

CALIFORNIA GAMBLING CONTROL COMMISSION

Although Its Interpretations of the Tribal-State Gaming Compacts Generally Appear Defensible, Some of Its Actions May Have Reduced the Funds Available for Distribution to Tribes

Audit Highlights . . .

Our review of the California Gambling Control Commission's (Gambling Commission) administration of the Indian Gaming Revenue Sharing Trust Fund (trust fund) revealed the following:

- Some tribes have questioned the Gambling Commission's decisions about such matters as:*
 - *The number of gaming devices that may be operated statewide.*
 - *The offsetting of quarterly license fees by the amount of nonrefundable, one-time prepayments.*
 - *The formula for calculating trust fund receipts.*
 - *The process for allocating gaming device licenses.*

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California Gambling Control Commission's response as of June 2005

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the California Gambling Control Commission's (Gambling Commission) administration of the Indian Gaming Revenue Sharing Trust Fund (trust fund). Specifically, the audit committee asked that we determine whether the Gambling Commission is complying with applicable requirements to collect and distribute money in the trust fund, as well as with the requirements regarding the allocation of gaming device licenses. Additionally, we were asked to evaluate the Gambling Commission's procedures for identifying and addressing conflicts of interest.

The Gambling Commission has operated amidst controversy since its inception in August 2000, with wide-ranging questions raised about its appropriate role, authority, and many of its actions related to Indian gaming. We found that certain provisions contained in the 1999 Tribal-State Gaming Compacts (compacts) between the State and various Indian tribes are susceptible to multiple interpretations. Ultimately, although tribal organizations and individual tribes have contested many of the Gambling Commission's actions, they are likely defensible given the ambiguous language used in the compact. We also concluded that the Gambling Commission generally administered the trust fund in compliance with its understanding of the requirements in the compact.

Finding #1: Some of the Gambling Commission's interpretations of compact provisions have been disputed.

- ☑ *Distributions to noncompact tribes were generally consistent with the Gambling Commission's policy, with the possible exception of one quarter.*
 - ☑ *The Gambling Commission did not follow its procedures for allocating gaming device licenses for two of the three draws it conducted.*
 - ☑ *The Gambling Commission has not adequately communicated its conflict-of-interest policy to staff and commissioners, and the law governing the outside financial activities of commissioners is not clear.*
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Concerns have arisen about specific decisions the Gambling Commission has made in collecting and distributing trust fund receipts and in allocating gaming device licenses. For example, the statewide limit on gaming devices is one of the most contentious issues arising from the compact. The number of available licenses has contributed to the importance of the debate about many of the Gambling Commission's decisions because the tribes are competing for a limited resource. Unfortunately, rather than specifying an actual maximum number of gaming devices, the compact describes the process to be used to arrive at the total number of gaming devices to be allowed in operation. Ambiguity in this description has resulted in a number of different interpretations on the maximum number of gaming devices allowed, ranging from 45,206 to 110,189.

The Gambling Commission's decision to offset quarterly license fees with prepayments has also met with opposition. The Gambling Commission interprets the compact language as requiring it to offset tribes' quarterly payments by the amount of the nonrefundable one-time prepayments the tribes paid to acquire and maintain the gaming device licenses. However, the California Tribes for Fairness in Compacting (coalition), a coalition of several noncompact tribes, believes the Gambling Commission is misinterpreting the intent of the prepayments, noting that the Gambling Commission's staff conceded that the probable intent of those who drafted the compact was to establish the prepayment as a separate nonrefundable fee rather than as a credit against quarterly payments. Nevertheless, the Gambling Commission notes that the compact's use of the term prepayment creates a high level of doubt as to the meaning of the language. The Gambling Commission focused on the term prepayment and argues that this term, in ordinary usage, means payment in advance. The Gambling Commission further points out that the compact specifies the quarterly payments are to "acquire and maintain a license." It reasons that the quarterly payments cannot logically be for the purpose of acquiring a license unless the prepayment is credited against them. Finally, the Gambling Commission staff believe that any ambiguities in the compact language should ultimately be resolved in favor of the compact payers as opposed to the compact beneficiaries, the noncompact tribes. The coalition believes this position does not comply with the Gambling Commission's role as trustee of the trust fund, which, according to the coalition, is to act in the best interest of the noncompact tribes. If the Gambling

Commission had used the coalition's interpretation, approximately \$37 million more would be available for distribution to noncompact tribes from the trust fund through December 2020, given the current allocation of gaming device licenses.

