



October 25, 2007

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**Re: *Cates v. Westly* (Superior Court Case No. GIC 82R775)**

Dear Counsel:

We're writing to invite discussion regarding a possible settlement of this case. This also serves as an informal introduction of our firm, Legion Counsel, which has been substituted for Ronquillo & Orderica, LLP, as counsel for plaintiff. As a consequence of the recent Appellate Court decision, we will be returning with you to the trial court to litigate this matter. We will be aggressively acting on behalf of our client and the California residents she represents. However, it seems an opportune time to take a fresh look at this controversy. We believe that the objective of our action is completely compatible with the obligations of the State and its officials – to collect all money due from tribal gambling. If this is true, what purpose is served by continuing with litigation?

This action was initiated by our client on behalf of California taxpayers simply to motivate the California Gambling Control Commission (CGCC) to collect the correct amount of payments due to the Special Distribution Fund under the Compacts. The Appellate Court declared that the CGCC had and has a mandatory duty to do this. As you well know, the Compacts provide that the definition of "net win" from slot machines (the basis for payments due from the tribes) is that stated by the American Institute of Certified Public Accountants, *i.e.*, the difference between gaming wins and losses before deducting costs and expenses.

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Testimony of CGCC officials established that as of Sept. 17, 2004:

- CGCC had not taken a position on the definition of "net win" on slot machines.
- No audits had been conducted of casinos.
- Audits would not have been effective anyway until the definition had been established.
- The tribes were making payments using their own differing definitions.
- The correct amounts owed could not be determined until audits were conducted.
- If amounts were found owing, CGCC should collect them.

Later testimony of CGCC officials established that as of May 12, 2005:

- CGCC acknowledged acceptance of the AICPA definition of "net win."
- CGCC has the right to access all records related to payments due from casinos.
- Tribe reports on payments made receive only desk reviews and "audits as needed or necessary."
- The only way to absolutely determine the accuracy of payments is by audit.
- Just one audit had been conducted, which showed an underpayment.
- Seven more audits were reportedly in progress or pending completion.

Actual net win results for the individual California casinos in question were not disclosed. However, the Special Distribution Fund report as to aggregate contributions of all tribes to the Special Distribution Fund for the entire period ending March 31, 2005, showed a payment of \$269,649,361. Our recognized gaming expert estimated real average net win results for the reporting casinos, based upon specific industry experience, of up to \$600 net win per machine per day. If this proved to be the average for all casinos, it would translate to almost a \$1 billion shortfall in payments due California for the period, with an additional 1% per month delinquency fee. Considering that the tribes have been self-reporting with no meaningful State oversight and have used their own definitions of "net win", and that actual slot machine revenue results from other venues are

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known and can be compared, there most certainly has been a substantial underpayment. This would presumably include the casinos of the Pechanga, Morongo, Sycuan and Aqua Caliente Tribes, whose recent expansions will be the subject of a February referendum. Only an audit of all casinos will determine exactly how much is owed.

Following the initiation of our action in November of 2003, the CGCC accepted the AICPA definition of "net win", and finally commenced a few real audits. The Appellate Court has now provided direction to the CGCC regarding its responsibilities under the Compacts to determine and collect correct amounts owing under the Compacts. Presumably, the CGCC and the State would now proceed to expeditiously conduct audits of all casinos paying into the Fund. This would establish proper "net win" calculations for payments made and payable by the tribes. That would be exactly what our action was intended to accomplish.

This suggests to us that our case could be satisfactorily resolved simply by a firm, enforceable commitment by the State to expedite independent audits of all casinos paying into the Fund. We would welcome a dialogue for this purpose.

Anticipating your reply, I remain,

Very truly yours,

LEGION COUNSEL



John K. Baldwin

JKB/sh