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March 18, 2024

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

Re: Update to Annual Fee
CGCC-CGA-2023-03-R

Dear Commissioners:

On February 12, 2023, I submitted a comment letter on the proposed regulations. Staff has issued responses to those comments (the "Responses"), and this letter replies to the Responses. The letter is organized to correspond to my original six points.

I. IMPOSITION OF A PERCENTAGE CHARGE BASED ON GROSS REVENUE WOULD CONSTITUTE A TAX, NOT A FEE

My comment letter argued that basing the annual fee on gross revenues and charging a percentage of gross revenue is both improper and unprecedented. I relied on a case where a state fee based on revenue was held improper. In *Howard Jarvis Taxpayers Association v. City of Roseville,* 97 Cal.App.4th 637 *("Roseville"),* the City charged customers of city-owned water, sewer, and refuse utilities a fee of 4% of the utilities' annual budgets. The court invalidated the fee and wrote, "this fee does not represent costs." The court further explained, "If the budget of a utility increases because of a cost increase unrelated to the in-lieu fee, the in-lieu revenues [to the City], as a flat percentage of that increased budget, increase as well." The same thing could be said here. The annual fee of 1.33% of gross revenue does not represent costs. Further, if revenue increases, the fees will increase whether or not agency costs increase. Thus it operates like a tax. Further, while the fee rate might be calculated to coincide with current costs, it is not allocated to payers on any basis that corresponds to the costs of regulation.

The Responses (on pp. 1-3) do not address *Roseville*, or discuss the propriety of using gross revenue as a basis for calculation of the fee.[1] Rather the Responses rely on cases that presented other issues and are not on point. In particular, the Responses rely on *American Coatings Assn. Inc. v. State Air Resources Board* (2021) 62 Cal.App.5th 1111 (*"American Coatings"*), but in that case, calculation of the fee at issue was based on emissions of a polluter, the subject of the regulation at issue in the case, not on their gross revenues. The Air Resources Board charged a fee calculated based on per ton of emissions. Emissions were the subject of the regulation, and the fee was tied to them. Here gaming is the subject of the regulation, but the fee is not tied to revenue, not to any measure of gaming.

The Responses also cite to *California Farm Bureau Fed'n v. State Water Res. Control Bd.* (2011) 51 Cal.4th 421 (*"Farm Bureau"*), but again, calculation of the fee at issue in that case was not based on gross revenue but on the amount of water taken and diverted. This was measured by acre-feet, and the annual fee was the greater of $100 or $0.03 per acre-foot. Again water was the subject of regulation, and the fee was calculated based on the amount of water used.

The Responses thirdly cited *California Bldg. Industry Assn. v. State Water Resources Control Board* (2018) 4 Cal.5th 1032 (*"CBIA v. Water Bd"*), but again, the case is not on point. The fee there was not based on gross revenue of the water user but on various factors concerning the wastewater discharged, including type of wastewater discharge, volume of discharge, and population served. The issue raised here was not present and was not discussed in any of these three cases.

My comment letter also argued that using gross revenue as the basis for calculation of a fee is unprecedented. There are many cases challenging fees, but I am unaware of any case where the fee was calculated as a percentage of gross revenue of the regulated company, let alone where such a scheme was upheld against a challenge. The Responses ignored this comment, and failed to cite any precedent for a fee rate calculated based on gross revenue.

As far as I am aware, fees are always tied to the activity being regulated. In this regard, the cases require not only that the fee not exceed the reasonable cost

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[1] The Responses discussed the *Roseville* case on page 5 in response to a different argument made in CGA's comment letter, and did not address whether a fee can be calculated based on gross revenue.

of providing the service for which the fee is charged, but also that "the amount of the fee bears a reasonable relationship to the burdens created by the fee payers' activities or operations." *CBIA v. Water Bd.* An element of that "reasonable relationship" of fees to burdens is that calculation of the fee is based on the costs and thus based on the activity regulated. In *Calif. Bldg. Industry Assn. v. San Joaquin Valley Air Pollution Control Dist.* (2009) 178 Cal.App.4th 120, 132, the court wrote, "[T]here must be a *nexus* between the amount of the fee and the cost of the service for which the fee is charged." (Emphasis added.) It is not enough that the total fees and the total costs are similar. The fees must have some nexus to the costs of regulation. Where calculation of the fees is based on revenues, that nexus is lacking and thus the fees are improper.

