review the state gaming requirements that apply to beneficial owners of securities of the gaming company. A state's gaming regulator typically maintains a website that includes links to the state's gaming statutes and related regulations. For example, the website of the Casino Control Commission of New Jersey contains links to the Casino Control Act and the New Jersey Casino Commission Control regulations. In some instances, a state's gaming statutes and regulations may not be clear as to an adviser's obligations, in which case a phone inquiry should be made to the state's gaming authority.

Ownership that Triggers Reporting Obligations

In many states, an investment adviser that acquires the beneficial ownership of more than 5% of the voting securities of a publicly traded gaming company must report such ownership to the state gaming authority by filing a copy of any report, and any amendments thereto, filed with the Securities and Exchange Commission ("SEC") pursuant to Section 13(d)(1), Section 13(g) or

Section 16(a) of the Securities Exchange Act of 1934. Some states, like Louisiana, require an adviser acquiring such beneficial ownership to submit to the state gaming authority a certification of the ownership position and the adviser's intent with respect to such ownership (e.g., a statement as to whether the acquisition is an attempt to exercise influence over the issuer). Other states require only that advisers acquiring such beneficial ownership notify the state gaming authority of the acquisition.

In most cases, the publicly traded gaming company must make reports to the state gaming authority that parallel the ownership information provided by the investment adviser. It is important to note, however, that the obligations of the gaming company and the obligations of the investment adviser are independent of each other.

Suitability Determinations and Exemptions from Regulations Requiring Suitability Determinations

In some states, the beneficial ownership of any voting security of a publicly traded gaming company, regardless of amount, may subject the beneficial owner to the state's "suitability" determinations. For example, an adviser that acquires beneficial ownership of any voting security of a publicly traded company registered with the Mississippi Gaming Commission may be required to be found suitable if the Mississippi Gaming Commission has reason to believe that the adviser's acquisition of that ownership would be inconsistent with the "declared policy" of the state.

More typically, however, a suitability determination is triggered by a beneficial owner exceeding a threshold of ownership in the gaming company. Although it varies by state, the acquisition of the beneficial ownership of 10% or more of the voting securities of a publicly traded gaming company would generally subject the holder of the securities to a suitability determination by the state gaming authority. The process for applying for a finding of suitability by a state gaming authority is very lengthy and expensive. An investment adviser seeking a finding of suitability is required to submit detailed financial information with respect to its business and personal information with respect to its control persons. Examiners from the state gaming authority typically conduct on-site examinations and background investigations and have the authority to deny a finding of suitability for any reason.

Many state gaming statutes and regulations provide exemptions from or waivers of the provisions requiring a suitability determination for "institutional investors". Institutional investors include banks, insurance companies, investment companies registered under Section 8 of the Investment Company Act of 1940 and investment advisers registered under Section 203 of the Investment Advisers Act of 1940.

To qualify, an institutional investor must apply for an exemption from or waiver of the provisions requiring a suitability determination. The application for an exemption must include representations by the institutional investor that the securities were acquired and are held in the ordinary course of business as an institutional investor and not for the purpose of causing, directly or indirectly, the election of a majority of the members of the board of directors or any change in the corporate charter, bylaws, management, policies or operations of the company.

Although an application for an exemption is not an application for a finding of suitability, the process for submitting an application for an exemption can also be lengthy and expensive. In many cases, examiners from the state gaming authority will investigate the institutional investor and the information it provided in the application, including any information regarding control persons of the institutional investor.

If granted, the exemption is typically limited and contains ongoing reporting requirements. In many states, the institutional investor is prohibited from acquiring beneficial ownership of more than 15% of the voting securities of the publicly traded gaming company. Acquiring beneficial ownership of more than 15% of the voting securities of the publicly traded gaming company would require a finding of suitability.

In general, any person that fails or refuses to apply for a finding of suitability after being ordered to do so by a state gaming authority may be found unsuitable. If a person is found unsuitable and beneficially owns any voting securities of a publicly traded gaming company beyond such period of time as prescribed by the state gaming authority, such person may be guilty of a criminal offense.

