

# COMMISSION FEES MODERNIZATION PROJECT III

CGCC-GCA-2022-03-C

## COMMENTS AND RESPONSES FOR PROPOSED REGULATIONS

### I. 5-DAY WRITTEN COMMENTS

The Commission received the following written comments/objections/recommendations regarding the text of the proposed action during the 5-day written comment period that commenced December 16, 2022, and ended December 21, 2022. This 5-day comment period for the second re-adoption of the emergency regulation associated with this compliance file occurred during the 45-day written comment period for the compliance file; as such, the Commission has elected to consider these comments as submitted during the 45-day written comment period that commenced on December 2, 2022, and ended on January 17, 2023.

#### A. COMMENTS MADE ON THE FINDING OF EMERGENCY.

These comments are made on the finding of emergency and are not directed at any specific regulatory section.

1. **Alan Titus, on behalf of Artichoke Joe's**: Mr. Titus expressed concern that because the Gambling Control Fund has a surplus that could cover any and all immediate expenditures of the California Gambling Control Commission (Commission) or Bureau of Gambling Control (Bureau), within the Department of Justice (DOJ), there is no emergency. Mr. Titus provided specific references to the 2022-23 Governor's Budget, including the beginning balance of the fund, monies borrowed by the Legislature in support of the General Fund, and approved expenditures.

**Recommended Response:** This comment was considered but was not incorporated. The commenter alleges that there is no emergency warranting the adoption of these regulations. However, with the adoption of Senate Bill (SB) 189 (Committee on Budget and Fiscal Review, Chapter 48, Statutes of 2022), the Commission now lacks the authority to maintain its existing annual fee methodology. As such, to maintain the collection of fees sufficient to cover the reasonable annual regulatory costs of the Commission and the DOJ, and to prevent any risk of becoming fiscally insolvent, the Commission, in Office of Administrative Law (OAL) matter number 2022-0721-07E, submitted emergency regulations, which were adopted by the OAL.

While the comment notes that there is a surplus amount currently within the Gambling Control Fund, including amounts that have not been reimbursed by the General Fund, these funds cannot currently be considered in addressing the Commission's and DOJ's current or future needs. The industry has filed a class action lawsuit (*Lucky Chances, Inc. et. al. v. California Gambling Control Commission and Bureau of Gambling Control*, Sacramento Superior Court Case No. 34-2020-80003510-CU-WM-GDS) on behalf of all cardrooms and third-party providers of proposition player services (TPPPS business

licensees) who have ever paid licensing or annual fees, including entities and natural persons that are no longer operating or employed. The class action lawsuit seeks restitution and disgorgement to the plaintiffs of any fees that are determined by the court to have been overpaid to the Commission or Bureau. Using the same funds at issue in the lawsuit in the manner suggested in the comment, would essentially offset annual fees for only operating cardrooms. This is not appropriate given the pending litigation, which includes a much broader class than operating cardrooms.

Finally, the Commission notes clarification regarding the commenter's indication that the General Fund borrowed \$85 million from the Gambling Control Fund. The General Fund loan amount was initially identified as \$85 million; however, within the same Budget Act and fiscal year, 2020-21, \$40 million was repaid, thus resulting in a total loan of \$45 million.

## **B. COMMENTS MADE ON THE PROPOSAL IN GENERAL.**

These comments are made on the proposal, in general, and are not directed at any specific regulatory section.

- 1. Becky Warren, on behalf of the California Gaming Association:** Ms. Warren expressed concern that the proposed regulations will result in non-licensing regulatory fee revenue being used to subsidize licensing expenditures. Ms. Warren notes that non-licensing fees are nonrefundable application fees for all license types and refundable background deposits that are intended to cover the actual costs incurred in the investigation and processing of an application. Ms. Warren additionally notes that historically, cardroom annual fees have been calculated based on the gross revenue and number of gaming tables a cardroom is authorized to operate and that TPPPS business licensee's annual fees have been based on their number of employees. Finally, Ms. Warren notes that the California Bureau of State Audits (State Auditor) audit report 2018-0132 (State Auditor's report) found that licensing fees were undercharged and non-licensing fees were over-charged, and therefore non-licensing fees were improperly subsidizing the activities of the Commission and Bureau. Ms. Warren expressed concern that in adopting the proposed regulations, the Commission has only re-categorized tasks historically treated by the Commission and Bureau as licensing related to non-licensing related.

**Recommended Response:** This comment was considered but was not incorporated. The Commission and Bureau collect three different types of fees related to the controlled gambling industry, each of which has a purpose that does not overlap with the others:

1. Fixed Application Fees
2. Application Deposits
3. Annual Fees

Fixed Application Fees represent those costs that occur with every application, and include such tasks as data entry of the application and other tasks necessary to process the application. These costs also include specific work performed by the Commission's staff

for each application once received from the Bureau. These costs are provided for in Title 4, California Code of Regulations (CCR), Section 12090. This proposed action does not amend any of the Fixed Application Fees.

Application Deposits are made for costs incurred by the Bureau while conducting background investigations and other tasks specifically linked to the specific nature of an application for licensure. While referenced in the Commission's regulations, these background deposits are controlled by the Bureau and can be found in Title 11, CCR, Section 2037, with a few provided by the Commission in Title 4, CCR, Section 12090. This proposed action does not amend any of these Application Deposits.

Annual Fees represent a sum of money paid annually by cardroom business licensees and TPPPS business licensees. These funds are designed to cover the additional costs that are not otherwise covered by a Fixed Application Fee or Application Deposit incurred by the Commission and DOJ in their oversight of the controlled gambling industry. This proposed action seeks to amend the annual fees for cardroom business licensees but does not include an amendment to the annual fees for TPPPS business licensees.

As part of the State Auditor report, released May 16, 2019, the State Auditor identified that the Bureau was misidentifying work functions and how they relate to the three types of fees collected, and therefore, as part of the MGT Consulting Group (MGT) study, the specific tasks of the Commission and Bureau were examined and allocated to the correct fee type. As such, the Commission significantly adjusted (mostly by reducing) the Fixed Application Fees (OAL Matter Number 2022-0721-10C, effective September 1, 2022).

