International Gaming Credit, Due Diligence and Enforcement: How Can the Risks be Mitigated?

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The amount of casino credit written off in Nevada as bad debt is staggering in absolute terms, and is increasing in what may be the nascent stages of an exponential rise which will possibly have a considerable impact on the industry's bottom line. Between 1984 and 1993, the cumulative amount of bad debt expenses by Nevada casinos was $811,976,817.[1]

The relationship between the rate by which bad debt was written off between fiscal years 1988 and 1993, and The rate of increase in total gaming revenue booked by Nevada casinos during the very same two years, regrettably, fortifies the proposition that, in relative terms, bad debt is increasing at a rate faster than the rate of increase in revenue. In 1988, $53,531,091 of casino credit was expenses in Nevada. In 1993, the amount of bad debt more than doubled to $113,129,820.[2] In contrast, total gaming revenues booked by Nevada casinos increased from $4,094,869,746 in 1988 to $5,880,592,442 in 1993.[3] Thus, total revenues in 1988, compared with revenue performance for the fiscal year 1993, showed an increase of 43.6 percent, while bad debt rose 111 percent.[4] It can be deduced that bad debt is increasing at a rate in excess of two times the rate of increase of gaming revenue. Statistics often offer only part of the story and can be somewhat misleading. But it is clear that there is a trend in what may be characterized as an exponential increase in poorly underwritten casino credit.[5]

The writer has conducted a substantial number of international enforcement cases to collect gaming credits ranging from $100,000 to $6,000,000 per matter. This writer has observed two sources exacerbating the increase of bad debt. These sources of exacerbation form the basis of a dual thesis to this article.

The first thesis is that the legal machinery supporting the capacity of a Nevada casino to enforce a gaming debt abroad is pregnant with obstacles. These can be surmounted. The machinery can be tuned up. It has to be geared not only for domestic collections, but also international ones. This can be done either through reform of the law by amendment to legislation or, more easily, by creative, lateral, and elegant modifications to the written contract governing the grant of casino credit.

The second thesis concerns a bundle of activities called due diligence. Strictly speaking, this bundle of activities has very little to do with deficiencies in the legal machinery. Due diligence offers a means to investigate or procure often purely factual information garnered outside of the activities attendant on the formation, management, and enforcement of a contract for casino credit. However, the clear objective of the information thus obtained is to support each and all of the formation, management and enforcement functions referenced above. And so, due diligence is truly part of the legal machinery, as has been recognized by other industries such as banking. It offers an expanded focus from which risk can be more accurately calibrated. It complements the exercise of extending credit and collecting it.

The writer asserts that the methodology employed to consider or underwrite applications for casino credit, as it pertains to foreign patrons, is wanting.[6]

Substantial, multi-million dollar credits are sometimes extended to patrons who either cannot possibly repay them, or who have no intention to do so and who fortify their wealth behind a labyrinth of puppet companies or trusts designed to secrete money and frustrate creditors. This mandates the use of an expansive and thorough due diligence procedure applied prior to the grant of credit to an international patron. Moreover, after credit has been granted, and if the patron breaches his promise to repay, due diligence should be employed to determine whether international litigation is appropriate and assets apparent.

The application of more thorough, lateral methods of due diligence will undoubtedly militate against the extension of bad credit and the prosecution of fruitless lawsuits in foreign lands. The absence of a modern, integrated approach to the underwriting of credit or the commencement of foreign enforcement proceedings presents a casino with the opportunity to grant credit blindly and, once such credit is in a state of default, to indulge in an inept, blundering attempt to enforce the credit abroad.

The Foundation to the Legal Machinery Available to Enforce Nevada Gaming Credits Abroad

To know how to cleanse the legal machinery of obstacles, one ought to know how the machinery works. Thus we begin with a conventional parlay through the first principles of gaming law. This takes us back to a less complex, smaller universe. That time commences with the seventeenth century, and endured principally to the early twentieth century. It finds its leitmotif in the British Empire, with its circumnavigation of the globe, and England's having control over more than one-third of the world's peoples and territory.

Before the seventeenth century, gaming in England was a part of the ruling class's repertoire of entertainment. It continued to be throughout the days of Empire. However, Parliament and the Courts, the fonts of law, began a steady progression over a span of 300 years to regulate against deceitful, disorderly, and excessive gaming. Perhaps British lawmakers of the time, in recognizing the excesses of their own youth, thought it best to restrain similar excesses in the youth of the day. This can be seen from the preamble to the Statute of Queen Anne of 1710, where it was recognized explicitly that young men were wont to attend upon common bawdy houses to game their life's savings away, largely on credit.[7] This was a mischief. The Statute of Anne and a long procession of Acts of Parliament of similar themes addressed this mischief by making any marker, cheque or bill drawn in payment of a gaming debt utterly void and unenforceable.