A Closer Look at Nevada Gaming Statutes and Regulations

For investment advisers acquiring beneficial ownership of securities of publicly traded gaming companies, the gaming statutes and regulations of Nevada should be given careful consideration in view of the large presence of gaming companies in that state. Any person, including investment advisers, acquiring beneficial ownership of any voting security of a publicly traded corporation registered with the Nevada Gaming Commission ("Nevada Commission") is subject to regulation by the Nevada Commission and the Nevada State Gaming Control Board ("Nevada Board"). Publicly traded corporations registered with the Nevada Commission include Boyd Gaming Corporation, Harrah's Entertainment, Inc., International Game Technology, MGM Mirage, Starwood Hotels & Resorts Worldwide, Inc. and Trump Hotels & Casinos Resorts, Inc.

If an investment adviser acquires beneficial ownership of 5% or more of the voting securities of a publicly traded gaming corporation, the adviser must file a copy of its Schedule 13D or Schedule 13G, and any amendments thereto, with respect to the publicly traded gaming corporation with the Nevada Commission within ten days of filing such Schedule with the SEC. If it acquires beneficial ownership of more than 10% of the voting securities of a publicly traded gaming corporation, the adviser must, absent a waiver from the Nevada Commission, apply to the Nevada Commission for a finding of suitability within 30 days after the Chairman of the Nevada Board mails a written notice that such application is required.

In lieu of applying for a finding of suitability, the adviser, if it qualifies, may submit to the Nevada Commission an application for a waiver of the regulatory provisions requiring a finding of suitability. The application must include a description of the adviser's business and a statement as to why the adviser is within the definition of "institutional investor" under the Nevada gaming regulations (i.e., the adviser is registered under Section 203 of the Investment

Advisers Act of 1940). The application must also include, among other things, (i) a certification made under oath that the voting securities were acquired and are held for investment purposes only and that the adviser agrees to be bound by and comply with the Nevada Gaming Control Act and the regulations adopted thereunder, (ii) information about the adviser's control persons and affiliates, and (iii) disclosure of all criminal or regulatory sanctions imposed during the preceding ten years and of any administrative or court proceedings filed by any regulatory agency during the preceding five years against the adviser, its affiliates, any current officer or director, or any former officer or director whose tenure ended within the 12 months preceding the submission of the application.

In connection with a waiver application, examiners from the Nevada Board conduct an on-site investigation of the adviser and its personnel. A representative of the adviser must appear in person before the Nevada Board and Nevada Commission to answer questions from the members of the Nevada Board and Nevada Commission in connection with the waiver application.

If granted, the waiver would permit the adviser to acquire beneficial ownership of up to 15% of the voting securities of the publicly traded corporation and, in certain cases, the voting securities of other publicly traded corporations. It would also require the adviser to provide the Nevada Board with monthly reports on the adviser's beneficial ownership of the voting securities of all publicly traded corporations registered with the Nevada Commission and quarterly certifications similar to those required in the waiver application for each publicly traded corporation in which it beneficially owns more than 10% of the voting securities. Except in limited circumstances, the waiver would not permit the adviser to acquire beneficial ownership of more than 15% of the voting securities of a publicly traded corporation. To acquire more than 15%, the adviser would need to submit an application for a finding of suitability.

Conclusion

Advisers may invest in the securities of publicly traded gaming corporations on behalf of their clients. Such companies are generally highly regulated at the state level and acquiring beneficial ownership of these securities can be a trap for the unwary. While the variety of requirements resulting from the application of various state gaming regulations can be daunting, a little knowledge and the right approach can make managing compliance with the various state gaming regulations less burdensome. As part of his or her due diligence efforts, the adviser's chief compliance officer should undertake an evaluation of these holdings, which at a minimum: (i) identifies those state(s) where a gaming company maintains a license, (ii) identifies the type of gaming license maintained by the company, (iii) catalogues any reporting requirements required under a particular state's statutes and regulations, (iv) considers whether ownership in the company subjects the adviser to a state's suitability determination requirements, and if so, determine whether a waiver from such requirements is available and evaluate the cost/benefits associated with complying with the requirements or seeking a waiver.

---

* This Article appeared in the March 1, 2006 Investment Adviser Association Newsletter and is reprinted with the permission of the Investment Adviser Association.