With the Fixed Application Fees properly adjusted to reflect the work necessary, and the ability of the Bureau to adjust their collection of Application Deposits already present in Title 11, CCR, Section 2037, the remaining work functions conducted by the Commission and Bureau are attributable to the Annual Fees. Costs were divided into six cost pools, as described in the associated Initial Statement of Reasons, starting on page 6.

As shown, while the Commission and Bureau have "shifted costs," as described in the comment, it has only been done to correctly attribute work functions between each of the three fee types and therefore will not be subsidizing one fee type with another. The Commission acknowledges that in order for this to remain true, the Commission and Bureau will need to conduct periodic reassessments of their work functions, costs, and fees collected in order to ensure that the fees collected remain accurate for the work functions performed.

**C. ADOPT SECTION 12368.2. CARDROOM BUSINESS LICENSE ANNUAL FEE AMOUNTS.**

This section provides the annual fee amounts required of cardroom business licensees. To determine the amounts provided in this section, the Commission utilized a calculation method that involved dividing identified costs into six cost pools, prorating the cost pools between cardroom business licensees and TPPPS business licensees, and then dividing the cardroom business licensees' total annual fee amongst each cardroom business licensee based upon the cardroom business licensee's status as either non-operational, operational

with a three-year average gross revenue under \$1.5 million, or operational with a three-year average gross revenue equal to or above \$1.5 million. This process is described in additional detail in the associated Initial Statement of Reasons, starting on page 6.

**1. Becky Warren, on behalf of the California Gaming Association:** Ms. Warren expressed concern that the proposed fee structure represents a tax that would be subject to legislative approval. Ms. Warren noted that in *American Coatings Assn. Inc. v. State Air Resources Board* (2021) 62 Cal.App.5th 1111 (*American Coatings*), it was found that to determine if a fee is a tax (and therefore requires legislative approval) there are the following standards to consider:

1. Whether the approved fee would exceed the reasonable, estimated costs of administering the permit 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.

Ms. Warren additionally noted that, according to the State Auditor, non-licensing costs should be \$6.9 million and noted that the Commission has determined that the annual fee should be over \$19 million. Ms. Warren stated that because the Commission's method for determining the annual fee includes both licensing and non-licensing regulatory costs, the annual fee grossly exceeds the actual costs represented by the non-licensing costs. Ms. Warren suggested that the Commission reduce the annual fee amounts to the \$6.9 million determined by the State Auditor.

**Recommended Response:** This comment was considered but was not incorporated. The fees proposed in this rulemaking action do not constitute a tax. Specifically, the Commission's proposed methodology is consistent with the requirements provided for in *American Coatings*:

1. The first factor from *American Coatings* is whether the approved fees would exceed the reasonable, estimated costs of administration. The commenter erroneously assumes that the Commission and Bureau's actual regulatory costs are based on a figure used by the State Auditor using prior year's data from fiscal years 2014-15 through 2017-18, rather than utilizing updated fiscal year 2022-23 data and operational practices and methodologies determined by MGT and reviewed by the Department of Finance (DOF) and the State Auditor after a thorough and comprehensive cost and fee analysis. Notably, the State Auditor directed the Commission to undergo the cost and fee analysis, indicating that the State Auditor's review was not a final determination or complete analysis of the Commission and Bureau's regulatory costs. The results of the MGT report provided the Commission the methodology for the determination of application and annual fees, but the Commission conducted an analysis using updated fiscal information.
2. The second factor from *American Coatings* is whether the fee is used to generate excess revenue, which the methodology used to determine the fee is designed

- specifically to avoid. If the Commission’s fees were to exceed the costs of providing necessary services, the Commission would be in violation of Business and Professions Code section 19951, subdivision (e). It is because of this requirement that the Commission has explicitly linked the determination of the annual fee amounts to be paid based on the historical annual fee workload hours performed, and associated costs incurred, by the Commission and DOJ for each part of the industry – cardroom business licensees and TPPPS business licensees.
3. The third factor from *American Coatings* is whether “any class of fee payers is shouldering too large a portion of the associated regulatory costs.” The MGT report considered the proper allocation of associated regulatory costs in both fixed application fees and in the annual fees for TPPPS and cardrooms. In their analysis, MGT determined that some fees must be increased and some must be decreased to accomplish the goal of aligning the fees collected with the costs incurred. Additionally, in compliance with Business and Professions Code section 19840, the annual fee calculations determined by MGT reflected the requirement that the Commission “take into consideration the operational differences of large and small establishments.” Thus, the fact that larger gambling establishments with higher revenue have a higher allocation of annual fees is consistent with the statutory direction. Finally, as mentioned above, the annual fee methodology considers the associated costs of the actual workload performed by the Commission and DOJ for each respective part of the industry.

In addition, the court in *American Coatings* held that the “question of proportionality is not measured on an individual basis. Rather, it is measured collectively, considering all rate payors.”

The court stated that “a fee is valid if there is a reasonable basis in the record for the allocation.” Further, “the record need only demonstrate a reasonable relationship, not an exact relationship.” Despite having concerns about the process used to set the fees, the court in *American Coatings* held that “the resulting fees are reasonably related to the burdens imposed by the affected manufacturers and are not illegal taxes.” As explained in this response, and in the Initial Statement of Reasons, the fees proposed to be assessed by the Commission are reasonably related to the “burdens” imposed by cardrooms, especially when taking into account their different sizes as required by Business and Professions Code section 19840.

2. **Alan Titus, on behalf of Artichoke Joe’s**: Mr. Titus expressed a concern that the proposed regulations are inconsistent with Business and Professions Code section 19951, subdivision (e), which provides:

(e) The amount of fees collected pursuant to this section shall be limited to the reasonable regulatory expenditures of the department and the commission to administer this chapter.

