March 1, 2023

Mr. Randall Keen, Esq.
Manatt, Phelps & Phillips, LLP
2049 Century Park East
Suite 1700
Los Angeles, CA 90067

Re: Response and Proposal for Alternative Methodologies for Cardroom and Third-Party Provider of Proposition Player Services Annual Fees

Dear Mr. Keen:

At your request, Green Hasson & Janks LLP ("GHJ")[1] submits the following in response to the letter from the California Gambling Control Commission ("Commission") dated December 28, 2022, whereby the Commission invited interested parties to provide suggestions and alternatives regarding how the Commission calculates and charges its Annual Fees to both cardrooms and third-party providers of proposition player services ("TPPPS").[2] We sincerely appreciate your providing us with the opportunity to comment and propose a revised fee structure and methodology.

Background

On May 16, 2019, the California State Auditor issued a report following its audit of the Commission and the California Department of Justice's Bureau of Gambling Control (the "Bureau"). The audit brought to light certain problems and shortcomings in both the Bureau's and the Commission's operations. Among other things, the audit concluded that the Bureau and the Commission have established regulatory fees that do not align with the actual costs that they incur when performing their respective oversight activities. Because some of the fees are higher than necessary, the auditor raised questions about the legality and fairness of the current fee structure. The auditor noted that the balance in the Gambling Control Fund ("GCF") has doubled over the past five years and was projected to increase to $97 million by June 2020. In addition, the auditor noted that because the fees are not related to actual costs, the supposed fee could be viewed as an unlawful tax in violation of Proposition 26.

This letter provides our suggestions on how to establish a fee structure that meets the primary objective of (1) covering costs, (2) avoids fees that are tied to revenues and appearance that the fees are a tax, (3) avoids overfunding, and (4) achieves the goal of being fair to both cardroom operators and TPPPS providers.

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[1] GHJ is an independent certified public accounting firm with offices in Southern and Northern California and practitioners throughout the United States.
[2] We include herein as **Exhibit 1** the letter from the Commission dated December 28, 2022.

To assist interested parties in developing alternative Annual Fee calculation methodologies, the Commission provided a set of "mock data," which appears to reasonably align to actual costs when compared to publicly available state budget information.[3] As such, our proposed methodology relies on Mock Data provided.

Proposed Methodology

Our suggested methodology does not propose any changes to the Cost Pools provided in the Mock Data, or to the relative allocations of these Cost Pools between Cardrooms and TPPPS providers. As such, we have relied upon the amounts and allocations between Cardrooms and TPPPS as included in the Cost Pools within the Mock Data. The Mock Data provides a total of $18M in Cost Pools 1-6, with $9.6M allocated to Cardrooms and $8.4M allocated to TPPPS.

The methodology we propose to spread costs to cardrooms and TPPPS providers is fairly simple. Cost Pools 1 through 4 are costs that are shared by both cardrooms and TPPPS providers, so those costs should be shared. Costs Pools 5 and 6 are specific to either cardrooms or TPPPS providers, so those costs are allocated accordingly. We note that this is consistent with the allocation methodology contained within the Mock Data provided.

Our general proposal is to have Annual Fees assessed to the cardrooms based upon the number of tables. For TPPPS providers, we propose the Commission assess fees based upon the number of licensed employees associated with the TPPPS provider. We further propose making adjustments to the costs that are allocated to non-operating cardrooms and non-operating TPPPS based upon the principle that many of the Bureau's and Commission's operating costs are not applicable to these non-operating entities.

- **Active Cardrooms:** Rather than assess fees as a percentage of revenue, we propose that the Commission adopt a methodology of assessing fees based upon the number of licensed tables for Active Cardrooms. We note that the Commission has used this methodology in the past. Allocating fees based on the number of tables is fair to all concerned and has the added benefit of likely not being viewed as a tax that is tied to revenues.
    - We propose allocating the portion of Cost Pools 1-6 attributable to Active Cardrooms based on the number of licensed tables per entity, after excluding any portion of Cost Pools 1 and 2 allocated to Non-Operating Cardrooms (detailed further below).

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[3] We include herein as **Exhibit 4** a report prepared by Streamline Strategies entitled "Commission on Gambling Control Fee Proposal Assumptions and Methodology Review" (the "Streamline Strategies Report"). The Streamline Strategies Report seeks to "verify information in the mock data and uses a number of reports, state budgets from various years, and other information to determine whether the mock data used by the Commission is comparable to these reference sources. GHJ did not audit or otherwise verify any of the information contained in the Streamline Strategies Report.

