

CALIFORNIA GAMBLING CONTROL COMMISSION
INITIAL STATEMENT OF REASONS
CGCC-GCA-2022-03-C

HEARING DATE: **None Scheduled**

SUBJECT MATTER OF PROPOSED REGULATIONS: Commission Fees Modernization Project III

SECTIONS AFFECTED: California Code of Regulations, Title 4, Division 18:
Sections 12112, 12318, 12360, 12368, 12368.2, 12470,
and 12472

SPECIFIC PURPOSE OF REGULATORY PROPOSAL:

INTRODUCTION:

The California Gambling Control Commission (Commission) is the state agency charged with the administration and implementation of the Gambling Control Act (Act).¹ The Commission is authorized to adopt regulations as necessary to implement the Act.

Senate Bill (SB) 189 (Chapter 48, Statutes of 2022) was signed into law on June 30, 2022. SB 189, in part, significantly modified Business and Professions Code (BPC) section 19951. BPC section 19951 is the section that provides the Commission the authority to charge an annual fee to cardrooms. Prior to the adoption of SB 189, the provision provided a specific fee structure that each cardroom was required to pay. This fee structure was based on the number of tables the cardroom was licensed to operate or the gross revenue of the cardroom, as specified.

With the adoption of SB 189, this fee structure has been repealed and replaced with authority for the Commission to adopt regulations to collect a fee that is limited to the reasonable regulatory expenditures of the Bureau of Gambling Control within the Department of Justice (Bureau) and the Commission. As the Commission is aware that the existing fee structure in regulation is not limited to the reasonable regulatory expenditures of the Bureau and Commission, maintaining these regulations is inconsistent with the requirements of BPC section 19951.

CHANGES MADE SINCE 1ST READOPTION:

This proposed action is the third phase of the Commission’s Fee Modernization regulation process.

Phase I consisted of emergency regulations [Office of Administrative Law (OAL) Matter Numbers 2021-0927-02E, 2022-0323-01EE, and 2022-0624-02EE] which provided adjustments to the Commission’s fixed application fees.

¹ Business and Professions Code, Division 8, Chapter 5, section 19800 et seq.

Phase II consisted of the certificate of compliance (OAL Matter Number 2022-0721-10) which made final the fixed fee adjustments from Phase I and provide new annual fee amounts for third-party providers of proposition player services (TPPPS).

Phase III, for which this is the certificate of compliance, includes new annual fee amounts for cardrooms.

During the review of the Phase II certificate of compliance, the Commission put forward and was approved for the initial emergency adoption for Phase III (OAL Matter Number 2022-0721-07E), which was submitted to and approved by OAL. At the conclusion of the Phase II certificate of compliance, OAL provided an approval in part. This resulted in those sections included in Phase I becoming final, but those sections related to the TPPPS annual fee were withdrawn by the Commission and a 15-day change noticed for public comment. In parallel with the changes to the TPPPS annual fee, the first readoption for the Phase III project was noticed and submitted to OAL (OAL Matter Number 2022-0922-01EE). The Phase III readoption included overlapping language with the 15-day public comment period for Phase II, and when both projects went to OAL for approval, OAL requested that the Phase II project be withdrawn and approved the Phase III readoption.

Those sections related to TPPPS, Sections 12002, 12252, and 12252.2, which were included in the first readoption for Phase III, have not been included in this certificate of compliance, but have instead been included in Phase II as an additional 15-day change.

PROBLEM ADDRESSED:

California State Auditor Report

As directed by the Joint Legislative Audit Committee, the California Bureau of State Audits (State Auditor) began conducting its audit of the Commission and the Bureau in 2018. The audit focused on each entity's regulatory duties that the Gambling Control Fund (GCF)² supports, which includes the licensing of individuals who own or work in cardrooms. The State Auditor's Report (Audit Report)³ released on May 16, 2019, found that to varying degrees, the fees charged have resulted in unequal treatment of license applicants, which do not align with the costs for providing regulatory oversight and related services. This has resulted in an excessive surplus in the GCF.

