MATTHEW C. SLENTZ | (209) 495-2082 | MSLENTZ@CHWLAW.US

Our File No. 33067.0002

March 1, 2023

VIA ELECTRONIC MAIL

California Gambling Control Commission
2399 Gateway Oaks Drive, Ste. 200
Sacramento, CA 95833-4231
Email: Comments@cgcc.ca.gov

Re: **California Gaming Association's Response to Request for Alternative Annual Fee Methodologies**

To the California Gambling Control Commission:

We write on behalf of the California Gaming Association ("CGA") to respond to the Gambling Control Commission's ("Commission") December 28, 2022 letter soliciting alternative calculation methodologies for annual fees charged to California cardrooms and Third-Party Providers of Proposition Player Services. CGA's membership includes both licensed cardrooms and third-party companies subject to the annual fees assessed by the Commission. The letter also provided access to "mock data" for simulated cardrooms and third-party providers, and data for Commission and Bureau of Gambling Control ("Bureau") costs. However, none of the information provided by the Commission, either in this data or during its most recent rulemaking setting annual fees, allows CGA to determine an appropriate and constitutional allocation of costs between licensing fees and annual fees. CGA therefore cannot propose an alternative fee methodology. We instead note the proper analysis the Commission must use when setting fees in the future.

1. CGA cannot propose a lawful annual fee methodology with the available information.

First, a regulatory fee is only valid if "(1) the amount of the fee does not exceed the reasonable costs of providing the services for which it is charged, (2) the fee is not levied for unrelated revenue purposes, and (3) the amount of the fee bears a reasonable relationship to the burdens created by the feepayers' activities or operations."[1] Our Constitution requires both that the Commission's fees not overcollect its total costs, and that its fees be fairly apportioned among feepayers based on the costs to regulate those feepayers' activities. Although the Commission provides approximate data related to the total revenues of each cardroom and third-party company, it has never provided a complete breakdown of the allocation of costs between licensing and non-licensing activities. For example, the mock data provided by the Commission already allocates its costs to cost pools, without offering the underlying rationale. Thus, CGA cannot determine if those allocations are accurate or correct.

Similarly, the 2021 fee study prepared by MGT Consulting ("MGT Report") states it relied on extensive meetings with staff where every fee-related activity was identified and categorized.[2] But the records from these meetings and the data produced were absent from the rulemaking file for the Commission's new annual fees. Nor did the rulemaking file contain the consultant's various underlying calculations or reasoning. The MGT Report states "[a] variety of methodologies were explored and tested but ultimately distribution of this cost was based on annual gross revenues. This methodology presented the fairest option for distribution."[3] The MGT Report provides no further explanation. The reader is left to speculate on what other methodologies were considered, and why a gross revenue basis was determined best.

CGA has good reason to believe that the cost allocations in the MGT report and mock data are inaccurate. As the Commission is aware, a May 2019 Audit Report ordered by the California legislature found that the Bureau and Commission were consistently charging annual non-licensing fees that "far exceed" the agencies' actual costs to administer their oversight responsibilities, while simultaneously undercharging

---

[1] *California Building Industry Association v. State Water Resources Control Board* (2018) 4 Cal.5th 1032, 1046 ("*CBIA v. SWRCB*")
[2] MGT Report at p. 5
[3] MGT Report at p. 1

licensing fees. However, the MGT Report startingly found the agencies' non-licensing regulatory costs were twice as high as identified in the Audit Report.[4]

The MGT Report reveals significant methodological flaws. Overall, it appears that if a cost could not be directly attributed to an individual license application, then it was assigned to the annual fee, despite the cost being for licensing activity. For example, costs for managing the **Licensing Section** itself are assigned to the annual fee.[5] There is no explanation in the MGT Report for this methodology, which violates basic cost allocation principles. In other instances, the Commission has admitted to shifting 100% of costs shared between licensing and non-licensing activity to the annual fee, again with no cost justification.[6]

Further, nowhere in this year's Governor's Budget, nor in any budget change proposal affecting the Gambling Control Fund, is there any mention of the new annual fee, and the administration has provided no detailed calculations or explanation of how this change will impact the budgeted revenues or expenditures for the Bureau or the Commission. Without some reconciliation between the Fund Condition statements for the Fund, and the new annual fee, CGA cannot determine the appropriateness of the Commission's proposed costs.

2. Suggestions for Future Annual Fee Rulemaking

Although CGA cannot propose a detailed methodology for calculating annual fees given the lack of information, there are certain principles the Commission must follow in setting future fees. First, as noted, any fee must bear a reasonable relationship to the burdens created by cardrooms' and third-party providers' activities and operations, and not exceed the reasonable costs of providing those services.[7] Although CGA disagrees

---

[4] MGT Report at p. 19 [approximately $7 million to $14 million]

[5] MGT Report at p. 17

[6] For, example, during the Commission's November 29, 2022 meeting, Director Baxter confirmed costs which could arguably be assigned to both annual fees and direct fees were applied to the annual fee to subsidize individual applicants.

[7] *CBIA v. SWRCB, supra*, 4 Cal.5th at p. 1046

with its ultimate conclusions, the MGT Report correctly lays out the steps that should be taken in establishing a fee.[8] The Commission must:

1. Determine the Commission and Bureau's total costs;

2. Assign those costs to the various functions of the agencies;

3. Allocate or "classify" those functionalized costs to the appropriate fees; and

4. Allocate the costs to be recovered from the fee among feepayers in proportion to each payer's benefits from or burdens on the regulatory program.

When the Commission revisits the annual fee, it should endeavor to properly functionalize and allocate its costs, and, in line with the State Auditor's findings, refrain from allocating licensing activities to the annual fees. The Commission should also address the significant surplus in the Gambling Control Fund and must avoid creating additional surpluses in the future.[9]

In general, the gross revenues of cardrooms and third-party providers do not reflect the Commission and Bureau's costs to regulate those entities and should not be used to set fees, especially where more accurate metrics are readily available, such as the number of tables or employees. In no instance should the Commission continue to impose annual fees based on a flat percentage of cardroom and third-party provider revenue. Such fees have been found unrepresentative of costs and unlawful.[10] The revenues collected from flat percentage fees will rise or fall unrelated to the regulatory costs they may recoup, and they are applied the same to every business despite disparate impacts on costs. Thus, they are not reasonably related to the costs of regulation.[11]

---

[8] MGT Report at pp. 18–21

[9] *CBIA v. SWRCB*, *supra*, 4 Cal.5th at p. 1046 [fees cannot exceed regulatory costs]

[10] See *Howard Jarvis Taxpayers Ass'n v. City of Roseville* (2002) 97 Cal.App.4th 637, 648–649 ("*Roseville*") ["On its face, this fee does not represent costs. It is a flat fee."]; *Howard Jarvis Taxpayers Assn. v. City of Fresno* (2005) 127 Cal.App.4th 914, 918

[11] *Roseville, supra,* 97 Cal.App.4th at p. 648

We hope the Commission finds this information helpful as it sets future annual fees. Should the Commission make additional data available regarding its costs and allocations, CGA will evaluate that data to determine if it may propose an alternative annual fee calculation.

Sincerely,

Matthew Slentz

Matthew C. Slentz