Further, inconsistent compact terms have caused disagreements over the calculation of quarterly fees for deposit in the trust fund. The Gambling Commission does not assess any quarterly fees on the first 350 licenses a tribe has. The coalition disagrees with the Gambling Commission's methodology, arguing that the intent of the compact was for fees to be assessed on all licenses and that the Gambling Commission's method for calculating fees has significantly reduced the amount of trust fund money available for distribution. The compact provides that the number of certain gaming devices a tribe operates determines the quarterly fee it pays per device. However, the terms of the compact are unclear as to which gaming devices are to be counted. Specifically, the compact's schedule of graduated payments indicates a tribe will pay nothing for its first 350 licensed devices. Consequently, the Gambling Commission not only does not assess any quarterly fees on the entitlement and grandfathered devices a tribe has—devices any tribe with a compact is allowed to operate without a license—but it also does not assess fees on the first 350 licensed devices. However, the coalition believes the intent of the payment schedule was to assess fees on all licensed devices instead of excluding the first 350 licenses. The coalition argues that the only devices for which no fees should be assessed are the entitlement and grandfathered devices. Using the coalition's interpretation, an additional \$19.1 million in gaming device license fees would have been paid from September 2002 through December 2003 for the 15 tribes we reviewed. Given the inconsistencies in the compact provisions, both interpretations appear defensible, and the compact terms again confused rather than clarified the intent of the compact.

Questions have also been raised about when to require tribes to begin making quarterly license fee payments. The Gambling Commission has taken the position that tribes should begin making quarterly payments when they receive licenses for gaming devices rather than after they put the devices into operation, but the tribes themselves have disagreed on this issue. For example, the Ewiiapaayp Band of Kumeyaay Indians has contended that its payment obligation to the trust fund should begin only with the commercial operation of the licensed gaming device. Because the tribe had not put any of its licensed gaming devices into commercial operation, it believed it did not owe any quarterly fees to the trust fund. However, the Gambling Commission charged this tribe and continues to charge other tribes quarterly fees from the time the licenses are issued until the licenses are surrendered. Furthermore, according to summaries of meetings the Gambling Commission held with various tribes, at least seven tribes agree with its decision. The Gambling Commission indicated that it based its decision on the operative language of the compact. Specifically, it concluded that the quarterly payments are in exchange for acquiring and maintaining "a license to operate a gaming device" rather than for the actual operation of the gaming device. Additionally, the Gambling Commission stated that it found no expression in the language of the compact requiring quarterly payments for a license to begin only when the tribe begins to receive revenues for the gaming device. The Gambling Commission

has not established when tribes begin operating their gaming devices, so we are not able to determine the extent to which trust fund deposits would have been reduced if the Gambling Commission had charged quarterly fees only when gaming devices were put in operation.

Additionally, some tribes disagree with the Gambling Commission's process for allocating gaming device licenses. Under the Gambling Commission's interpretation of the process described in the compact for allocating licenses to tribes that have applied for them, two tribes that applied did not receive any gaming device licenses during the Gambling Commission's third license draw. The compact indicates that gaming device licenses are to be awarded through a mechanism that places tribes into five categories of priority based on the number of gaming devices the tribes already have and whether they have previously drawn licenses. Noting the compact provisions state that tribes in a particular priority include those that received licenses under a previous priority, the Gambling Commission moves the tribe to a lower priority for the next draw that it participates in, regardless of how many licenses it receives in the first draw as long as it received at least one license. At least two tribes, the Colusa Indian Community of the Colusa Rancheria (Colusa) and the Paskenta Band of Nomelaki Indians (Paskenta), disagree with the Gambling Commission's interpretation of the license draw process. These tribes believe the compact bases the priority for awarding gaming device licenses solely on the number of gaming devices they have. Had the Gambling Commission interpreted the compact as the two tribes do, Colusa would have received 108 licenses and Paskenta would have received 75 during the Gambling Commission's third license draw. However, under the Gambling Commission's interpretation, neither tribe received any licenses.