Mr. Titus noted that, inconsistent with this requirement, the proposed regulations involve the following:

1. The annual fees established by the proposed action do not provide for use of the existing surplus in the Gambling Control Fund and are designed to recover agency expenses in full.
2. The regulations are not “reasonable,” pursuant Section 19951, if they do not include credit for the previous year’s overpayments.
3. A percentage fee based on gross revenue is a tax, not a fee because there is an insufficient nexus to the services provided.

Mr. Titus additionally noted that in *California Building Industry Assn. v. State Water Resources Control Board* (2018) 4 Cal.5<sup>th</sup> 1032, 1046, the court found that a fee is different from a tax in that the fee “bears a reasonable relationship to the burdens created by the fee payers’ activities or operations.” Mr. Titus stated that where a fee consists of a percentage of gross revenue, the nexus between the fee and the services provided is too weak, and the fee is really a hidden tax.

Mr. Titus observed that the proposed regulations originally adopted by the Commission during the initial emergency file, OAL Matter Number 2022-0927-02E, included reconciliation language allowing for crediting to be applied to future annual fees if fees charged proved too high, but that this language was deleted in later versions of the emergency file. Mr. Titus commented that this type of reconciliation protects against overcharges of fees, because when fees are charged at the beginning of a fiscal period they are based on estimated costs and reconciliation allows for a precise charge based on actual costs. Mr. Titus commented that by removing the reconciliation language and the language outlining the methodology for determining the annual fee originally adopted in the initial emergency file, the new fixed fee is no longer reasonable as required by Business and Professions Code section 19951, subdivision (e).

Mr. Titus expressed concern that SB 189 did not authorize a change in the calculation method of annual fees (previously determined in tiers and based on either gross revenue or the number of tables). Mr. Titus noted that, in contrast to a fee based on revenue, a fee based on the number of tables bears a much stronger nexus to the burdens created by the fee payer’s activities and is more consistent with other Commission regulations, such as the minimum internal control regulations. Finally, Mr. Titus noted that in his review of four legal cases that involved fees, only one of them included fees based on gross revenue; however, Mr. Titus notes in that case (Limited Liability Company fees), rates are tiered with flat fees rather than percentages.

**Recommended Response:** This comment was considered but was not incorporated. The commenter notes a concern that the proposed action is inconsistent with the requirements of Business and Professions Code section 19951, subdivision (e), for the three reasons stated above; however, the Commission maintains that the proposal is consistent with the requirements of Business and Professions Code section 19951, subdivision (e).

For a detailed discussion on why the Commission did not consider the use of the existing fund balance when determining the new annual fee calculations, see the response to

comment I.A.1. Additionally, while it is true that the proposed regulations originally adopted by the Commission during the initial emergency file included reconciliation language for previous years, this language was not intended to provide an offset for an existing fund balance but was intended for adjustments to this new annual fee determination method. The originally adopted language, while approved as an emergency filing, was later determined by the OAL to lack the specificity necessary for a fee to exist in regulations. Therefore, at OAL's direction, instead of adopting a fee determination methodology, the Commission performed the fee determination and adopted the 2023 fee amounts into regulation. As was previously stated in the Finding of Emergency for the first readoption of this filing, OAL Matter Number 2022-0922-01EE, the amounts billed for the 2023 annual fee did not change. With this shift in regulation philosophy (changing from adopting the methodology to adopting the actual annual fee amount), the Commission moved the methodology to the Finding of Emergency. However, since this was the first year of the new methodology, there was no offset and so the offset language was not likewise moved to the Finding of Emergency. This does not mean that the Commission does not intend for there to be future offsets as the Commission continues to monitor and adjust the annual fee rates in future years; the Commission intends for an offset to be considered, if necessary, as part of future annual fee adjustments.

Additionally, as outlined in the methodology explanation provided in the Initial Statement of Reasons, the Commission explicitly linked the determination of the annual fee amounts to those costs borne by the Commission and DOJ, related to TPPPS and cardroom expenditures, and not otherwise directly related to another charged fee or deposit. While reflected as a percentage of gross revenue, the fee amount is determined by the Commission's and DOJ's actual relevant workload and associated costs and not an arbitrary percentage of gross revenue. See response to comment I.C.1 for a more detailed explanation on the link between the Commission's and Bureau's costs and the determination of the cardroom annual fees.

Therefore, as shown, though the final regulation does not include the inherent and automatic adjustment to reflect changes to the Commission's and DOJ's costs, the proposed amounts for 2023 are reflective of the Commission's and DOJ's actual current costs. Additionally, it is the intent, and legal requirement, for the Commission to continue to monitor and adjust (including offsets) for future years.

**3. Becky Warren, on behalf of the California Gaming Association:** Ms. Warren expressed concern that the division of the cost pools between cardroom business licensees and TPPPS business licensees is arbitrary and not based on the differences associated with regulating the licensees. Ms. Warren expresses specific concerns regarding two of the cost pools:

- Ms. Warren expressed concern that Cost Pool 3 has been divided between cardroom business licensees and TPPPS business licensees by utilizing the percentage of active and non-operational licensees represented by each industry. Ms. Warren contends that there is no rationale for using the number of licensees

to allocate the largest cost pool, particularly given that Cost Pool 3 is for non-licensing related costs.

- Ms. Warren expressed concern that Cost Pool 4 relates to application determinations and therefore is not “non-application costs” as described in the Initial Statement of Reasons. Additionally, Ms. Warren noted that the allocation of this section is based only on the number of items that appear on a Commission meeting agenda without regard to the relative time requirements of each of those items.

**Recommended Response:** This comment was considered but was not incorporated. The purpose of the use of cost pools is to allow different types of costs to be distributed differently considering the actual work performed when calculating the cardroom annual fees and TPPPS annual fees. The comments specifically mention Cost Pool 3 and Cost Pool 4. As provided in the Commission’s finding of emergency for the proposed action, these cost pools represent the following expenditures:

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 borne 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 3 represents work performed by the Bureau outside of the licensing process. These are compliance and enforcement-related tasks that are performed on or available to all licensees, both cardrooms and TPPPS. Examining the specific tasks that make up the costs, it is reasonable that the distribution of costs for Cost Pool 3 activities is weighted towards cardrooms because cardrooms comprise the majority of licensees, and the role of a TPPPS is intrinsically linked to and dependent upon the actions of a cardroom. For example, if a Bureau representative were to perform a compliance or enforcement review on a TPPPS, while doing so they would also perform similar tasks on a cardroom where the TPPPS is physically providing services.