The reader might well ask what the regulation of excesses in the expression of the gambling spirit in eighteenth century England has to do with the enforcement of gaming obligations in contemporary Nevada. The concise answer is, "Everything." The basis for this possibly surprising response is that, in 1865, the newly admitted State of Nevada inherited the Statute of Queen Anne of 1710, an English statute that preceded the Declaration of Independence. A case can be made that this ancient English statute prevailed in Nevada until 1983. Accordingly, an examination of the Statute of Anne provides a current framework for a discussion of gaming obligations and the providence attendant on their enforcement.

Prior to 1983, it is common ground that gaming debts were not enforceable under Nevada law. Thus, they could not be paid under compulsion of law.

In 1908, the Court of Appeal of England and Wales had to address the Statute of Queen Anne in the context of a gaming loan incurred in a foreign casino. That was the case of *Saxby v. Fulton*.[8] In 1905 and 1906 an Englishman named Saxby lent his friend Brook significant sums for the purpose of playing roulette at Monte Carlo. Mr. Brook lost. In 1908, Mr. Brook died, and Mr. Saxby brought an action against his estate to recover the balance due. The estate demurred, asserting that the money, having been lent for the purpose of gaming, was not recoverable in England because of the Statute of Queen Anne. The game was not played and the loan was not made in England. Their Lordships in the Court of Appeal canvassed the relevant authorities. Implicitly, the Court expressed bewilderment at the often tortured results reached by a strict and unyielding application of the Statute of Queen Anne. They correctly noted that, to Englishmen, there was nothing untoward with gambling per se. Rather, it was the gambling spirit drawn to excess, and the consequences for certain young men who, in a drunken stupor, could blindly sign notes, sometimes disposing of their entire inheritance, which was the mischief. The well-established and clearly well-greased English class system had to be kept established and greased by protecting itself against the ruination of its young gentlemen. Their Lordships, who no doubt had found themselves in common bawdy houses during their youth, nevertheless saw that the Statute and not the young men was the folly.

In *Saxby v. Fulton*, their Lordships drew a distinction between gaming conducted in a common bawdy house in London and that which takes place outside of England. In the latter case, if gambling, whether with ready money or credit, were compatible with the system of law where these activities took place, then there could be no reason why such a foreign obligation

would not be recognized by the English Courts. This distinction is based on an inherent respect for foreign countries, courts, and legal systems, known as *comity*.

A second very important distinction was drawn in the 1927 decision of the *Societe Anonyme des Grands Etablissements du Touquet paris-Plage v. Baumgart.*[9] In that case, the gambler had drawn three cheques totalling £300 in the English language, and against an account with an English bank. These cheques were given in exchange for chips at a casino at Le Touquet, France. The contract of presentment between the payee (casino) and the drawee (English) bank was governed by the *lex loci solutionis* (or the law of the place of payment of the cheques). As the Statute of Queen Anne made unenforceable every cheque that was subject to English law and given in payment of a gaming debt, the French casino could not frame an action on the cheques. However, the casino could employ a lawyer's device — a legal fiction. The casino could ignore the cheques, as they did, and sue on the underlying contract of loan. Thus arose the curious rule of international gaming practice that a casino must ignore a marker or a cheque drawn on a foreign bank (if it be located in a Statute of Queen Anne jurisdiction), and instead sue on the underlying contract of loan (which is much like a loan agreement at a bank).

When casinos began to extend credit in Nevada to foreign gamblers, they had to do so with reference to this convoluted fiction, in particular where the foreign patron lived in a British Commonwealth (or a Statute of Queen Anne) jurisdiction. Until some eleven years ago, even Nevada itself was visited with the curious goings on of English law. And this for a state which is warm and intimate with the gaming spirit.

In England as well as most other mature legal systems, a contract is, for the most part, governed and interpreted in accordance with its proper law.

Given the foundation laid out before us, it would appear that courts throughout the British Commonwealth[10] will enforce Nevada gaming debts so long as (i) the casino sues on the underlying contract of loan (and ignores a marker drawn on a British Commonwealth sitused bank), and (ii) the contract of loan is governed by a system of law where the enforcement of gaming debts is lawful. Accordingly, the very excellent practice of expressly making casino credit application forms and markers governed by the laws of the State of Nevada (or, where appropriate, New Jersey) has developed. Provisions such as these give a United States-based casino the apparent comfort of being able to enforce the obligation abroad. But this apparent comfort is belied by several problems. What follows are four thorns in the casino industry's international litigation side. By no means is this an exhaustive list of obstacles or areas of difficulty.

International Litigation Thorn Number 1-The *Ralli Brothers* Defense

In England as well as most other mature legal systems, a contract is, for the most part, governed and interpreted in accordance with its proper law. Thus, the parties are generally free to choose the body of rules — the "proper law" — with which to govern their performance, the meaning of their contract and their relationship as a whole. Accordingly, a choice of, say, Nevada or New Jersey law to govern a contract for casino credit will generally be honored by foreign courts. It is important therefore that casinos expressly select the law of the place of the casino as the governing (or proper) law of the contract of loan. Such a provision is vital. Unfortunately, some United States casino credit documents make no reference to a governing law.