If the governor concludes the Gambling Commission's interpretation and policies do not meet the intended purposes of the compact, the governor should consider renegotiating the compact with the tribes to clarify the intent of the compact language, to help resolve disputes over the interpretation of compact language, and to enable the efficient and appropriate administration of the trust fund in each of the following areas:

- The maximum number of licensed gaming devices that all compact tribes in the aggregate may have.
- The offset of quarterly license fees by nonrefundable one-time prepayments.
- The number of licensed gaming devices for which each tribe should pay quarterly license fees.
- The date at which tribes should begin paying quarterly license fees.
- Automatic placement of a tribe into a lower priority for subsequent license draws.

Governor's Office's Action: None.

- The Governor's Office has renegotiated compacts with several Indian tribes. However, it has not taken any specific action on the issues discussed above.

Finding #2: Some tribes believe the Gambling Commission staff's interpretation of "commercial operation" is not equitable.

According to the compact, the license for any gaming device should be canceled if the device is not in commercial operation within 12 months of the license being issued, but the compact does not define what is meant by "commercial operation." At least three tribes have argued that the Gambling Commission staff's definition of commercial operation does not agree with the compact language and that the staff have added requirements not stated in the compact. Gambling Commission staff believe the intent of the 12-month rule, including the term "in commercial operation," is to keep tribes from hoarding licenses for gaming devices, which would prevent other tribes from having the opportunity to obtain the licenses. They have therefore been applying a definition of commercial operation that requires all gaming devices, licensed and unlicensed, to be available to the public on a continuous basis and to be simultaneously placed in service on the casino floor. The underlying rationale for the continuous and simultaneous requirements is the staff's position that the license grants a tribe the right to operate a gaming device, but the license is not attached to any particular gaming device. However, the commissioners have not yet formally endorsed this definition. Nevertheless, the Shingle Springs Band of Miwok Indians had 650 licenses canceled, and the Cahuilla Band of Mission Indians had 100 licenses canceled when they did not challenge the Gambling Commission's notice of intent to cancel them. Two other tribes—the Campo Band of Diegueno Mission Indians and the Pauma Band of Luiseno Mission Indians—challenged the Gambling Commission staff's position that all devices, licensed and unlicensed, must be in commercial operation. They argue that the compact does not require unlicensed devices to be in commercial operation.

If compact language is not renegotiated, to permit the efficient and effective tracking of gaming devices in order to determine whether tribes are appropriately placing them in operation rather than hoarding licenses, the Gambling Commission should finalize its definition of what constitutes commercial operation of gaming devices.

Gambling Commission's Action: Corrective action taken.

The Gambling Commission has determined that in order to meet the compact requirement that a gaming device authorized by a license is "in commercial operation" within 12 months of the date of issuance of that license, an Indian tribe must establish each of the following elements:

- The gaming device must be operable and available for play to the public.
- The gaming device must be capable of accepting consideration or something of value that permits play.

- The gaming device must be capable of awarding a prize.

The Gambling Commission further stated that once a gaming device is placed into commercial operation, the compact provision would be satisfied. Therefore, the Gambling Commission would consider the Indian tribe in compliance with the compact provision even if the gaming device were placed into operation for only one quarter, one month, or one day.

Finding #3: A decision regarding multiterminal gaming devices may result in some tribes being ineligible for trust fund disbursements and others exceeding the gaming device limit.

The Gambling Commission has had to address how to count certain electronic games for the purposes of determining the tribes' eligibility for receiving trust fund disbursements and establishing their gaming device allotments under the compact. The compact limits the number of gaming devices a tribe may operate to 2,000. However, certain electronic roulette and craps games are played from multiterminals, meaning that one machine has several terminals, and at each separate terminal a player wagers against a common outcome. The Gambling Commission's concern was whether it should count the entire system or each separate terminal as a gaming device. Although the commissioners have yet to formally adopt a position on multiterminal devices, the staff's position is that it should count each separate terminal as a gaming device, reasoning that such an interpretation gives meaning to every provision in the compact's definition of a gaming device.