Cost Pool 4 represents work performed by the Commission outside of tasks directly associated with application costs, such as the preparation and conducting of licensing meetings and evidentiary hearings. Holding these meetings involves broader efforts not necessarily linked to a specific application, so the distribution of these costs based on the proportionate share of the costs associated with preparing for and conducting public meetings related to cardrooms and TPPPS entities is reasonable.

4. **Alan Titus, on behalf of Artichoke Joe’s**: Mr. Titus expressed a concern that there is insufficient evidence in the rulemaking file to determine that the fees comply with the limitation in Business and Professions Code section 19951. Mr. Titus opined that the Commission has not presented sufficient information regarding the regulatory expenditures of the two agencies to ensure that the fees are not excessive, and noted that



there are wide differences between the calculations of non-licensing regulatory fees between the State Auditor's report, the MGT report, and recent fee invoices.

Mr. Titus questioned how MGT came to the conclusion that "[t]he methodologies used to assess the annual fee for the cardroom and third party companies...did not account for true and complete costs" and questioned if MGT was reallocating expenditures previously attributed to tribal matters or non-Gambling Control Act matters, to Gambling Control Act matters. Mr. Titus inquired if the Commission or Bureau were receiving budget allocations from the General Fund in order to make up the differences in expenditures (\$6.9 million pursuant to the State Auditor versus \$14.1 million identified in the MGT report). Mr. Titus expressed concern that the MGT report fails to discuss the buildup of the surplus and so it is unclear if the MGT recommendations will result in a further buildup of surplus in the Gambling Control Fund.

Mr. Titus expressed further concern that the information provided with the annual fee invoices fails to provide sufficient detail to determine how the amounts were calculated or to verify that the expenditures are eligible under Business and Professions Code section 19951, subdivision (e). Mr. Titus suggested that the allocation needs to start with the whole budget and then show not only what is being allocated to costs of administrating the Gambling Control Act, but also what is being allocated to these other duties. Mr. Titus suggested that the following steps be taken in verifying the propriety of the fees:

1. Start with publically available budget material. Provide explanation of how many people are covered and whether they work solely on matters under the Gambling Control Act or perform other functions, such as administration of tribal gaming compacts.
2. Where an employee works on both matters under the Gambling Control Act (GCA) and matters not under the GCA, such as tribal gaming, allocate the employee's salary among GCA and non-GCA matters. Non-GCA also includes expenditures for the Major League Sports Raffle Program under Penal Code section 320.6. This should provide total of expenditures under the GCA.
3. Strip out costs under the GCA not attributable to cardrooms or TPPPS, such as expenditures on Nonprofit Organization Gambling Fundraiser Registration Program under Business and Professions Code sections 19985-19987 and registration of manufactures and distributors.
4. Credit amounts recovered as costs in disciplinary matters. This should provide a total of expenditures chargeable to the cardrooms and the TPPPS.
5. Allocate the remaining costs between the cardrooms and TPPPS. The six cost pools in the original emergency regulation and now in the Finding of Emergency pertain to this step.

**Recommended Response:** This comment was considered but was not incorporated. The commenter raises a number of concerns about how the Commission determined and detailed the specific breakdown of the calculation process in determining the annual fees.

Specifically, most of what the commenter suggests was explicitly or implicitly done as part of the Commission's process, even if such was not explicitly detailed. As provided in the 2022-23 Gambling Control Fund condition statement, the allocation from the Gambling Control Fund to the Commission and Bureau was \$23,219,000 (\$4,610,000 for the Commission and \$18,609,000 for the Bureau). This amount reflects a level of work in excess of just those costs associated with the annual fee, and as such is a higher number. The Gambling Control Fund only identifies expenditure authority for workload and associated costs related to the cardrooms and TPPPS, as previously justified and approved by the Legislature.

Likewise, when the Commission and Bureau track their work time, they allocate their tasks to specific functions, which are then in turn attributed to specific funds. The document the Commission provided as an attachment to the invoice, as identified in the comment, reflects an aggregation of those amounts, as providing a specific list of work tasks and time spent per task for every employee and for every day of the calendar year would be excessive and burdensome. However, in determining those aggregations, issues such as funding source (as suggested in steps 2 and 3 of the commenter's suggestion), were taken into account.

The commenter suggested that the annual fee should be offset by costs received in relation to disciplinary matters. While Cost Pool 3 includes non-application costs generated by non-Commission actions, such as costs associated with compliance and enforcement, the Commission lacks the authority to allocate or utilize the funds placed in the special account in the General Fund, also known as the Gambling Control Fund Fines and Penalties Account, established by Business and Professions Code section 19950, subdivision (a), which specifies that fines and penalties collected pursuant to the GCA may be expended by the Department of Justice upon appropriation. Therefore, without legislative action, the Commission cannot include such an offset within the Annual Fee methodology. Additionally, the source of funds for the Gambling Control Fund Fines and Penalties Account can arise from fines and penalties associated with sources other than cardroom business licensees and TPPPS business licensees, and so the appropriateness of such an offset to annual fees is unclear. However, it should be noted, that when the DOJ receives an appropriation to utilize funds from the Gambling Control Fund Fines and Penalties Account, that money offsets costs that would likely otherwise have been included in the annual fees for cardroom business licensees and TPPPS business licensees. For example, the Bureau received expenditure authority in fiscal year 2022-23 to utilize funds from the Gambling Control Fund Fines and Penalties Account to support costs associated with replacing the Licensing Information System, the database system used by the Commission and Bureau. Therefore, costs that could have reasonably been borne by the cardroom business licensees and TPPPS business licensees, via the annual fee, were instead supported by the Gambling Control Fund Fines and Penalties Account and not included in the calculations to determine the annual fees.