The freedom of contracting parties to choose Nevada, New Jersey, or indeed any system of law to govern their contract is not without limit. One such limitation was established by the decision of the English Court of Appeal in *Ralli Brothers v. Compania Naviera Sota y Aznar.*[11] In *Ralli Brothers*, a contract to carry jute (or rope) by sea from Calcutta to Barcelona was formed. By the choice of the parties, it was governed by English law. The contract provided for the payment of freight by *X*, the charterer, to *A*, the ship owner, at the rate of £50 per ton payable on delivery of the cargo at Barcelona, Spain. After the contract was signed, but before the shop arrived in Barcelona, the Government of Spain decreed that the maximum amount which could be charged for the carriage of jute by sea to Spain was £10 per ton. It thus became illegal for a Spanish citizen to pay any more than £10 per ton. Accordingly, X paid A only £10 per ton. *A*, the ship owner, sued *X*, the charterer, in England to recover the per tonnage differ-

ence between £10 and £50. The ship owner's action was dismissed, notwithstanding that, under English law — the system of law which purportedly governed the contract — the ship owner was entitled to the full benefit of his bargain, namely, £50 per ton. Surprisingly, Spanish law invaded the parties' choice of English law.

The principal of this case is directly applicable to casinos. A contract of credit granted by a casino, even if it be expressly governed by Nevada law, is, in general, invalid insofar as its performance is unlawful under the law of the country where the contract is to be performed. Thus, if a Nevada casino were to sue a patron in Hong Kong on a contract of loan governed by Nevada law, that contract may not be enforcement if the place of the patron's performance (that is, the place where the patron is to repay the debt) is in Hong Kong. A casino must be able to assert that the place where the patron must repay the credit is within the territorial boundaries of, say, Nevada, in contrast with those of the British Colony of Hong Kong. If a contract is silent as to the place where the patron is to repay a casino, a general rule of private international law will operate to impute a place. It will be presumed that it be situate in the place where the debt may be enforced, such place being the place of habitual residence of the debtor.[12]

The writer has reviewed markers and credit application forms by numerous casinos in Nevada and New Jersey. He has yet to find a single instance where the place of payment is called out for explicitly (or even remotely, by implication) on the face of the documents. It is recommended that all preprinted credit application forms and markers be modified to avoid the *Ralli Brothers* defense.[13] Accordingly, on the face of the marker, the patron, ought to be asked to state expressly:

> I hereby unconditionally promise to pay on demand $[ ] to XYZ or order at [street address of casino], Las Vegas, Nevada [zip code] USA.

Moreover, in the credit line application form, the patron could be required to indicate expressly:

> I acknowledge that by signing this casino credit line application form, I am expressing an intention to borrow money from [ ] Casino. I hereby covenant and agree to repay any and all amount of credit extended to me by such Casino at [street address of Casino] Las Vegas, Nevada [zip code] USA.

Unless the place of repayment is identified in all relevant credit line documents as being situate at a specific address in Nevada, a casino may not be able to enforce a credit against a foreign patron who lives in a Statute of Queen Anne jurisdiction.[14]

International Litigation Thorn Number 2-The Requirement that a Credit Instrument Be Presented for Payment

A. Before Suit may be Brought on the Underlying Obligation.

Oftentimes, markers are signed on large, oversized, pre-printed cheque stock. They are unsuitable for presentation through the banking system since they will be chewed up by the automatic machines used by banks in the bulk exchange of items. Also, markers are often not drawn against a specific bank or bank account. If this is the case, it is impossible to present them through the banking system, as the instruments do not express a place for the casino's bank (the presenting bank) to draw against.

As the writer has observed, there appears to be a practice which has developed in the industry (for these and perhaps other practical reasons), to refrain from formally presenting markers for payment at the bank against which they are apparently drawn (or in the absence of a drawee bank, at the place of residence of the patron). Under Nevada commercial paper law, where a negotiable instrument (such as a marker or cheque) is taken in payment of an underlying obligation, the obligation is suspended *pro tanto* until it is presented for payment and dishonored.[15] As described in the foundational section to this paper, casinos must refrain from suing on a marker where it is drawn against a bank (or can be presented at the home of the foreign patron) if such bank (or patron) is located in a British Commonwealth jurisdiction. Accordingly, casinos must sue on the underlying discrete obligation, or contract of loan. As noted, Nevada commercial paper law suspends the right to sue on the underlying obligation

pro tanto (meaning, for so long as the holder of the market fails to present it for payment, or until it has been dishonored). At first blush, therefore, unless a marker has been presented for payment, a Nevada casino will not be able to enforce the underlying obligation against the foreign patron. One might think that a simple answer to this problem would be to attempt to present the market for payment, after the fact. But that will not work frequently, particularly where the instrument is stale dated (which occurs normally 6 months after its issue).