To better align the revenue in the GCF with the costs of the activities that the fund supports, the Audit Report recommended the Commission and the Bureau conduct cost analyses of those activities by July 2020, which include at a minimum, the following:

- The entities' personnel costs, operating costs, and any program overhead costs.
- Updated time estimates for their core and support activities.
- The cost of their enforcement activities.

² Gambling Control Fund (0567)

³ State Audit Report 2018-132

Further, the Audit Report recommended that in using such information, the Commission and the Bureau should reset their regulatory fees to reflect their actual costs.

Cost and Fee Study

Pursuant to the State Auditor's recommendation, in late 2019 the Commission and the Bureau contracted with MGT Consulting Group (MGT), a third-party consulting company, to complete a cost and fee study. The study's primary objective was to conduct a cost analysis to determine if the revenue collected and deposited into the GCF aligned with the costs of the activities that the fund supports. The study details the full cost of services provided by the Commission and the Bureau and presents full cost fee adjustments including their fiscal impact. MGT presented the fee study recently, which was submitted to the Department of Finance (DOF) and State Auditor. The DOF provided their approval of the fee study on September 16, 2021, and as such, precipitated these emergency regulations.

MGT used its standard approach for analyzing a majority of the costs of providing fee-related services, which is commonly referred to as a "bottom up" approach. With the exception of annual fees for cardroom and TPPPS businesses, all other regulatory fees were analyzed using the bottom-up approach. This bottom-up approach incorporated personnel costs, operating costs, and any program overhead costs, which allowed MGT to determine the individual per unit cost for these services. The study provides fee recommendations to align the revenue collected and deposited into the GCF with the costs of the activities provided by the Commission and the DOJ that the fund supports. The report is the culmination of an extensive analysis conducted by MGT in collaboration with both the Bureau and the Commission's management and staff.

PURPOSE:

This proposed action has been prepared to implement the annual fee calculation recommended by MGT in response to the Auditor's Report, as discussed above, in regards to cardrooms. Additionally, as the TPPPS annual fee has already been adopted, this proposed action amends the existing TPPPS annual fee to combine both annual fees to remove duplicative regulatory structures.

ANTICIPATED BENEFITS OF PROPOSED REGULATION:

This proposed action will have the benefit of requiring cardroom business licensees to pay total annual fees in an amount necessary for the Commission and Bureau to maintain proper funding levels while removing any inappropriate additional payments.

PROPOSED ACTION:

This proposed action will make changes within the California Code of Regulations, Title 4, Division 18 as follows:

CHAPTER 2. LICENSES AND WORK PERMITS

ARTICLE 2. INITIAL AND RENEWAL LICENSES AND WORK PERMITS

Amend 12112. Initial License Applications; Required Forms.

Section 12112 provides the forms and other information necessary for an application for an initial license to be considered complete. This section includes the attachment of many forms,

including the Application for Owner Category License, CGCC-CH2-05. As part of submitting this form, applicants for cardroom business licenses and TPPPS business licenses are required to submit their annual fees. Section 12368 has been amended to provide a separate timeline for submitting annual fees. As such, requiring them as part of this application form is inconsistent and needs to be removed.

CHAPTER 5. ACCOUNTING AND TRANSACTION APPROVALS

ARTICLE 1. ACCOUNTING AND FINANCIAL REPORTING

Adopt 12318. Cardroom Business License Gaming Revenue Report.