Therefore, while not directly referenced and incorporated in the invoice attachments, which were provided as a courtesy in excess of the regulatory requirement provided for in

this proposed action, the steps proposed by the commenter were, in fact, incorporated in the Commission's annual fee determinations.

Please see the response to comment I.C.1 for a more detailed response related to the differences between the determinations of the State Auditor and the MGT report; specifically that the State Auditor directed the Commission to undergo the cost and fee analysis, indicating that the State Auditor's review was not a final determination or complete analysis of the Commission and Bureau's regulatory costs.

5. **Alan Titus, on behalf of Artichoke Joe's**: Mr. Titus expressed a concern that the fees provided in this regulation, even if not excessive based on current expenditures, are based on a three-year average gross revenue that includes years in which revenues were impacted by COVID. Mr. Titus noted that these years included the shutdown of all cardrooms and that as gross revenues increase, the annual fees collected will likewise increase, and this will result in an overfunding of the Gambling Control Fund in violation of Business and Professions Code section 19951, subdivision (e).

**Recommended Response:** This comment was considered but was not incorporated. Please see the response to comment I.C.2, which discusses in more detail the Commission's intent to continue to monitor and adjust the annual fee amounts. This adjustment will account for future changes in the costs to the Commission and DOJ, changes in the gross revenue of both cardroom business licensees and TPPPS business licensees, and any shifts in the Commission's and Bureau's work that might alter the various methods of proration determined within the calculation methods. Additionally, the Commission intends to provide adjustments for any over- or under-charged annual fees that applied to the previous year's billing. The specifics of that adjustment, and discussion of their impacts, will be part of future anticipated rulemaking actions.

## **II. 45-DAY WRITTEN COMMENTS**

The Commission received the following written comments/objections/recommendations regarding the text of the proposed action during the 45-day written comment period that commenced December 2, 2022, and ended on January 17, 2023.

### **A. COMMENTS MADE ON THE FINDING OF EMERGENCY.**

These comments are made on the finding of emergency and are not directed at any specific regulatory section.

1. **Michael G. Colantuono, on behalf of the California Gaming Association**: Mr. Colantuono expressed concern that no emergency justifies the emergency regulation procedures. Specifically, Mr. Colantuono contends that the proposed action does not meet the criteria of an emergency regulation for the reason that the Commission's representation of fiscal insolvency without emergency regulation is untrue because the Gambling Control Fund had sufficient reserves to operate during the time it would have taken to adopt this proposed action on a non-emergency basis.

**Recommended Response:** This comment was considered but was not incorporated. See response to comment I.A.1 for a discussion on why the Commission is not able to access or consider the existing fund balance within the Gambling Control Fund when determining the expediency with which a new annual fee determination and billing structure is required.

**B. COMMENTS MADE ON THE PROPOSAL IN GENERAL.**

These comments are made on the proposal, in general, and are not directed at any specific regulatory section.

**1. Michael G. Colantuono, on behalf of the California Gaming Association:** Mr. Colantuono expressed concern that while the current readoption of the emergency regulations extends to April 2023, the Commission nevertheless scheduled a 45-day public comment period to include some holidays, and this resulted in cardrooms not having adequate time to review the record or prepare and submit their objections.

In addition, Mr. Colantuono expressed concern that the Commission’s rulemaking file is woefully deficient. Mr. Colantuono contends that the Commission has failed to include all data and other factual information. Specially, Mr. Colantuono noted that this requirement would include “not only a consultant’s final report, but the information underlying its findings, including even emails between the agency and consultants.” Mr. Colantuono noted that the MGT report “states it relied on extensive meetings with staff where every fee related activity was identified and categorized.” Mr. Colantuono points out that records from these meetings and the data they produced, along with MGT’s various underlying calculations or reasoning, are absent from the rulemaking file, making it impossible to evaluate the reasonableness of the Commission’s allocations.

Finally, Mr. Colantuono noted that while the MGT report states that MGT explored and tested a variety of methodologies and decided that the final methodology presented the fairest option for distribution, the MGT report provides no further explanation of what other methodologies were considered. Mr. Colantuono stated that this conclusion requires more explanation and support, and he would expect such records to be thousands of pages long. Mr. Colantuono expressed concern that without this additional information, a court may declare the record failed to comply with the Administrative Procedure Act (APA) as the omission of these documents in the rulemaking file is a substantial failure.

**Recommended Response:** This comment was considered but was not incorporated. The commenter’s concern regarding the timeline of the Commission’s issuance of the notice of proposed action and the subsequent 45-day public comment period is unfounded. The notice period was consistent with the requirements of the APA and relevant OAL regulations. The Commission did not feel it had the flexibility to wait until after the holidays, as the emergency regulation is set to expire on April 3, 2023, and the Commission must have its completed rulemaking record submitted to OAL no later than March 30, 2023. With no additional extensions available, and critical timelines such as a required 30-day review by the Department of Finance, the Commission lacked the flexibility to consider an alternative timeline. The Commission notes that this certificate

of compliance filing is consistent with the regulations considered and adopted in the first and second emergency readoptions, and the rulemaking action that adopted TPPPS business licensee annual fees, CGCC-GCA-2021-07R/C (OAL Matter Number 2022-1021-06SR), which have been publicly available and the subject of several Commission meetings and public comment periods. Therefore, there were numerous opportunities to provide public comment on the text of this proposed action that preceded the 45-day comment period.

Additionally, the Commission does not believe that the rulemaking file is required to include the emails and additional documents referenced by the commenter. MGT was not hired by the Commission to provide assistance in promulgating regulations, but was hired to assist in ascertaining costs and the possible distribution of those costs within the various fees issued by the Commission. This is different from the example provided by the commenter, when consultants were specifically hired to assist with the promulgation of regulations, and as such the requirements to provide documentation are different. MGT provided a cost breakdown and suggested fees to be charged. The Commission used that report as a document relied upon when promulgating regulations (both this proposed action and one other), but has not directly copied any product of MGT for placement into regulation. Finally, the Commission did not consider, as part of its rulemaking process, any alternative annual fee structure and so has indicated such in its Notice of Proposed Action, as required.