However, there are instances where a casino can be excused from the requirement of presenting a marker for payment prior to the commencement of an action on the underlying contract of loan.

These include:

(i) *Express Waiver of the Requirement of Presentment.* If on the marker or the credit line application form, the patron waives expressly the requirement that the marker be presented to his bank (or to him) for payment, the barrier to the commencement of suit on the underlying loan obligation is lifted; or

(ii) *Implicit Waiver of Requirement of Presentment.* Where the patron implicitly waives the requirement of presentment by his conduct, after the fact, suit can similarly be brought on the loan contract;[16]

International Litigation Thorn Number 3-Public Policy of the Place of the Debtor's Domicile

Perhaps the most eviscerating thorn in the side of the United States casino industry in compelling international patrons to repay their credits is the notion that gaming, and gaming debts, are incompatible with the public policy or morality of the place where the debtor resides — his or her domicile.[17]

The Statute of Queen Anne and other foreign laws apparently precluding the enforcement of gaming credits are, to the knowledge of this writer, domestic statutes. They have no extraterritorial effect outside the jurisdiction in which they were enacted. Thus, on the surface, a contract of loan made for the purpose of gaming in a casino, governed by Nevada law, should be enforceable in a foreign land, as has been indicated above. But the public policy (or fundamental morality) of a country may act as an independent ground to deny enforcement of such a contract.

However, there are instances where a casino can be excused from the requirement of presenting a marker for payment prior to the commencement of an action on the underlying contract of loan.

English law (and, therefore, the law of most British Commonwealth jurisdictions) has been employed in this paper as a paradigm for describing a potpourri of loops, barriers, and obstacles that must be crossed when attempting to enforce this very special nature of obligation abroad. Some other mature foreign legal systems are sources of slightly different problems — albeit all being of a similar theme.

Almost universally, the public policy hurdle must be jumped in every jurisdiction outside of the United States where there has been some past history of anti-gaming legislation or morality. This would include most of the mature legal systems in the world. In almost every case, a judgment based on a gaming credit (such as a Nevada state or federal judgment) or a contract of loan governed by a gaming-friendly jurisdiction may be found to be incompatible with the public policy of a foreign land, and therefore unenforceable.

In Japan, the following rule applies to the enforcement of foreign judgments, on this general point. Article 200 of the Japanese Code of Civil Procedure provides that a foreign judgment will be recognized only if the judgment of the foreign court is not contrary to the public order or morals of Japan. Taiwan and South Korea have identical provisions.

Most foreign courts exercise some discretion to review the underlying facts giving rise to, say, a Nevada or New Jersey judgment based on a gaming debt, before they will enforce it.

However, the general trend in the late 1980s and early 1990s is for this so-called public policy defense to be denied foreign patrons of United States-based casinos. The writer's law firm has circumnavigated the globe in enforcing gaming credits in the face of this defense. In many jurisdictions, it has been overruled or eliminated. In others (such as, to the writer's knowledge, Japan), the position awaits a test case.

Public policy is an unruly horse, as one court observed in Kuala Lumpur, Malaysia, when it was seized of an English gaming debt case:

> It is a very unruly horse, and when once you get astride it, you never know where it will carry you. It may lead you from the sound law. It is never argued at all, save for when other points fail.[18]

Another helpful example of a foreign court dismissing a debtor's plea to public policy can be found in the British Columbia, Canada, decision in the unreported case of *GNLV Corp v. Wan*[19]. In that case, Mr. Justice Hutchison quoted an unreported decision of his Honour Judge Harding out of the Vancouver Registry[20] in *Desert Palace, Inc. v. Zigdon*, where he said:

> Before going to the Defendant's authorities, I pause here simply to mention that gambling in the Province of British Columbia is not, I think, in this day and age, considered to be morally or fundamentally contrary to public policy. Rather, it seems to be, . . . "it's okay provided it is operated by the Government." We have as is known various lotteries run by the Government. We also have racetrack betting and I believe a certain amount of offtrack betting where bets can be placed by means of telephone in this Province. So although I accept that the Gaming Acts of 1835 and 1845 are still law in British Columbia, the morality of gambling itself has perhaps changed somewhat since the enactment of those two statutes.

This recent, practical approach to public policy and the acceptance of gaming debts, can also be found in Quebec,[21] Ontario,[22] and Hong Kong.[23]

Public policy is a dynamic concept that changes through the affluxion of time. Accordingly, the countries that will, in 1994, refuse to enforce a Nevada or New Jersey gaming obligation on the ground of its being incompatible with its fundamental public policy are rare and difficult to find. This is a very positive and helpful development. Perhaps as recently as five years ago, the majority of foreign counsel would opine peremptorily that it was impossible to enforce a Nevada gaming debt on the ground of its being manifestly inconsistent with the public policy of their country. Caution should not be thrown to the wind, however. Public policy defenses must still be attacked vigorously in those remaining countries where the position remains equivocal.