II. EQUAL PROTECTION ISSUE–FLAT FEES FOR CARDROOMS WITH REVENUE UNDER $1.5 MILLION AND PERCENTAGE FEES FOR CARDROOMS WITH REVENUE OVER $1.5 MILLION VIOLATES EQUAL PROTECTION

My comment letter next argued that the fee schedule violates equal protection principles because a cardroom with $1.5 million in revenue would owe $7,482 more in fees than a cardroom with $1 less in revenue.

The Responses assert a number of arguments (pp. 4-5). First, the Responses argue that the fees are consistent with section 19840 of the Gambling Control Act which requires the Commission to take into consideration the operational differences of large and small establishments. While that might justify heavier regulation of larger operations and thus higher fees, it does not justify this particular method of calculating fees and the discrepancy in amounts discussed in my comment letter. Further, a statute cannot override a constitutional provision.

The Responses next argue that the fees here are similar to the fees charged in *Farm Bureau*, which set the fee as the greater of $100 or $0.03. That is not true. The formula in *Farm Bureau* would not result in a discrepancy like that noted here. The two would be similar if the fees here were "the greater of $19,950 or 1.33%" or if the fees were "the greater of $12,468 or 1.33%" in which case the break point would be $937,443, not $1.5 million. In those cases, there would be no huge difference in the fee as a result of a $1 increase in revenue. Further, it is not clear that the Supreme Court in *Farm Bureau* would have upheld a minimum fee of either $12,468 or $19,950. The court stated that the reason for the minimum fee was "because most persons and entities subject to the annual fee held permits

or licenses for less than 10 acre-feet of water, a minimum fee was necessary to cover the cost of sending out the fee bills." *Farm Bureau*, at 434. Here, the $12,468 fee cannot be described as a minimal fee to cover the cost of the fee bills. Rather the proposed regulation uses an arbitrary cut off point of $1.5 million that does not seem directly related to either costs or a legally meaningful difference.

The Responses argue that the fees here are similar to those charged in *CBIA v. Water Board* where there were eight program areas, one of which was a stormwater fee, and the stormwater fee covered more than the costs of that program. The court held that the eight programs should be judged together, not individually. The stormwater fee generated 26% of the fees but only 23% of the costs, and the court held that to be close enough. That case did not involve an equal protection claim, but the 60% difference in fees for a licensee with revenues at $1.5 million. That is not 3%. Nor are there distinct program areas. Rather the $1.5 million cut off classifies cardrooms solely by revenue.

The Responses also argue this is the same as in *American Coatings* where polluters emitting less than 250 tons were exempted from the fee. Again, that case did not involve an equal protection challenge and the case does not speak to that issue, and the purpose of that exemption was not discussed.

III. INSUFFICIENT EVIDENCE IN MATERIALS CIRCULATED

My comment letter objected that insufficient evidence was circulated to justify the fee rates. My letter raised two particular concerns. First, I objected to the lack of official source for the amounts of the Commission costs, and noted the discrepancies in cost numbers since the State Audit was released in 2019. The State Audit found non-licensing costs were $6.9 million; the MGT Report asserted that non-licensing costs were $14.2 million, and the Commission now claims non-licensing costs are $21.9 million. These are very different numbers, not explained by inflation, and the differences have never been adequately explained. If the goals are transparency, open government, and public participation, more information needs to be provided so the public and the industry can be assured of the propriety of the proposed fees.

The Responses (on pp. 6-7) answer that staff generated three spreadsheets which are in the Rulemaking file. The Responses do not address the objection to lack of source documents for these spreadsheets or respond to the discussion of

the differences between the State Audit, the MGT Report and current Commission claims. The fact is that annual fees built up a $95 million surplus in the GCF, and now the annual fees are being doubled to tripled. The natural question is why won't this result in even more excessive fees?

The second concern was with insufficient information regarding the cardroom gross revenue numbers. Point IV, below, concerns a problem with those numbers if they include 2020 gross revenue. Disclosure of year-by-year revenue numbers would reveal this problem. The Responses did not address this second concern.