Subsection (c) of Section 12368 required the submittal of a completed Cardroom Business License: Annual Fee Calculation, CGCC-CH7-03, alongside the submittal of the current year's annual fee (which itself is due no later than 120 calendar days following the end of the cardroom business licensee's preceding fiscal year). This form includes information both to report the revenue for gambling activities, broken down by individual games and tournaments, and information for the determination of the cardroom business licensee's annual fee. With the change to the annual fee payment structure, the section related to the annual fee schedule is inconsistent, no longer necessary, and is therefore repealed. The remainder of the form and the current submittal timeline was moved to this new section. Due to the move to Chapter 5 and the removal of part of the form, it has been renamed Cardroom Business License: Gaming Revenue Report, CGCC-CH5-01.

CHAPTER 7. CONDITIONS OF OPERATION FOR GAMBLING ESTABLISHMENTS

ARTICLE 1. GENERAL PROVISIONS

Amend 12360. Definitions.

Section 12360 provides the definitions that pertain only to Chapter 7. The Commission is proposing to add six new definitions to this section. All existing definitions are renumbered accordingly, which is a non-substantive change.

Paragraph (b)(1) provides the definition of "Active Licensee" to mean a cardroom business licensee who has generated revenue for at least the last year as reported in Section 12313. This means that if a cardroom business licensee has reported revenue in the previous year's financial statement, they are considered active. This definition is necessary to allow other provisions to easily reference this category of licensee.

Paragraph (b)(2) provides the definition of "Annual Fee" to mean the amount a cardroom business licensee is required to pay to cover Non-Application Costs pursuant to Section 12368.2. This definition is necessary to allow other provisions to easily reference this concept.

Paragraph (b)(3) provides the definition of "Application Cost" to mean all costs, including the deposit, related to the processing of an application. This definition is necessary as it allows for the easy reference to a series of fees and deposits that may be required.

Paragraph (b)(10) provides the definition of "Non-Application Cost" to mean all costs other than application costs borne by the Commission, Department of Justice, and all other State operations

expenditures for the administration and enforcement of the Act. This definition is necessary as it allows for the easy reference of a multi-step mathematical calculation.

Paragraph (b)(11) provides the definition of “Non-Operational Licensee” to mean a cardroom business licensee that maintains a valid license but did not generate revenue in the past year as reported in Section 12313. This means that if a cardroom business licensee has not reported revenue in the previous year’s financial statement, they are considered non-operational. This definition is necessary to allow other provisions to easily reference this category of licensee.

Paragraph (b)(13) provides the definition of “Surrendered or Revoked Licensee” to mean a former cardroom business licensee who stopped operating and ceased to maintain a valid license prior to August 31 of the year the invoices are created. This definition is necessary to allow other provisions to easily reference this category of licensee.

Amend 12368. Cardroom Business License Annual Fee.

Section 12368 provides the process and timelines for a cardroom business licensee to submit their annual fee. The current provision mirrors the previous process and fee schedule provided in BPC 19951, which has since been repealed. As such, all of the existing Section 12368 is proposed be repealed and replaced as follows:

Subsection (a) provides that no later than October 1 of each year an invoice in an amount determined by the Commission pursuant to Section 12368.2 will be sent by the Bureau to each cardroom business licensee. This is necessary to provide clear guidance to the Bureau and cardroom business licensees on the timelines for invoicing and paying an annual fee.

Subsection (b) provides that the annual fee may be paid in installments if the cardroom business licensee submits a written request to the Bureau within 30 calendar days from the date the invoice was mailed. The deadline ensures that the Bureau has adequate time to review the request and the cardroom business licensee has enough time to submit its payment timely, either the first installment payment, or the full amount if the Bureau provides a notice of disapproval.

Subsection (c) provides that a request for installment payments is to be considered approved unless, within 14 calendar days of receiving the request, the Bureau determines and notifies the cardroom business licensee that it has been disapproved. If not disapproved, a cardroom business licensee will provide its payments January 1, April 1, and June 30 of the payment year. If disapproved, or if not requested, the cardroom business licensee will pay the entire amount by January 1. The standard for disapproval by the Commission is based on if the cardroom business licensee has shown a history of failing to make installment payments as required or failed to submit the request within the required 30 calendar days. This provides the cardroom business licensee with a clear understanding of when and how payment(s) are requested and allowed, and if paying through installments, equally separates the payment through the remaining State fiscal year.