The most powerful method of attacking the public policy point is to demonstrate that manifestations of the gambling spirit abound in the very country which purports to consider gaming to be a perversion. The presence of government-run lotteries, or pari-mutuel wagering at thoroughbred race tracks are very helpful in terms of smashing an alleged anti-gaming debt public policy defense.

International Litigation Thorn Number 4-Managing Foreign Exchange Rate Risks

When a Nevada casino extends a credit to a nonresident patron, the obligation to repay is expressed in United States currency. The vast preponderance of assets owned by foreign patrons are denominated or expressed in a foreign currency. Accordingly, the value of the currency of obligation (namely, U.S. dollars) will, for the most part, be very different from the currency of judgment or the currency in which the patron's assets are expressed. Generally, the creditor casino bears the risk of the depreciation in the value of U.S. dollars against the currency of judgment. The patron bears the inverse risk, namely, appreciation in the value of the currency in which the debt is expressed (U.S. dollars) in contrast to depreciation in the value of his (foreign) currency. This principle, known as nominalism, forms part of the legal system of all civilized countries.[24]

If the patron's assets are expressed in a foreign currency and if his obligation to a casino is reduced to a U.S. dollar-denominated judgment, the date used to convert the judgment into the local currency of the patron will determine the real value of the casino's debt. Perhaps

unwittingly, in extending U.S. dollar-denominated credits to international patrons, casinos speculate in the foreign currency of its patrons.

Several points must be considered. Firstly, the date imposed on a casino to convert its U.S. dollar-denominated receivable into the local currency of its patron is subject to variation, depending on the jurisdiction involved. For instance, in England prior to 1975 the date of conversion was the date when the cause of action arose. For purposes of this paper, such date is the date when an international patron breaches his promise to repay a casino. If the value of the patron's currency depreciates between the date of his failure to repay and the date, sometimes months or years later, when the obligation is reduced to a foreign money judgment, the casino will suffer loss, since the patron can properly repay his obligation with depreciated foreign currency. Accordingly, if a U.S. dollar debt is converted into the currency of judgment on the date the debt becomes due, the U.S. casino may be unwittingly speculating in the currency of its international patron throughout the entire pendency of the litigation.

In 1975, this rule was changed in England. The House of Lords in *Miliangos v. George Frank Textiles Ltd.*[25] discarded the old rule for determining the value of a foreign-denominated debt from the date of the maturity of the obligation to the date of actual payment.

It is not possible in the context of this paper to canvass all of the rules which determine when the currency of obligation is converted into the currency of judgment. Suffice it to say, however, that three principal variations are possible. The currency of obligation is sometimes converted into the currency of judgment (i) on the date the obligation to pay money matures, (ii) on the date a judgment is entered in a foreign court, or (iii) on the date the foreign judgment is ultimately satisfied by seizure of assets expressed in a foreign currency. The number of U.S. dollars payable by the foreign debtor can change materially depending on which conversion date applies. For instance, even if the more sophisticated jurisdictions, where foreign courts convert the currency of obligation to the currency of obligation to the currency of judgment at the moment in time when assets are seized, distortions regularly occur. If an English debtor were once obligated to pay U.S.$1 million when the U.S. dollar/Sterling exchange rate was $1.50:£1, and should that rate change to $2.00:£1 on the date of entry of an English judgment, the creditor will receive only £500,000 instead of £667,000. Distortions are further exacerbated in those jurisdictions where the old rule continues to apply, namely where the date of conversion is retroactive to the date when the debtor first failed to pay.

A casino has two practical options from which to select when managing its exchange rate risk relative to foreign gaming credits.

The application of these varying rules can result in an enormous windfall or loss to the casino. What was once booked as a $1 million gaming credit on the date that it was extended may, if a foreign court converts it into its own currency as at, say, the date of maturity of the obligation, depreciate radically by the time that assets are found, seized, and liquidated, all of such assets being expressed, again, in foreign currency. This phenomenon can provide a foreign patron with a significant economic incentive to delay payment. But it can also work the other way. A foreign patron can suffer loss in attempting to speculate. The value of his currency may indeed appreciate relative to U.S. dollars, in which case a casino could earn a windfall at his expense.