- 2. Randall W. Keen, on behalf of Parkwest Casinos, Inc.:** Mr. Keen expressed a concern that the Commission has not complied with the requirements of the APA. Specifically, Mr. Keen expressed concern that the Commission has only relied on the MGT report, which Mr. Keen opined does not contain an adequate assessment of the potential economic impact of the proposed fee structure on California businesses.

Additionally, Mr. Keen disagreed with the Commission's statement in the Initial Statement of Reasons that the proposed action imposes no new mandatory requirements on businesses. Mr. Keen stated that in fact, the proposed action will impose an annual tax on California cardrooms that far exceeds the previous fees that were paid.

Finally, Mr. Keen expressed concern that the Commission has not included any considered alternatives, despite the APA requiring a description of reasonable alternatives and the agency's reasons for rejecting those alternatives. Mr. Keen stated that the Commission did not invite alternative proposals "until a few days ago" and that there are reasonable alternatives.

**Recommended Response:** This comment was considered but was not incorporated. The commenter asserts that the MGT report, upon which the Commission relied, did not contain an adequate assessment of potential economic impacts. However, the Commission did not entirely rely on the determinations of the MGT report for this purpose. In assessing potential economic impacts, the Commission independently determined, utilizing updated gaming revenues, what the new annual fee amounts would

be and compared them to what the annual fee would have been had SB 189 not been passed.

The proposed action does not impose any new regulatory requirement. Prior to the implementation of SB 189, cardroom business licensees paid an annual fee to cover costs of the Commission and Bureau. This proposed action continues the payment of an annual fee, though the determination of that annual fee has changed. With a new calculation method, it should be expected that individual cardroom business licensees will pay a different annual fee, either more or less; however, this does not result in an overall significant statewide adverse economic impact that would harm the cardroom business industry as a whole.

See response to comment II.B.1 for a discussion on why no alternative was included in the Initial Statement of Reasons. Specifically, in response to the commenter's concerns about the Commission's recent request for alternative methodologies; this request shows the Commission's willingness to not only monitor its existing proposal in future years, but also a willingness to consider a completely different methodology. No response from this request was received during any comment period for this rulemaking action.

**C. ADOPT SECTION 12368.2. CARDROOM BUSINESS LICENSE ANNUAL FEE AMOUNTS.**

This section provides the annual fee amounts required of cardroom business licensees. To determine the amounts provided in this section, the Commission utilized a calculation method that involved dividing identified costs into six cost pools based on the actual work performed, prorating the cost pools between cardroom business licensees and TPPPS business licensees, and then dividing the cardroom business licensees' total annual fee amongst each cardroom business licensee based upon the cardroom business licensee's status as either non-operational, operational with a three-year average gross revenue under \$1.5 million, or operational with a three-year average gross revenue equal to or above 1.5 million.

**1. Michael G. Colantuono, on behalf of the California Gaming Association: Mr.**

Colantuono expressed a concern that the Commission's methodology is flawed and therefore does not meet the requirements of Business and Professions Code section 19951, subdivision (e), to be "limited to the reasonable regulatory expenditures...to administer this chapter." Mr. Colantuono noted that in *American Coatings* it was found that to determine if a fee is a tax (and therefore requires legislative approval) there are the following standards to consider:

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 fee payers' activities or operations.

Mr. Colantuono opined that the methodology of the Commission is not calibrated to the true costs to regulate cardrooms and provided an example of this in that the MGT report found that the Commission's non-licensing regulatory costs were twice as high as

identified by the State Auditor. Mr. Colantuono expressed concern that a review of the MGT report reveals significant methodological flaws, because it appears that if MGT could not directly attribute a cost to an individual license application, then it was assigned to the annual fee despite the cost being a licensing activity. Mr. Colantuono stated that this violates basic cost allocation principals.

Additionally, Mr. Colantuono stated that the MGT report, and by extension, the new rates, fail to address many of the concerns identified in the State Auditor's report. Mr. Colantuono provides an example of the Commission's and Bureau's time spent on work permit applications, with the State Auditor indicating that these costs were being passed to the annual fee, and notes that the proposed annual fee continues this practice.

Finally, Mr. Colantuono noted that initial versions of the Commission's proposed regulation included an annual recalculation of the annual fee percentage and because they were developed based on a three-year average that included gross revenues impacted by the COVID, those gross revenues are too low going forward, which will result in a dramatic increase in the gross revenues and associated annual fees in future years while costs will remain the same.

**Recommended Response:** This comment was considered but was not incorporated. Please see the response to comment I.C.1 for a discussion on *American Coatings* and why the Commission's proposed action is consistent with those requirements. Please see the response to comment I.C.1 for a discussion on the differences in the State Auditor and MGT's conclusions. Please see the responses to comments I.C.2 and I.C.5 for discussions on the suitability of the proposed annual fee methodology, current versus future gross revenues, and the Commission's understanding that there must be ongoing monitoring and adjustments based on future gross revenues and changes to the costs of both the Commission and DOJ.

- 2. Randall W. Keen, on behalf of Parkwest Casinos, Inc.:** Mr. Keen expressed concern that the Commission's proposal does not address the concerns of the State Auditor because the proposed annual fees do not reflect the Commission and Bureau's actual costs. Mr. Keen noted that the Commission's original emergency regulations did attempt to adopt a methodology to ensure that fees would reflect the Commission's and Bureau's costs, but that the Commission then replaced the methodology with an annual fee that had no basis in fact and left the industry no ability to reconcile the annual fees to the Commission's and Bureau's costs. Mr. Keen opined that this results in an annual fee calculation that is "underground."