For reasons involving a multiterminal gaming device, Gambling Commission staff determined that one tribe, the Augustine Band of Cahuilla Indians (Augustine), was ineligible for trust fund distributions during one quarter in fiscal year 2002–03 for which the tribe claimed that it was eligible because Augustine had counted a multiterminal gaming device as one device on its self-certification of the number of gaming devices it was operating, making it appear eligible for a trust fund disbursement that quarter. However, Gambling Commission staff determined that the tribe operated 351 gaming devices for this quarter, exceeding the eligibility requirement by two gaming devices.

Similarly, tribes that count multiterminals as a single gaming device may exceed the 2,000 maximum for gaming devices they can operate. In fact, according to a February 2004 report on a review performed jointly by the Gambling Commission and the Department of Justice, eight tribes were found to be operating more than 2,000 gaming devices at least in part because they were counting a multiterminal device as only one device.

The Gambling Commission should finalize its position regarding gaming devices with more than one terminal to determine whether these devices are counted as one device or as more than one device. Once its position is final, the Gambling Commission should enforce

compliance with the provisions of the compact for those tribes operating more than 2,000 gaming devices and should determine whether any tribe could lose its eligibility for trust fund distributions by exceeding 350 gaming devices.

Gambling Commission's Action: Corrective action taken.

At its February 16, 2005, meeting the Gambling Commission voted to follow the California Department of Justice, Division of Gambling Control's Tribal Casino Advisory regarding the term "Gaming Device" as that term is used in the Tribal-State Gaming Compacts. Pursuant to this advisory each terminal or player station attached to a gaming system is accounted for as a separate gaming device. The Gambling Commission now adheres to this application of the term "Gaming Device" in its treatment of multiple terminal/station systems.

Finding #4: The Gambling Commission may have underpaid the Lower Lake Rancheria on one of its quarterly distributions from the trust fund.

The Gambling Commission may have inappropriately underpaid Lower Lake Rancheria (Lowerlake) by \$416,000 and overpaid by \$5,100 each of the other tribes eligible in a quarterly distribution from the trust fund. The former chief counsel of the Gambling Commission indicated that it did not distribute funds to Lower Lake for the quarter ending September 30, 2000, because the federal register did not list it as a federally recognized tribe. Although the federal Bureau of Indian Affairs (BIA) acknowledged that it erred in excluding Lower Lake from the register, the former chief counsel explained that the Gambling Commission bases eligibility for such payments from the date stated in written evidence of that recognition, and the BIA did not officially reaffirm the government-to-government relationship with the tribe until December 29, 2000. Consequently, the Gambling Commission concluded that Lower Lake was eligible to receive a share of trust fund receipts only beginning with the quarter ending December 31, 2000. However, the BIA also stated in writing that the government-to-government relationship between the federal government and Lower Lake was never severed. Therefore, although Lower Lake did not appear on the register, the federal government acknowledged that the tribe had consistently retained its status as a federally recognized tribe. Furthermore, only an act of Congress can terminate a tribe's federal recognition, and to date no act has terminated Lower Lake's federal recognition. Finally, the Gambling Commission was made aware of the BIA error when it received a letter of protest from the tribe's attorney 11 months before it made the adjustment distribution in question. However, because it chose to focus on the date that Lower Lake's status as a federally recognized tribe was reaffirmed, the Gambling Commission concluded that Lower Lake was ineligible for distributions prior to that date and, consequently, it did not adjust its first quarterly allocation to include Lower Lake.

The Gambling Commission should confer with the federal Bureau of Indian Affairs and determine whether there is any federal requirement that it pay Lower Lake for the quarter ending September 30, 2000, and, if not, whether anything prohibits it

from paying Lower Lake. Barring any prohibition, we believe it is appropriate for the Gambling Commission to provide Lower Lake a share of the funds allocated that quarter and to deduct that amount from distributions to tribes that received distributions in that quarter. If any one of these tribes is no longer eligible to receive trust fund distributions, the Gambling Commission should either bill the tribe for the overpayment or seek other remedies to recover the overpayment.