  - Our proposed methodology does not distinguish between those Active Cardrooms whose revenue is over or under any dollar threshold, as our methodology does not rely on revenue as a basis for allocation. Therefore, for ease of analysis, we combined the "Active Over" and "Active Under" category on the Mock Data to a single category – "Active."
  - To calculate the annual fee on a per-table basis, we started with the $9.6M in Cost Pools 1-6 which have been allocated to Cardrooms per the Mock Data. We then deducted any fees which will be allocated to Non-Operating Cardrooms. The remaining amount (approximately $9.5M) is then divided by the number of Tables licensed to Active Cardrooms (1,764). Based on the Mock Data, this methodology yields an estimated annual fee per table of $5,400. To calculate the annual fee per Active Cardroom, this annual fee per table is multiplied by the number of licensed tables for each cardroom.

- **Non-Operating Cardrooms:** We propose that Non-Operating Cardrooms should only be allocated costs associated with Cost Pools 1 and 2, which generally consist of certain overhead and application costs. It is our view that Non-Operating Cardrooms should not be allocated any portion of Cost Pools 3-6, as these Cost Pools are more closely aligned with the ongoing monitoring and enforcement of active entities.
  - To allocate a portion of Cost Pools 1 and 2 to the Non-Operating Cardrooms, we calculated the percentage of tables licensed for Non-Operating Cardrooms (33) versus for all Cardrooms (1,797) using the "Table Count" data included in the Mock Data. The resulting percentage is 1.84%; therefore, we propose allocating 1.84% of the portion of Cost Pools 1 and 2 attributable to Cardrooms to these Non-Operating Cardrooms.
  - Applying 1.84% of Cost Pools 1 and 2 attributable to Cardrooms results in approximately $44,000 of fees to allocate to the Non-Operating Cardrooms. We propose allocating these costs among the Non-Operating Cardrooms on a per-entity basis. The Mock Data lists a total of 17 Non-Operating Cardrooms, which results in an annual fee of approximately $2,600 for each Non-Operating Cardroom.

- **Active TPPPS:** We propose that Active TPPPS providers be allocated an annual fee based on the number of licensed employees associated with each TPPPS entity. We believe this is a more equitable system than basing the fee on a percentage of revenues or basing the fee upon the number of employees. In our view, the TPPPS providers should not have a disincentive to hire non-licensed staff.
  - The number of licensed employees was not included in the Mock Data, so we have used the number of employees as a proxy for licensed employees for illustrative purposes. If the number of licensed

employees per entity is made available, we would be happy to update our calculation accordingly.

- We propose allocating the portion of Cost Pools 1-6 attributable to TPPPS based on the number of licensed employees per entity, after excluding any portion of Cost Pools 1 and 2 allocated to Non-Operating TPPPS (detailed further below).
- Our proposed methodology does not distinguish between those Active TPPPS whose revenue is over or under any dollar threshold, as our methodology does not rely on revenue as a basis for allocation. Therefore, for ease of analysis, we combined the "Active Over" and "Active Under" category on the Mock Data to a single category – "Active."
- To calculate the annual fee on a per-licensed employee basis, we started with the $8.4M in Cost Pools 1-6 which have been allocated to TPPPS per the Mock Data. We then deducted any fees which will be allocated to Non-Operating TPPPS. The remaining amount is then divided by the number of employees employed by Active TPPPS (8,842). (As noted previously, our proposed methodology allocates costs based on the number of licensed employees, but as this information was not provided in the Mock Data, we have used the number of staff as a proxy for licensed employees.)
- Based on the Mock Data, this methodology yields an estimated annual fee per licensed employee of $950. To calculate the annual fee, this annual fee per licensed employee is multiplied by the number of licensed employees at each Active TPPPS.

- **Non-Operating TPPPS:** We propose that Non-Operating TPPPS providers be allocated an annual fee for a portion of the costs included in Cost Pools 1 and 2, which consist of certain overhead and application costs. It is our view that Non-Operating TPPPS should not be allocated any portion of Cost Pools 3-6, as these Cost Pools are more closely aligned with the ongoing monitoring and enforcement of active entities.
  - To allocate a portion of Cost Pools 1 and 2 to the Non-Operating TPPPS, we calculated the percentage of employees for Non-Operating TPPPS (13) versus for all TPPPS (8,855) using the "Total Staff" data included in the Mock Data. (Our proposed methodology relies on allocations based on licensed employees, but we have used total staff as a proxy for licensed employees in the interim.) The resulting percentage is 0.15%; therefore, we propose allocating 0.15% of the portion of Cost Pools 1 and 2 attributable to TPPPS to Non-Operating TPPPS.
  - Applying 0.15% of Cost Pools 1 and 2 attributable to TPPPS results in approximately $5,300 of fees to allocate to the Non-Operating TPPPS. We propose allocating these costs among the Non-Operating TPPPS on a per-entity basis. The Mock Data lists a total of 9 Non-Operating

TPPPS, which results in an annual fee of approximately $600 per Non-Operating TPPPS entity.