A casino has two practical options from which to select when managing its exchange rate risk relative to foreign gaming credits. Firstly, it can simply ignore the issue, speculate in the currency of its foreign patron, and suffer the loss or profit from the windfall in a cavalier and random way. Secondly, it can modify its pre-printed contracts of credit to impose upon the foreign patron every economic incentive to repay on the date that his obligation matures. Perhaps language could be included in the casino credit line application form. The patron could oblige himself to pay the casino the U.S. dollar equivalent of his debt, expressed in the currency of the place of his residence, at the highest rate of exchange between the date of maturity of his obligation and the actual date that he satisfies it. This will provide the casino with either a neutral or advantageous result. If U.S. dollars depreciate in value, the casino will be entitled to seize a sufficient amount of assets expressed in the patron's currency to satisfy the original U.S. dollar obligation, in any event. If, however, the foreign currency were to appreciate against the U.S. dollar, the casino will enjoy the windfall, since the patron will have obliged himself to pay at the highest rate of exchange between the date that he was supposed to pay, and the date

that he actually does pay. Either way, the patron is under a greater economic incentive to pay than he would otherwise be, since he stands to suffer loss, yet will never enjoy any amount of gain associated with the fluctuation of the two currencies involved.

The writer does not intend to imply that there are no other means available to a casino to manage its foreign exchange rate risk. To the contrary, all of the devices generally available to manage exchange rate risks can be applied to these credits. This would include the practice of "matching," which is the practice of balancing receivables and payables in the same currencies. But this is probably not a practical alternative.

Other devices are more sophisticated. They include the purchase of an (i) optioned-dated forward exchange contract, (ii) an outward forward exchange contract, (iii) foreign currency futures, (iv) foreign currency options, and (v) foreign currency swaps. The difficulty with these devices, however, is that, unless one is involved in substantial international trading sufficient to justify their cost, they are not practicable.

Due Diligence - A Meaningful Tool[26]

The writer asks a foundational question: "How and how well do you know your international gaming patron?" Economics demand that new gaming patrons be identified, courted and brought into the casino. Competition between casinos is robust. International gaming patrons who are responsible consumers of credit are scarce. Naturally there exists a presumption in favor of the integrity of the prospective consumer of casino credit. But operating purely from such a presumption is unsatisfactory.

Why is this? The concise answer is that in a world of free flowing goods, capital and people, the old barriers against misconduct by borrowers (whether that be misrepresentation as to their financial position, or the hiding of assets subsequent to a default) have disintegrated. It was only a brief time ago when a person would be from a single community and would be born and would die in the same place. Against this backdrop, the fundamental rule of prudential banking — know your customer (or, in the context of casino credit, know your patron) — was capable of being met almost effortlessly.

No longer. Fraud on financial institutions (including casino credit departments) is endemic. The sophistication and complexity of international white collar crime, or of rough and ready debtors who misrepresent fact and financial position for credit, is limited only by the depth of the creative imagination and expert knowledge of the protagonists. As one delightful character recently told our investigator, "Money moves and it moves fast. The bank was an easy take. They were dumb — and their lawyers were especially dumb." The bank to which this man referred was the victim of a multiple hundred-million dollar manipulative contrivance which had been conceived and orchestrated by him.

The principal benefit of a thoughtfully constructed due diligence system, vigilantly applied to the casino credit application approval process, is the mitigation of legal, business, and reputation risk.

Certainly, one can go over the top with the fear of the unknown casino patron. However, a proper due diligence system can have the unexpected benefit of identifying those patrons who at first sight appear to be unsuitable only because they are especially secretive and because the source of their wealth is not apparent. The distinction between good and bad patrons can be drawn with greater precision. Consequently, some apparently rough prospective patrons who are now turned away for failure to measure up under the traditional but less than illuminating methods of due diligence, may be appropriately accepted as consumers of casino credit.

The most traditional form of due diligence, the old school tie method, is unsatisfactory. Under this method, a prospective patron of credit expresses an intention to transact. A casino expects him to tell a story, and he will tell it laconically on a casino credit application form. His passport is photocopied. The information deriving from the patron's statements is verified, but not within the contours of an orderly structured system. Rather, telephone calls are placed and letters written in search for that warm and fuzzy feeling which comes from knowing that a financial institution or a consumer credit database considers this potential protagonist a good and proper person, monied, and trustworthy. Reliance is placed on the measure of the integrity of the person who introduced the patron to the casino — most typically a junketeer. Genuineness is imputed by association.

This, the nineteenth century model for due diligence, was for simpler and gentler times. But no longer. In the twentieth century, legal theories in most of the mature legal systems have

gone to the outer limits of their recognizing liability on some or other exotic theory. This in turn has caused economic pressures which are felt in all commercial dealings.

One of the principal results of this intricacy has been complex legal maneuvering (for legitimate ends) by well-established businessmen or institutions, and similar maneuvering (for most unsavory ends) by others. It is these others whose corporate webs, transactional complexes, and multijurisdictional activities present the need for a creative and lateral methodology to due diligence that produces more accurate results. A clearly defined set of standards and practices ought to be developed to enhance objectivity in the casino credit approval process.

There are two essential problems with the old methods of due diligence. These problems are particularly exacerbated in the context of international patrons.