Gambling Commission's Action: Pending.

The Gambling Commission directed the specific questions raised by the Bureau of State Audits to the BIA. According to the Gambling Commission, it has made every effort, both by letter and telephone, to obtain clarification from BIA and has received no response. The Gambling Commission further stated that this matter has been made even more complex by questions that have been raised about the propriety of the re-recognition action taken by a former director of the BIA. The questions raised about re-recognition involve other tribes in addition to Lower Lake. The Gambling Commission reported that it would continue its efforts to seek clarification from the BIA and to explore options that might be available to it in the resolution of this issue.

Finding #5: The Gambling Commission did not always follow its license draw procedures.

Although staff developed procedures for allocating gaming device licenses, they did not follow these procedures when the Gambling Commission conducted its first gaming device license draw in September 2002 or when it held its second draw in July 2003. As a result, some tribes received licenses that should have been allocated to other tribes under the Gambling Commission's established procedures.

The compact requires gaming device licenses to be awarded to tribes through a priority mechanism with five categories. Under the Gambling Commission's established procedures, a tribe's priority for each draw is based on the priority it was placed in when it last drew licenses, with each tribe automatically moved to a lower priority category for each draw, and on the total number of gaming devices it has. In addition, the compact limits the number of licenses a tribe can draw in each of the first four priorities (150, 500, 750, and 500, respectively). For the fifth priority, the only limit in compact language is the number of licenses that would bring a tribe's total gaming devices, licensed and unlicensed, to 2,000. The Gambling Commission followed these procedures for only one of its three gaming device license draws. Overall, for the two draws for which it did not follow its procedures, the Gambling Commission did not award 307 gaming device licenses to the appropriate tribes according to its official allocation process.

To ensure that all tribes applying for gaming device licenses are provided the appropriate opportunity to obtain the number of licenses they are applying for, the Gambling Commission should consistently follow the license allocation procedures it

has adopted. Further, it should change its current policy of limiting to 500 the number of licenses a tribe in the fifth priority may draw, allowing tribes instead to draw up to their maximum total authorization to operate up to 2,000 gaming devices.

Gambling Commission's Action: Corrective action taken.

Effective September 28, 2004, the Gambling Commission adopted a policy that is intended to clarify the gaming device license draw process and ensure that draws are conducted in accordance with the compact provisions. The adopted policy no longer limits the number of licenses a tribe in the fifth priority may draw to 500.

Finding #6: The Gambling Commission does not have a thorough system for avoiding potential conflict-of-interest issues.

Although the Gambling Commission has a conflict-of-interest policy, it has not adequately communicated the policy to designated staff. For example, key staff we interviewed stated that they were not aware of any formal, written conflict-of-interest policy. In fact, after repeated requests for a copy of its conflict-of-interest policy, the Gambling Commission finally provided us with a copy, two months after our initial request. Additionally, a former commissioner had to file an amended statement of economic interest because he was not fully aware of the requirements for completing the form. By not ensuring that the commissioners and its staff are aware of its conflict-of-interest policy, the Gambling Commission runs the risk that affected employees will not understand their obligations under the law.

The Gambling Commission should ensure that all staff are informed of its conflict-of-interest policy. Additionally, the Gambling Commission should seek clarification of the law governing the outside financial activities that commissioners may engage in.

Gambling Commission's Action: Pending.

The Gambling Commission is in the final stages of adopting a conflict-of-interest policy in accordance with the provisions of California Government Code, Section 19990. According to the Gambling Commission, the process of adopting a policy includes employee and labor union(s) review and input. Employees have reviewed the policy and submitted their input to their personnel unit. Labor unions also completed their review and Gambling Commission staff has met with union representatives concerning the proposed policy. As of June 2005, the Gambling Commission was reaching the conclusion of the process and the policy was under review by the Department of Personnel Administration. It is anticipated that the Gambling Commission will give the final draft to the unions by the end of July 2005, with a proposed implementation date of 30 days from the date of the final draft. The Gambling Commission will then provide a copy of the approved policy to its staff.