Mr. Keen noted that MGT did not recommend an annual fee based on a percentage of revenue, but proposed a flat fee based on a range of revenues, and the Commission made MGT's recommendation worse by imposing its annual fee based on its gaming revenue and by removing any reconciliation. Mr. Keen stated that this has resulted in a percentage annual fee that only exacerbates the issues identified by the State Auditor, namely annual fees higher than the Commission's and Bureau's costs, without providing any reconciliation process. Mr. Keen opined that the change in processes, from including the

methodology in regulation to only providing a fixed percentage annual fee, was done without the opportunity for public comment. Finally, Mr. Keen stated that without an annual reconciliation process and without a comparison to the Commission's actual costs, an annual fee based on a percentage of revenue is a tax in violation of Proposition 26.

Mr. Keen noted that for the purposes of Proposition 26, courts evaluate (referencing *American Coatings*):

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.

Mr. Keen expressed a concern that MGT made two faulty assumptions in its analysis: (1) utilizing data from years covered by shut down emergency orders; and, (2) the assumption that basing the annual fee on the revenue of a cardroom business licensee or TPPPS business licensee would reflect the costs of the Bureau or Commission related to that licensee. Mr. Keen commented that the utilization of years that include shut down orders means that future revenues will be higher, which will result in more annual fees being collected that the Commission and Bureau require. Additionally, Mr. Keen commented that by not comparing cardroom business licensees by gaming tables fails to acknowledge that differences in gaming revenues could be due to factors such as differences in location, management, or type of clientele, and it is almost impossible to imagine that the services provided by the Commission and Bureau to two near-identical cardrooms would vary significantly based solely on differences in revenue.

Finally, Mr. Keen opined that in violation of Proposition 26, the Commission's proposed regulations are destined to exceed the Commission's and Bureau's reasonable costs of administering the licensing program because the fees are based on revenues rather than services, and one or more classes of fee payers are shouldering too large a portion of the associated regulatory costs.

**Recommended Response:** This comment was considered but was not incorporated. Please see the response to comment I.C.1 for a discussion on the differences in the State Auditor and MGT's conclusions. The Commission disagrees that anything has been "underground." This specific rulemaking exists for the purpose of allowing the public to participate in the rulemaking process. In all, the Commission has held four comment periods, one additional formal public hearing for the receipt of comments, and three other Commission hearings for the purposes of discussing this specific rulemaking process. Additional comment periods and public meetings were held in conjunction with another rulemaking process that also referenced the MGT report.

Please see the responses to comments I.C.2 and I.C.5 for discussions on the suitability of the proposed annual fee methodology, current versus future gross revenues, and the



Commission's understanding that there must be ongoing monitoring and adjustments based on future gross revenues and changes to the costs of both the Commission and Bureau. Please see the response to comment I.C.1 for a discussion on *American Coatings* and why the Commission's proposed action is consistent with those requirements. Additionally, the Commission would like to correct a misstatement by the commenter. The commenter stated that the MGT report proposed a flat fee based on a range of revenues. The MGT report actually included a fee range based on a range of revenues, reflecting that even within a range of revenues the annual fee would be different. Also, the commenter's assertion that utilizing only gaming revenue does not link the cardroom business licensee to the services provided by the Commission and Bureau is false. A cardroom business licensee that has more gaming revenue than a comparably sized cardroom business licensee is more likely to utilize services provided by the Commission and the Bureau, such as the filing of Incident Reports, and as such, a higher annual fee payment is reasonable.

The Commission notes, that despite Mr. Keen's statement regarding MGT's use of shut down related data, the MGT report's data was collected using years prior to any shut downs. While the Commission did utilize data that included periods where the cardroom business licensees were shut down, it is with an understanding (as previously addressed) that the Commission will need to reexamine its annual fee determinations on an ongoing basis. Finally, the Commission notes that during those shut down years, cardroom business licensees were excused from paying a portion of the annual fees that would have normally been required.

Please see the response to comment I.C.1 for a discussion on the requirements of Business and Professions Code section 19840 as it relates to small and large cardroom business licensees. As explained in the Initial Statement of Reasons, the proposed action requires a proportional percentage of the total annual fee to be paid by cardroom business licensees. This is to protect smaller cardroom business licensees from paying an amount that, while smaller than that of a more profitable cardroom business licensee, is of a much higher percentage, and therefore much more impactful and burdensome. By limiting the payments of cardroom business licensees that are non-operational or with a gross revenue of under \$1.5 million, the Commission is following the requirements of Business and Professions Code section 19840.

- 3. Michael G. Colantuono, on behalf of the California Gaming Association:** Mr. Colantuono expressed concern that the MGT report fails to address the massive surplus that has built up in the Gambling Control Fund.

**Recommended Response:** This comment was considered but was not incorporated. See response to comment I.A.1 for a discussion on why the Commission cannot consider the existing surplus when determining annual fees.

- 4. Alan Titus, on behalf of Artichoke Joe's:** Mr. Titus repeated a comment previously submitted that expressed a concern that the proposed regulations are inconsistent with Business and Professions Code section 19951, subdivision (e). Please see the summary of

comment I.C.2 for more information. In addition to this repeated comment, Mr. Titus noted that there have been multiple loans from the Gambling Control Fund to the General Fund, and that an amount remains unpaid today. Mr. Titus expressed a concern that it was not the purpose of the Gambling Control Fund to provide long-term, interest free loans to the General Fund for purposes unrelated to fees paid by licensees. Mr. Titus opined that the annual fees are not being collected to cover only the costs of the Commission and Bureau, but are being pooled to pay future costs and to finance other state costs, and are therefore inconsistent with Business and Professions Code section 19951, subdivision (e).

Mr. Titus repeated a comment previously submitted that expressed a concern that there is insufficient evidence in the rulemaking file to determine that the fees to be generated comply with the limitation in Business and Professions Code section 19951. Please see the summary of comment I.C.4 for more information. Mr. Titus stated that three steps should be included in the rulemaking file to provide this additional information:

1. Show the costs incurred by the Commission and Bureau to fully carry out their duties under the Gambling Control Act, removing any other duties, such as oversight of tribal compacts. Employees whose duties involve both the Gambling Control Act and other duties must have their salaries reasonably allocated between the two types of duties.
2. Divide costs incurred under the Gambling Control Act between licensing costs, recovered through licensing fees, and non-licensing costs, recovered through annual fees.
3. Divide the non-licensing costs between cardroom business licensees and TPPPS business licensees.

