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JOSEPH W. ROBB A PROFESSIONAL CORPORATION

PHILIP A. ROBB
ALAN J. TITUS
ANNE C. SLATER †
JOSEPH W. ROBB **
**(1926 - 2019)

591 REDWOOD HIGHWAY, SUITE 2250
MILL VALLEY, CALIFORNIA 94941
TELEPHONE: (415) 332-3831
FAX: (415) 383-2074

STERLING L. ROSS, JR. •
•RETIRED

†CERTIFIED SPECIALIST IN ESTATE
PLANNING, PROBATE AND
TRUST LAW, THE STATE BAR OF
CALIFORNIA BOARD OF
LEGAL SPECIALIZATION

March 1, 2023

Ms. Stacey Luna Baxter
California Gambling Control Commission
Comments@cgcc.ca.gov

Re: Alternative Annual Fee Calculation Methodology

Dear Ms. Luna Baxter:

I write on behalf of Artichoke Joe's in response to the Commission's invitation to provide an alternative proposal for calculation of the annual cardroom and Third Party Proposition Player ("TPPP") fees.

Our main objections to the recently adopted regulations are (1) to the collection of fees while the Gambling Control Fund has such a high balance of previously collected and unspent fees, and (2) to the use of gross revenue to calculate the fee. Collection of excess amounts and using gross revenue as the basis for the fee raises issue that the "fee" is really an illegal tax.

The Gambling Control Act ("GCA") allows the Commission and the Bureau to impose a few types of fees. Section 19867 allows the Bureau to impose investigation fees (called charges in section 19867 but fees in section 19868), and Section 19951 allows for two other fees, (1) license application fees, and (2) annual gambling license fees. Section 19951 sets two criteria which apply to the latter fees. The fees must be sufficient to enable the department and the commission to fully carry out their duties and responsibilities under the Gambling Control Act, but also must be limited to the reasonable regulatory expenditures of the department and the commission to administer the Gambling Control Act.

A legal principle developed under case law distinguishing fees from taxes imposes another requirement. The fees "allocated to a payor [must] bear a fair or reasonable relationship to the payor's burdens on or benefits from the regulatory activity." *Sinclair Paint Company v. State Board of Equalization* (1997) 15 Cal.4th 866, 878. It is not enough that the total fees collected by the regulators are no

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more than the cost of regulation if certain cardrooms bear an inordinate burden compared to other cardrooms.

We see two primary tasks in the process of setting fees. First, determine the amount of the costs to be recovered, and second, set fees to recover those costs. Each task involves multiple steps which we detail below.

I. DETERMINE THE AMOUNT OF COSTS TO BE RECOVERED

In order to start the process for the calculation of fees on a transparent foundation, it should start with a budget number that is public and verifiable. Steps 1 through 5 below detail the specific steps for this first task.

STEP 1: Separate GCA Costs from Non-GCA Costs

If the starting number includes costs to regulate any non-GCA matters, step 1 would be to strip out those costs. The Commission and the Bureau regulate gaming governed by the GCA, mainly cardrooms, and gaming not governed by the GCA, mainly Indian gaming. Other non-GCA matters would include raffles for non-profits under Penal C. §320.5, Major League Sporting Event Raffles under Penal C. §320.6, and charitable bingo under Penal C. §326.5. Because only costs generated by enforcement of the GCA can be recovered, the costs related to regulation outside the GCA must be separated out.

If the starting number includes only costs to regulate matters under the GCA, then Step 1 could be skipped, and the starting point would be Step 2.

STEP 2: Separate out GCA Costs not Attributable to Cardrooms

The GCA governs at least one type of gambling in addition to cardroom gambling, namely, non-profit organization fundraisers. Cardrooms should not bear these costs, and so the costs to regulate these activities must be stripped out of the costs to be recovered. This will leave costs attributable to cardrooms.

Again, if the starting number includes only costs to regulate cardrooms, this step could be skipped.

STEP 3: Credit Costs Recovered in Disciplinary Matters

When the Bureau brings disciplinary matters against a licensee, frequently costs are recovered. Amounts recovered as costs in disciplinary matters should be credited to the costs to be recovered in annual fees. Otherwise, the agencies are collecting twice for the same costs. Section 19950 of the GCA allows for a special account in the General Fund for fines and penalties, but does not include costs recovered.