Firstly, the information is derived solely from the patron, his bank, and perhaps others in the patron's circle of people or professionals. It is not independently verified in a predictable way per se. That is to say, the mechanism for ready access to independent opinion is not apparent. Oftentimes, to apply for casino credit, a patron merely fills out a form, indicates the name of his bank and account number and provides a representation as to his annual earnings or net worth.

It is important that the information which flows into the casino credit department from the prospective patron meets prescribed standards and be assessed in accordance with tangible criteria. Much if not all of this work can be performed without unduly imposing on the applicant, since the information will principally be obtained from foreign databases and other special methods, supplementing the domestic databases currently used by credit departments, some of these having absolutely no relevance to the international patron. The application papers should indicate, as for the most part they do, that the applicant authorizes the casino to verify independently, through any public database or otherwise, the accuracy of his representations.

A second principal problem with the present system is that the quality and comprehensiveness of the information given can change materially depending on the preprinted forms used by casinos. Further, these forms are designed principally for the extension of domestic credits, and not international ones. Without a harmonized, lateral approach to the independent verification and assessment of information uttered by an applicant for credit to a casino, there is no reliable norm by which to measure the quality and validity of that information.

It must be remembered that in the international sphere, things are radically different. The United States, in relative terms, is an open and public society. The databases available in this country for assessing the background of a prospective consumer of casino credit are not readily available elsewhere, save for a very few countries.

A methodology ought to be developed on a country-by-country or region-by-region basis. The frequency and volume of business generated by international patrons from a particular region will undoubtedly influence the application of resources on such a system. Less emphasis ought to be placed on databases, and more on an extensive long-standing network of local contacts. For instance, a low-level investigator in Hong Kong can be used efficiently at a cost of, say, $500, to verify the presence of a factory or home there or in South China. Among the more helpful information services or databases available outside the United States are services on offer from the *Financial Times* or Reuters. These databases provide current business articles retrieved with plain English commands. Searches for articles may be made in more than 2,000 publications, including the international edition of *The Wall Street Journal*, the *South China News*, newspapers in the Philippines, and other major third world cities. The number of publications which are accessible and their nature and extent are quite astonishing. A variety of sophisticated searches are possible. Judicious use of these facilities and clever searching may produce information which is not necessarily available elsewhere.

In the case of more prominent patrons who seek very substantial credits and who legitimately have been made the subject of international press comment, much of such comment including articles appearing in principal trade journals is available.

Before large sums are loaned, it is recommended that casinos employ the services of intelligence operatives who are expert in uncovering frauds, locating recalcitrants, and finding assets internationally. This nature of covert intelligence is particularly important in the context of the international, post-breach, pre-litigation environs. It is a nonsense to incur legal costs, waste management time, and undergo the laborious exercise of obtaining a Nevada state or federal judgment, have it recognized abroad, or to sue directly in a foreign land, only to find that the defendant has either secreted his wealth behind an expanding array of secret companies or trusts, or was utterly penniless from the outset. Preemptive strikes to freeze assets in

foreign lands, sometimes in several jurisdictions at once, are now the flavour of the month in international litigation.

Conclusions.

The object of this article was to provide the reader with a baseline understanding for the legal and practical complex which presents itself, and some of the difficulties attendant on it, to a casino which extends credit to international patrons. This discussion is certainly not exhaustive. Rather, it is intended to stimulate debate on a subject which rarely is the beneficiary of serious comment.

References

[1]The source of this cumulative statistic and the individual statistics that follow in the text is the NEVADA STATE GAMING CONTROL BOARD, NEVADA GAMING ABSTRACT for the years 1984 through 1993. ABSTRACTS for years prior to 1984 used a different format, and apparently do not present information in a form that can be used to determine the amount of bad debt expenses prior to that year. Letter from William A. Bible, Chairman, Nevada State Gaming Control Board, to the author (July 14, 1992). The annual bad debt expense figure, as reported in the ABSTRACTS for the years 1984 through 1993, is not audited by the Gaming Control Board; it is merely collated. *Bad debt expense* is defined as the amount of credit expensed by casino licenses as uncollectible during a given fiscal year.

[2]It is of moment to note that, in 1991, $166,556,365 of bad debt was expenses. This figure is, in relative terms, enormous. It represents a 294 percent increase in bad debt expenses when contrasted with the 1984 figure of $56,738,786. In historical terms, 1991 would appear to be an aberration.

[3]The total revenue figure represents the amount of pre-expense, pretax revenue allocable to gaming activities only. It is audited by the State Gaming Control Board.

[4]Regrettably, there do not appear to be any figures available analyzing the volume of credits by jurisdiction, continent, or world region that would allow one to determine where issues concerning the international enforcement and underwriting of gaming credits would be of the greatest moment. These statistics may be available on a casino-by-casino basis. However, they appear not to have been collated by the Nevada State Gaming Control Board, Letter from William A. Bible, Chairman, Nevada State Gaming Control Board, to the author (July 14, 1992), or by any other public or private body.