Subsection (d) provides that the cardroom business license certificate will not be issued until the Bureau has received the cardroom annual fees, or has approved the cardroom business licensee

for installment payments. This provision is necessary to ensure that a business is not indefinitely able to operate while unpaid annual fees remain.

Subsection (e) provides that that any renewal application for a cardroom business licensee will not be approved if the cardroom business licensee has any outstanding annual fees. This provision is necessary to ensure that a business is not indefinitely able to operate while unpaid annual fees remain.

Subsection (f) provides that no application for a contract may be approved by the Bureau for a TPPPS to operate at this cardroom until any delinquent annual fees have been paid in full. This provision is necessary to ensure that a business is not indefinitely able to operate while unpaid annual fees remain.

Subsection (g) provides the invoice amounts for cardroom business licensees when they first receive their licenses. Since the definition of an active licensee requires the submittal of fiscal information, it is likely that a newly approved cardroom business licensee will not have operated for a sufficient time to have completed a full fiscal year in the timeframe required for the calculation of an annual fee. This subsection is necessary in order to include an operating cardroom business licensee in the payment of the necessary operation fees of the Commission and Bureau during this interim period.

Paragraph (1) provides that upon the first issuance of a cardroom business license, either as a temporary or an initial license, the Bureau will issue an invoice in the amount required of an active licensee with a gross revenue under \$1,500,000, as provided in Section 12368.2, divided by 12, multiplied by the number of whole months remaining in the current calendar year, the cardroom business licensee must submit to the Bureau the annual fee within 30 calendar days from the date the invoice was mailed.

Paragraph (2) provides that for the first full calendar year of licensure, a cardroom business licensee will be invoiced the unadjusted annual fee required of an active licensee with a gross revenue under \$1,500,000, as provided in Section 12368.2 for the following calendar year. As previously mentioned, while a newly issued cardroom business licensee may be active, the definition of active licensee might exclude the cardroom business licensee from having to pay annual fees due to there not being time for a full fiscal year, and this requirement ensures that they still share in the payment of all necessary costs required by the Commission and Bureau. For the invoice period, if the cardroom business licensee had their license issued prior to October 1, their invoice will be issued alongside all other cardroom business licensee invoices, on October 1. If the cardroom business licensee had their license issued after October 1, their invoice will be issued alongside their partial year invoice required in paragraph (1) of this subsection. This is necessary to provide clarity on how a cardroom business licensee will have their invoice issued for this interim time period.

Adopt 12368.2. Cardroom Business License Annual Fee Amounts.

Section 12368.2 provides the annual fee amounts required of cardroom business licensees. The fees required include:

- \$0 for surrendered or revoked licensees;
- \$5,237 for non-operational licensees;
- \$10,473 for active licensees with a three-year average gross revenue under \$1,500,000; or,
- 1.29% of the three-year average gross revenue for active licensees with a three-year average gross revenue of \$1,500,000 or more.

The Commission used a step-by-step calculation method that begins with the Commission's and Bureau's operation costs, which are not directly related to any charged fee or deposit to determine these values, following the MGT Cost and Fee Study. The process was as follows:

The Commission collected the cost data from the Commission and Bureau to determine which costs were not directly related to any charged fee or deposit. These costs were examined based on what type of function they were associated with and divided into one of six categories, or "cost pools":