STEP 4: Adjust the Costs at the End of the Year

A fee reconciliation should occur after the end of the year and adjustments made for any over-charges. Although case law allows for some leeway in setting fees and requires only that fees be set in a "reasonable" way, section 19951 is stricter. Section 19951 limits the fees to the "regulatory expenditures." Although the term "reasonable" is used in section 19951, it is used to modify the term "expenditures" not the term "fees." A fee that proves to be more than the expenditures will violate the statute.

Therefore, the regulations need to include a provision requiring adjustment of the fee at the end of the year. Such a provision was included in the first version of the regulations approved on an emergency basis by the OAL on August 1, 2022. Section 12368.1 provided:

"For future years each cost pool will need to account for any prior year adjustments through a carry forward. A carry forward as used in this section will account for and reconcile any over and under costs allocated in prior years for each cost pool."

This type of provision has been employed by other agencies in regulations which recoup all their costs in fees. See *Calif. Bldg. Industry Assn. v. State Water Resources Control Board* (2018), 4 Cal.5th 1032, 1045 [pertaining to Water Code §13260(f)(1)] and *California Farm Bureau Federation v. State Water Resources Control Board* (2011) 51 Cal.4th 421 [involving Water Code §1525.] Such a provision is needed here.

STEP 5: Adjust the Amount of Costs Based on Any Excess Surplus in the Gambling Control Fund

The Gambling Control Fund has held an excessive surplus for many years, due to the overcharging of fees and lack of any adjustment mechanism. Any excessive surplus should be used as a credit against future costs so that the Fund surplus is drawn down to a proper level before additional fees are collected.

II. SETTING SPECIFIC FEES TO RECOVER COSTS

The prior section determined the costs to be recovered. This section details the specific steps necessary to set specific fees to recover those costs.

STEP 6: Impose Fees for All Services Rendered to a Specific Cardroom to That Cardroom

As noted above, fees “allocated to a payor [must] bear a fair or reasonable relationship to the payor’s burdens on or benefits from the regulatory activity.” Where costs can be attributed to a specific cardroom, the fair result is to charge that specific cardroom with fees to recover the costs incurred on their behalf.

As discussed above, section 19951 requires imposition of application fees and annual fees, and section 19867 contemplates imposition of investigation fees. In addition, the Commission and the Bureau have both passed regulations imposing other fees in appropriate circumstances. Thus, there are fees for approval of third party contracts, for approval of playing books, for approval of additional tables, and for review and authorization of play of specific games.

We suggest that additional specific fees should be charged. Where a specific cardroom seeks any type of action by the Bureau or the Commission, that specific cardroom should bear the cost. Examples of such services include requests for approval of transactions such as a transfer of shares, transfer of assets, transfer of ownership, approvals to move a cardroom location, requests to remove a condition from a license, and review by the Bureau of city or county ordinances. In addition, when the Commission holds a GCA or an APA hearing on an application or license, the applicant or licensee should bear that cost. To make the industry as a whole bear a cost for a specific licensee is to create a tax. Where a specific service is rendered for a specific cardroom, that cardroom should pay the fee. The general

pool should only include costs that cannot be attributed to a specific cardroom and that benefit the whole.

We do not believe that the full cost of processing applications are covered by the current fees, and they should be. In 2021, Regulation 12090 lowered the application fee from \$1,000 to \$164, but \$164 is inadequate to cover processing of an application by the Bureau, processing of it by the Commission, and hearing the matter by the Commission. The fee should cover the full cost of processing the application. We note that section 19951 of the GCA still authorizes an application fee of as much as \$1,200. In 1997, when the GCA was first adopted, the application fee was set by statute at \$500. In 2007, the Legislature authorized the Commission to set the fee by regulation, but set a limit of \$1,200. Soon thereafter the Commission set the fee at \$1,000. The fact that the Legislature did not amend this limit in 2022 when the annual fee was changed leads to the implication that the Legislature had not changed its judgment on the appropriate fee. The fee of \$164 seems totally off-base.