[5]Although comfort may be taken in the apparently high collection rate of casino credit, its being estimated by some authors as being 92 percent and others as high as 95 percent, the amount of bad debt expenses on an annual basis is, in absolute terms, staggering, and in relationship to the period of time noted above, on the rise.

[6]The writer is not qualified to speak to domestic collections, or due diligence practices in that regard.

[7]There are a number of literary examples of this stock of young gentlemen. One such is as illuminated by Dr. David Castronovo in his THE ENGLISH GENTLEMAN — IMAGES AND IDEALS IN LITERATURE AND SOCIETY 104 (1987) in his reference to Thackeray's YELLOWPLUSH PAPERS, as follows:

Mr Deuceace, the son of the Earl of Crabs, is a Barrister, but he does not regard his profession as his major activity: "the young gnlmn [gentleman] was a gnlmn]gentleman]," his servant Charles reminds the reader. "He kep a kab — he went to Holman —and Crockfuds — he moved in the most xequizzit suckels [exquisite circles] — and trubbled the law boox [read his law books] very little, I can tell you." Deuceace has run up debts, and Charles comments that "to know even what a real gnlmn [gentleman] owes is somethink instructif and agreeable." The more fashionable you are, the more money you owe, and Deuceace has spent his days since youth becoming fashionable . . . . To make up for some of these losses, Deuceace took to a life of gambling.

[8][1909] KB 208.

[9][1927] KB 789.

[10]These jurisdictions are many and varied. They include Canada (save for Quebec), Australia, New Zealand, Pakistan, India, Malaysia, Hong Kong, parts of Africa, Singapore, the Bahamas, the Cayman Islands, and many others.

[11][1920] 2 KB 287.

[12]Goober v. Custodian of Absentee's Property of the State of Israel [1954] 1 All E.R. 145.

[13]The writer has not yet seen this defense raised in the context of gaming credits. It is potent. Yet it can be extinguished with facility by following the suggestion noted above.

[14]Again, such jurisdictions include Australia, nine of ten Canadian Provinces, India, Malaysia, New Zealand, the Bahamas, Singapore, and Hong Kong.

[15]NEV. REV. STAT. § 104.3310(2)(a) (1993).

[16]An example of an implicit waiver of presentment arose in the 1992 Hong Kong Supreme Court case of GNLV Corp. v. Wong, where the patron, after he had defaulted, caused his Taiwanese friend, Fong, to tender to the casino checks totaling $500,000 in value. Implicitly, the checks were intended to stand in the place and stead of the patron's (then stale-dated) markers, which had been presented for payment by the casino. Thus, Wong, the patron, implicitly waived the requirement of presentation of his markers. As

Fong's checks were presented for payment by the casino timely and were subsequently dishonored, the casino's right to commence suit on the underlying obligation was no longer in a state of abeyance.

[17]One qualification should be made to this. An international patron may very well transact in a multiplicity of jurisdictions, through multiple companies or trusts, or in his own name. Accordingly, enforcement proceedings may be peremptorily brought in one or more jurisdictions to freeze or seize assets. If this is the case, it is possible that the public policy of the place where the assets lie (setting aside the place of the patron's domicile) may similarly be found to be incompatible with gaming or the enforcement of gaming credits.

[18]The Aspinall Curzon Ltd. v. Khoo Teng Hock, a judgment of Dato'Hj Mohd. Eusoff b. Chin J. (Feb. 18, 1991). In this case, the Malaysian Court held that the enforcement of an English judgment based on a gaming debt incurred in a licensed casino in London could not be considered as being contrary to the public policy of Malaysia.

[19]No. C914422, Vancouver Register (B.C. S. Ct. Sept. 11, 1991) (in chambers).

[20]No. F861194.

[21]See Auerbach v. Resorts International Inc, Quebec Court of Appeal, in the Montreal Registry No. 500-09-001339-860 and 50002023762-854, Monet Rothman, Mailhot, JJCA (Dec. 10, 1991).

[22]Boardwalk Regency Corp. v Maalouf, Court of Appeal, Ontario, File No. 754/88.

[23]GNLV Corp. v. Tseng Hsiao Tsun, the Supreme Court of Hong Kong High Court 1991, No. A4188 (Feb. 24, 1992) (Jones, J.) (in chambers).

[24]F.A. MANN, THE LEGAL ASPECT OF MONEY 92 (5th ed. 1991).

[25][1976] AC 443 (Lord Simon of Glaisdale, dissenting).

[26]The following section dealing with due diligence and underwriting practices is, in large measure, derived from the text of the writer's speech to the members of the Bahamian Banker's Association in Nassau on October 28, 1993, on the topic *Offshore Banking, Due Diligence, Your Customer — How Well Do You Know Him?,* an edited version of which was published in INTERNATIONAL TRADE JOURNAL, *Offshore Investment* (Feb. 1994).