IV. USE OF 2020 REVENUE DATA TO DETERMINE FEE RATE WILL RESULT IN EXCESSIVE FEES WHEN THE RATE IS APPLIED TO MUCH HIGHER 2023 REVENUE

My comment letter objected to the fact that rates were being determined using revenue data from 2020 but those rates would be applied to revenue data from 2023 instead of 2020. This is a problem because 2020 was the year of Covid, when cardrooms were closed about 45% of the year and revenues were significantly lower than usual. In contrast 2023 was a normal year. I estimated that the result of this mismatch will be fee collections about 20% higher than costs.

The Responses (on pp. 4-5) have two responses to this objection. First, it argues that the possibility of collection of surplus fees is always present. However, there is a difference between foreseeable problems which can be addressed up front, which this is, and the possibility of unforeseeable events which the Responses posit. Here, the likelihood of substantial excess collections is foreseeable and fairly certain and should be addressed up front.

Second, the Responses aver that the Commission has "committed" itself to evaluating fees and adjustments annually. However, this is not an enforceable commitment. Further, we note that at the time of the State Audit, the Commission had built up a $85 million surplus and was doing nothing to remedy this. If the Commission were statutorily required to adjust for fee surplus, this would be much less an issue, but it is not. (See Point VI, below.)

V. THE FEES ARE ILLEGAL IN LIGHT OF THE LARGE SURPLUS IN THE GAMBLING CONTROL FUND

My letter next argued that the GCF currently has a surplus of over $45 million (including monies loaned to the General Fund), which should be used to cover costs. This surplus accumulated over years, and the State Auditor warned, "The bureau and the commission need to take steps to reduce this fund balance to a more reasonable level." The State Auditor suggested that in this case, a surplus equal to a year's expenditures might be appropriate. The surplus cover about two year's worth of fees. Given the existence of that surplus, there is no need to charge fees this year.

The Responses (on pp. 7-8) state that "the industry" filed a class action lawsuit which seeks restitution and disgorgement and therefore the Commission cannot use these funds to defer current fees. The Response reasons that if the surplus is used to defer costs and then have to pay restitution, they would have to double pay. There are a number of problems with this response. First, the lawsuit was filed in May 2020, almost four full years ago, and the case seems dormant. No papers have been filed in the case since February 2022. Second, it is not a class action because plaintiffs' attorneys have never tried to certify the case as a class action. In fact, the number of plaintiffs has come down. The complaint named 10 plaintiffs, two cardrooms and eights TPPPs, but one of the cardroom companies no longer exists (VC Cardroom), and three of the TPPPs no longer exist, so it is a limited and shrinking group.

The existence of the surplus as a problem was first raised in July 2018 by then assemblyman (now Attorney General) Rob Banta. That was six years ago. The Commission should be proactive and propose some plan for use of the monies already collected and not spent, rather than just collect more and more fees.

Last, the Responses note that the surplus built up while annual fees were based on number of tables operated. We agree that those were excessive. But the new fees are two to three times more than the old table-based fees. This is not ironic. Frustrating is more the word that comes to mind.

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VI. THE LACK OF A REQUIREMENT TO CORRECT SURPLUS MAKE THE PROPOSED REGULATION INVALID

The last point raised in my original comment letter was the lack of a requirement to correct for surpluses in the Gambling Control Fund or to prevent a further build up in the fund. I noted that the first version of these regulations, adopted on an emergency basis by OAL on August 1, 2022, included such a provision. In this type of situation, where the fee is intended to cover not a specific service but an entire agency, there needs to be a corrective mechanism. The fee payors deserve such protection.

The Responses (pp. 8-9) states that while such a provision existed in the emergency regulations, OAL determined the provision to lack the specificity necessary. It is not clear what exactly was the problem, but we note that two prominent court cases on fees concern provisions which included such corrective provisions. See *CB/A v. Water Board* at 1045 [Water Code §13260(f)(1)] and *Farm Bureau* [Water Code §1525].

Here Section 19951 (e) requires that fees be limited to costs. That provision seems not just to justify a corrective provision but to require such a provision.

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We appreciate your consideration of these replies.

Sincerely,

Alan Titus