Related to this point, we do not believe that Cost Pool 2 is proper in calculating annual fees. Cost Pool 2 is described as "a cost allocation for all non-application costs on a per-application basis." The description further states that these costs have a "direct connection to the processing of applications" but cannot be "directly linked to the fee or deposit associated with the review of an application." While this description is not entirely clear, these costs seem to be costs linked to the processing and handling of applications and should be part of the fee for applications.

The calculations under this step 6 will separate costs to be recovered through specific fees from costs to be recovered through annual fees.

STEP 7: Allocate Costs to Be Recovered Through Annual Fees Between the Cardrooms as a Group and Third Parties as a Group

Much of the Commission's efforts in Fee Modernization regulations focused on this step, the allocation of costs between the cardrooms and the third parties.

We generally agree with the cost pools, though as discussed above, we would eliminate cost pool 2. However, we lack sufficient information to confirm the actual costs and their allocation among the cost pools. Further, we note that the information available is all inconsistent. The State Auditor "estimated that the

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bureau and commission had combined regulatory costs of \$6.9 million in fiscal year 2017-18." (St. Auditor Rpt., p. 34.) The MGT consulting report stated that the nonlicensing regulatory costs for the 2019-20 year were \$14,186,313. The fee invoices received October 1, 2022 from the Bureau, and the invitation showed total non-licensing costs for the 2023 fees of \$19,175,000, consisting of \$15,513,000 for the Bureau and \$3,662,000 for the Commission. Finally, SB 72 has been introduced and it shows an allocation of \$17,955,000 for the Bureau of Gambling Control, less \$6,005,000 that goes to the Indian Gaming Special Distribution Fund (p. 73) and an allocation of \$4,777,000 for the Commission (p. 86), all of which total \$16,727,000 and presumably this includes both licensing and non-licensing and maybe other costs that would need to be segregated out.

STEP 8: Allocate costs to be recovered from each group among the various individual cardrooms and individual TPPPs

Fees for both these types of businesses should be based on the total number of gaming tables operated or serviced, not on gross revenue.

From 1998 through 2022, cardroom fees were based on the number of tables operated by each cardroom. No reason has been provided for changing the basis of the fee from tables to revenue, and none is apparent.

Gross revenue is not a proper basis for imposition of a fee because gross revenue has no proximate nexus to regulation. Two cardrooms with the same number of tables and same number of employees and even same amount of gaming could have very different revenue simply because one cardroom charges more than another cardroom for the same games. In that case, regulatory burdens would imposed by the two cardrooms would be the same but fees would be different because of what should be irrelevant differences in revenue. The fact is that gross revenue has no connection with regulatory burdens.

In contrast, regulatory burdens generally will correlate to the number of gaming tables. In fact, some regulations are based on the number of tables. For example, the minimum internal control regulations (Reg. 12380) base regulatory requirements on the number of tables operated at the club.

We are unaware of any government agency fees based on revenue and believe this regulation is unprecedented. Further, the courts have struck down a fee that was similar as being improper tax. In *Howard Jarvis Taxpayers Ass'n v.*

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City of Roseville (2002) 97 Cal.App.4th 637, 648–649, the court ruled that an in lieu fee imposed by a city on the budget of a city-operated utilities was illegal. The court wrote, “Roseville sets the in-lieu fee at a flat 4 percent of each of the three utilities’ annual budgets. On its face, this fee does not represent costs.” The court explained that the utilities’ budgets were untethered to the costs incurred by the city and could increase for a reason unrelated to the costs upon which the city could impose an in-lieu fee. The court concluded, “It cannot be said that this flat fee on budgets coincides with these costs.” Similarly here, the agencies’ costs are not linked to gaming revenue, and are not a proper basis for the fees.

A fee based on gross revenue looks just like an income tax. Not only is it imposed on revenue, but it also imposes a percentage charge instead of a flat fee. A fee based on number of tables would be neither.

For cardrooms, the total costs to be recovered from cardrooms through annual fees would simply be divided by the total number of tables licensed by cardrooms. For TPPPs, the total costs to be recovered from TPPPs through annual fees would be divided by the total number of tables serviced by TPPPs.

We appreciate the invitation to provide an alternate proposal for the calculation of annual fee. Please feel free to contact me to discuss this proposal.

Sincerely,


Alan Titus