- Cost Pool 1. Non-application costs that are not directly attributed to an application fee or deposit. This includes all costs associated with administration, information technology, and legislative and regulatory workload.
- Cost Pool 2. Non-application costs that have a direct connection to the processing of applications for the controlled gambling industry, and are not directly attributed to an application fee or deposit. This includes such costs associated with responding to general phone calls, and the processing of electronic and regular mail.
- Cost Pool 3. Non-application costs generated by non-Commission actions. This includes costs associated with compliance and enforcement, financial audits, calls for service, and incident reports born separately amongst TPPPS business licensees and cardroom business licensees.
- Cost Pool 4. Non-application costs generated by matters requiring Commission action. This includes such costs associated with administrative hearings and decisions, and Commission meetings.
- Cost Pool 5. Non-application costs that are specific to cardroom business licensees but not directly linked to a Commission approval, such as compliance reviews of games, reviews of reports, and local ordinance reviews.
- Cost Pool 6. Non-application costs that are specific to TPPPS business licensees but not directly linked to a Commission approval, such as, contract renewal notices and non-investigation industry inquiries or correspondence.

The cost pools were then each divided into two sections, those costs associated with TPPPS business licensees and those costs associated with cardroom business licensees. For purposes of determining the annual fee amounts for cardroom business licensees, those costs identified as associated with TPPPS business licensees no longer factor into the calculation, and so are not discussed further.

The cost pools were separated as follows:

- Cost Pool 1. The Commission determined the percentage of active and non-operational cardroom business licensees compared to the total of all active and non-operational TPPPS business licensees and cardroom business licensees. This percentage was applied to cost pool 1.
- Cost Pool 2. The Commission calculated the percentage of total applications for cardroom business licensees compared to the total of all applications for TPPPS business licensees and cardroom business licensees. This percentage was applied to cost pool 2.
- Cost Pool 3. The Commission determined the percentage of active and non-operational cardroom business licensees compared to the total of all active and non-operational TPPPS business licensees and cardroom business licensees. This percentage was applied to cost pool 3.
- Cost Pool 4. The Commission determined the percentage of total Commission actions for TPPPS business licensees and cardroom business licensees using the average number of applicable Commission actions over the previous three fiscal years. This percentage was applied to cost pool 4.
- Cost Pool 5. The entirety of this cost pool is associated with cardroom business licensees.
- Cost Pool 6. The entirety of this cost pool is associated with TPPPS business licensees.

The Commission then totaled the results of the separated costs pool amounts for cost pools 1 through 4 and added the amount of cost pool 5. The result of this is the total annual fee to be paid by all cardroom business licensees who are either active licensees or non-operational licensees. To determine the amounts owed by each individual cardroom, the Commission did the following:

- The Commission set the annual fee amount of surrendered or revoked licensees at \$0 as these persons are no longer licensees with the Commission.
- To determine the amount owned by each active licensee whose three-year average gross revenue is under \$1,500,000, the Commission divided the total annual fee by the three-year average number of Commission actions.
- To determine the amount owed by each non-operational licensee, the Commission took the amount owned by each active licensee whose three-year average gross revenue is under \$1,500,000 and divided it by half.
- To determine the percentage of three-year average gross revenue of \$1,500,000 or more, the Commission determined the remaining annual fee owed by subtracting the amounts determined for active licensee whose three-year average gross revenue is under \$1,500,000 and non-operational licensees from the total amount owed by all cardroom business licensees.

The remainder amount is divided by the total average gross revenue of all cardroom licensees with \$1,500,000 or more in revenue. The resulting percentage is what is provided in the regulation, and will be applied to each cardroom licensee's three-year average gross revenue to issue the invoice.

This distribution, as provided in the MGT Cost and Fee Study, provides that larger cardroom business licensees, who generally require more non-application administrative costs since they

operate more tables and have more employees/licenseses, pay a larger portion of the required total fee amount as their annual fee. By splitting up the remainder of the total fee amongst these licensees and utilizing their three-year average gross revenue, each cardroom business licensee is required to pay a proportional percentage of the total fee while still ensuring that the Commission and Bureau receive all fees necessary to cover the costs of these necessary services.

ARTICLE 10. GAMING TABLES

Amend 12470. Request for Additional Temporary Tables for Tournaments or Special Events.