We have attached an Excel file which includes our proposed methodology.[4] The basis for this analysis is the Mock Data. A summary of the updates we have made to the original Mock Data is listed below:

- **Mock Data (Tab 1)**
    - Combined "Active Over" and "Active Under" categories into a single category ("Active")
    - Calculated the percentage of Active versus Non-Active tables for Cardrooms and employees for TPPPS
    - For illustrative purposes, we have displayed the annual fee for each entity based on our proposed methodology
- **Annual Fee Detail – Mock Data (Tab 2)**
    - No changes
- **Mock Data – Current Methodology (Tab 3)**
    - Split the portion of Cost Pools 1-6 assigned to Cardrooms and TPPPS between Active and Non-Operating entities using the percentage of Active versus Non-Active tables for Cardrooms and employees for TPPPS
    - Calculated the Annual Fee on a per-table basis for Active Cardrooms and a per-entity basis for Non-Operating Cardrooms, and on a per-licensee basis for Active TPPPS and a per-entity basis for Non-Operating TPPPS

The following table provides a summary of our proposed methodology for Active and Non-Operating Cardrooms and TPPPS:

Entity Type	# of Active Tables (Cardrooms) or Licenses (TPPPS)	Annual Fee Cost Allocated to Active Entities	Annual Fee for Active Entities per Table (Cardrooms) or Licenses (TPPPS)
	A	*B*	*B/A*
Cardroom	1,764	$ 9,522,259	$ 5,398
TPPPS	8,842	$ 8,428,128	$ 953
TOTAL		**$ 17,950,386**	

Entity Type	# of Non-Operating Entities	Annual Fee Cost Allocated to Non-Operating Entities	Annual Fee for Non-Operating Entities
	C	*D*	*D/C*
Cardroom	17	$ 44,351	$ 2,609
TPPPS	9	$ 5,263	$ 585
TOTAL		**$ 49,614**	

[4] See attached **Exhibit 2**: GHJ Fee Proposal.

Benefits and Fairness of Our Proposed Methodology

We believe the methodology as outlined above is fair to all concerned for the following reasons:

1. Determining Annual Fees for cardrooms using the number of tables as the primary metric will effectively level the playing field for all cardroom operators. As it stands now, there is no evidence that cardroom operators that are more successful and earn more revenue than other cardrooms actually require more Bureau and Commission resources. In fact, the larger and more successful operators must adhere to more stringent internal controls per the Minimum Internal Control Standards ("MICS"), which should ensure a stronger internal control environment and lessen the degree of Bureau and Commissions resources needed for ongoing monitoring and enforcement.
2. As it stands now, cardrooms that have near-identical number of tables and near-identical number of employees, but which have significantly different revenues pay significantly different Annual Fees. Differences between the cardrooms' financial performance could be due to differences in location, management, and/or the type of clientele. There is no evidence that the services provided by the Commission and the Bureau to two cardrooms with near-identical table counts and employee headcount vary significantly based solely on differences in revenue. As such, the Annual Fees they pay should not vary significantly. Allocating fees based on the number of tables will alleviate this disparity.
3. Similarly, there is no evidence that TPPPS providers with larger revenues require more Bureau and Commission resources on a per license basis than smaller TPPPS providers.
4. Lastly, in determining whether a regulatory fee is a tax for purposes of Proposition 26, courts evaluate (1) whether the approved fees would exceed the reasonable, estimated costs of administering the program; (2) whether the fee is used to generate excess revenue, that is, to generate more revenue than necessary to pay for the regulatory program; and (3) whether any class of fee payers is shouldering too large a portion of the associated regulatory costs. As it stands now, the current Annual Fee structure results in fees that exceed the Bureau's and Commission's reasonable, estimated costs. By allocating fees on a relatively stable base such as the number of tables and the number of licenses, we believe the Bureau and the Commission will find it much easier to budget and establish fees that approximate actual costs.

Should you have any additional questions regarding this proposed alternative methodology, please feel free to contact me:

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Respectfully submitted,

Green Hasson & Janks LLP

Peter W. Brown
Partner

[5] Mr. Brown's CV is attached as **Exhibit 3**.