Mr. Titus expressed concern regarding his proposed step 1 in that little to no information has been provided. Further, for step 2, Mr. Titus noted that there are differences in calculations between the State Auditor's report and the MGT report. Mr. Titus expressed concern that detail is needed to show that the changes will accomplish the Legislature's charge to reduce the surplus in the Gambling Control Fund.

Finally, Mr. Titus repeated a comment previously submitted that expressed a concern that the fee determination includes years impacted by COVID and their continued use will result in an overfunding of the Gambling Control Fund in violation of Business and Professions Code section 19951, subdivision (e). Please see the summary of comment I.C.5 for more information.

**Recommended Response:** This comment was considered but was not incorporated. For the repeated comments, please see the responses to comments I.C.2, I.C.4, and I.C.5. Additionally, for the comment expressing concern related to the General Fund and the amounts that remain unpaid, and the suitability of the proposed fees, see the response to comment I.A.1. Finally, for a discussion on the Commission's processes related to the examination of the costs of the Commission and Bureau, including the removal of non-Gambling Control Act related costs, see the response to comment I.C.4.

### **III. WRITTEN COMMENTS SUBMITTED DURING PUBLIC HEARING**

The Commission received the following written comments/objections/recommendations regarding the text of the proposed action during the public hearing held on January 24, 2023.

#### **A. COMMENTS MADE ON THE PROPOSAL IN GENERAL.**

These comments are made on the proposal, in general, and are not directed at any specific regulatory section.

1. **Alan Titus, on behalf of Artichoke Joe's**: Mr. Titus advised the Commission that in his letter dated January 17, 2023, submitted as a 45-day comment, there was a typo. "On page 10, in the second to last paragraph, the third sentence should have read, 'Even if that is so currently, in a year or two when the **2020** year figures are not used to determine average annual revenues over a three year period, fees will increase significantly and create even more of a surplus in the Gambling Control Fund.'" Mr. Titus noted that 2000 should have read 2020.

**Recommended Response:** The Commission acknowledges the correction to the submitted letter. Summaries and responses to Mr. Titus' January 17, 2023 letter have been drafted assuming the noted correction, where relevant.

### **IV. ORAL COMMENTS SUBMITTED DURING PUBLIC HEARING**

The Commission received the following oral comments/objections/recommendations regarding the text of the proposed action during the public hearing held on January 24, 2023.

#### **A. COMMENTS MADE ON THE PROPOSAL IN GENERAL.**

These comments are made on the proposal, in general, and are not directed at any specific regulatory section.

1. **Matthew Slentz, on behalf of the California Gaming Association**: Mr. Slentz repeated Mr. Colantuono's comment in II.B.1 that expressed concern that the rulemaking file lacks supporting back-up data upon which the MGT report relied. Mr. Slentz repeated Mr. Colantuono's comment in II.C.4 that the MGT study fails to address the massive surplus built up in the Gambling Control Fund. Mr. Slentz repeated Mr. Colantuono's comment in II.C.1, which expressed concern that MGT included in the annual fee, any cost it could not directly attribute to an individual license application. Finally, Mr. Slentz expressed concern that a flat percentage fee is unrelated to costs and as time goes on, will become more disparate to costs.

**Recommended Response:** This comment was considered but was not incorporated. Please see the response to comments II.B.1, II.B.4, and II.C.1 for responses to the repeated comments. Finally, please see the responses to comments I.C.2 and I.C.5 for discussions on the suitability of the proposed annual fee methodology, current versus future gross revenues, and the Commission's understanding that there must be ongoing monitoring and adjustments based on future gross revenues and changes to the costs of both the Commission and DOJ.

2. **Randall W. Keen, on behalf of Parkwest Casinos, Inc.**: Mr. Keen repeated his concerns that the cardroom business licensee annual fees are based on gross revenue without any evidence and constitutes a tax, as summarized in comment II.C.2. Additionally, Mr. Keen repeated his concerns that MGT report's recommended annual adjustment of the annual fees was originally included in the Commission's proposed action and then subsequently removed, as summarized in comment II.C.2.

**Recommended Response:** This comment was considered but was not incorporated. Please see the response to comments II.C.2.

3. **Alan Titus, on behalf of Artichoke Joe's**: Mr. Titus expressed a concern that the proposed action represents an annual fee increase of 72 percent and does not address the State Auditor's findings that the Gambling Control Fund's significant surplus. Additionally, Mr. Titus repeated the correction to his January 17, 2023 letter, as summarized in comment III.A.1.

**Recommended Response:** This comment was considered but was not incorporated. The commenter is correct that the State Auditor indicated a finding that the Commission and Bureau were collecting fees in excess of their use; however, the commenter's characterization that an increase to the annual fees collected from cardroom business licensees is inconsistent with the findings of the State Auditor disregards differences between the conclusions of the State Auditor and MGT, namely that the State Auditor directed the Commission to undergo a cost and fee analysis, indicating that the State Auditor's review was not a final determination or complete analysis of the Commission and Bureau's regulatory costs. Please see the response to comment I.C.1 for a discussion on the differences in the State Auditor and MGT's conclusions.

Additionally, the changes to annual fees for cardroom business licensees only reflect a portion of the Commission's efforts to meet the recommendations of the State Auditor. An examination of the total rulemaking actions borne by the Commission in response to the State Auditor is necessary. A previous rulemaking action, CGCC-GCA-2021-07R/C (OAL Matter Number 2022-1021-06SR), made changes to annual fees for TPPPS business licensees and various application fees that resulted in net estimated industry savings of nearly \$4 million.

See response to comment I.A.1 for a discussion on why the Commission cannot consider the existing surplus when determining annual fees. Additionally, please see response to comment III.A.1 regarding the commenter's correction to his January 17, 2023 letter.