Section 12470 provides the process by which a cardroom business licensee can request additional tables for use on a temporary basis. Currently, this process includes two fees, a fixed application fee to cover the costs of processing the application and an adjustment to the cardroom business licensee's annual fee to reflect the additional tables. Now that the annual fee payment is no longer linked to the number of tables operated by the cardroom business licensee, this additional fee is inconsistent, unnecessary, and is therefore repealed.

Paragraph (3) of subsection (a) provides that the fee is required to be submitted with the application. Additionally, the form Cardroom Business License: Gaming Tables, CGCC-CH7-07, attached to the Appendix in this section, provides the same requirement. It is repealed from both the section and the form.

Subsection (f) provides the calculation for this fee. As this fee is no longer being collected, its calculation is unnecessary and therefore repealed.

Amend 12472. Request for Additional Permanent Tables.

Section 12472 provides the process by which a cardroom business licensee can request additional permanent tables. Currently, this process includes an adjustment to the cardroom business licensee's annual fees; however, as those fees are no longer being based on the total number of tables operated by the cardroom business license, this additional fee is being repealed.

Subsection (d) provides the timeline for the Bureau and Commission to review and consider the application for additional permanent tables. This includes a notification and submittal of additional annual fees. As previously stated, the calculation of annual fees is no longer being determined based on the number of tables being operated and so the increase is inconsistent and therefore is repealed.

REQUIRED DETERMINATIONS:

LOCAL MANDATE:

A mandate is not imposed on local agencies or school districts.

UNDERLYING DATA:

Technical, theoretical, or empirical studies or reports relied upon: None.

BUSINESS IMPACT:

The Commission has made a determination that the proposed regulatory action will not have a significant statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. This determination is based on the following facts or evidence/documents/testimony:

This proposed action imposes no new mandatory requirements on businesses.

The Commission is anticipating an additional statewide cost of \$4,726,704 in cardroom annual fees. This cost would directly impact cardroom businesses licensees. This is reflected in an average increase of \$764,801 in annual fees for a typical business and \$48,652 for a small business. The calculation method has been weighted to ensure that those businesses whose three-year average gross revenue is under \$1,500,000 per year pay a lower proportion of the total fees necessary in order to ensure that no cardroom business licensee is significantly impacted.

SPECIFIC TECHNOLOGIES OR EQUIPMENT:

The proposed action does not mandate the use of specific technologies or equipment.

ECONOMIC IMPACT ASSESSMENT/ANALYSIS:

IMPACT ON JOBS/NEW BUSINESSES:

The Commission has determined that this regulatory proposal will not have a significant impact on the creation of new jobs or businesses, the elimination of jobs or existing businesses, or the expansion of businesses in California. For this purpose, the definition of a small business as defined by the federal Small Business Administration was utilized.

The basis for this determination is that this proposed action only adjusts cardroom business licensee's annual fees to reflect actual costs incurred by the Commission and Bureau, which is unlikely to result in additional or reduced industry participation or performance.

HEALTH AND WELFARE OF CALIFORNIA RESIDENTS:

It has been determined that the proposed action will protect the health, safety, and general welfare of California residents by aiding and preserving the integrity of controlled gambling.

WORKER SAFETY:

It has been determined that the proposed action will not affect worker safety because it does not pertain to working conditions or worker safety issues.

STATE'S ENVIRONMENT:

It has been determined that the proposed action will not affect the State's environment because it does not pertain to environmental issues.

CONSIDERATION OF ALTERNATIVES:

No reasonable alternative to the regulations would be more effective in carrying out the purpose for which the action is proposed. No reasonable alternative would be as effective as and less burdensome to affected private persons than the proposed action, nor would be more cost-

effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

Set forth below are the alternatives that were considered and the reasons each alternative was rejected: No reasonable alternative has been developed or otherwise identified and brought to the attention of the Commission.