LYTTON RANCHERIA • Lytton Band of Pomo Indians

437 Aviation Blvd • Santa Rosa, California 95403

(707) 575-5917 • Fax (707) 575-6974

May 9, 2012

The Honorable Darrell Steinberg
Senate President Pro Tempore
State Capitol, Room 205
Sacramento, CA 95814

The Honorable Roderick Wright, Chair
Senate Government Organization Committee
State Capitol, Room 5064
Sacramento, CA 95814

Re: Oppose Unless Amended SB 1463 (Internet Gaming Bill)

Dear Senators:

I am writing on behalf of the Lytton Rancheria to express our opposition to SB 1463 as presently drafted. While my tribe does not oppose internet gaming in general, we believe that SB 1463 is fatally flawed in its current form. Below are a number of our most serious concerns with the bill. While these and other concerns force us to presently oppose SB 1463 unless amended, it remains our hope that we can work with you to revise the bill in a manner that will be acceptable to both tribes and the State.

Eligible Entities

1. Excludes Indian Tribes Presently Authorized to Conduct Poker. The bill would allow only those tribes that have had a Class III Compact with the State for at least three years to receive a license.

> "A federally recognized California Indian tribe operating a casino pursuant to a tribal-state gaming compact under the federal Indian Gaming Regulatory Act of 1988, that has been subject to oversight by, and in good standing with, the commission and the department for the

> three years immediately preceding its application for licensure." Sec. 19990.21(b)(2).

This would exclude tribes such as Lytton that are presently authorized to offer poker pursuant to gaming ordinances approved by the National Indian Gaming Commission, including tribes that do not have Compacts and tribes that have had Compacts for less than three years. There is no rational basis for such a discriminatory approach with respect to the tribes, especially since tribes do not require state oversight or authorization to offer poker. (Poker is generally a Class II game and tribes do not require a Compact to offer such games.)

To the extent that there are concerns about the regulatory experience of tribes with Class II gaming operations, such concerns are unfounded. Tribal Class II gaming operations are subject to extensive federal regulations, including federal minimum internal control standards and federal technical standards, with oversight by the National Indian Gaming Commission. These regulations go far beyond those applicable to Class III gaming operations.

The bill should be amended to allow any federally recognized California Indian tribe with an NIGC-approved gaming ordinance that authorizes poker to receive a license to offer internet poker.[1] It is ironic that the present bill would allow horse racing interests, which have no experience offering regulated poker, to receive licenses to offer poker online (see below), while excluding tribes that have years of experience offering poker under comprehensive federal regulations.

2. Opens the Door to Market Domination by Commercial Gaming Interests. While the bill would require that licensees and subcontractors be organized in California, nothing would appear to prohibit a commercial gaming company from establishing a California entity to serve as a technology subcontractor. Moreover, the bill would appear to permit the subcontractor to finance the operation and receive the majority of the economic benefit. In fact, the bill expressly states that it is the intent of the Legislature to:

> "Ensure that there are no artificial business constraints on the licensee, such as limits on the percentage of revenues that may be paid to technology supply contractors. Licensees and suppliers are free to structure their own desired relationships without interference from the state." Sec. 19990.03(p).

Thus, as written, it appears that an out-of-state entity could enter into an arrangement with a licensee where the out-of-state entity, through a subsidiary organized in California, could receive 99% or more of the economic benefit derived from the licensee's internet gaming operation. As a matter of policy, the Legislature should not pass legislation that would transfer both the economic benefits and control of internet gaming in California to out-of-state interests.[2]

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[1] We would be happy to provide a more detailed explanation of the regulatory framework for Class II gaming.

[2] Congress confronted similar policy concerns when it developed the Indian Gaming Regulatory Act. In the end, it chose to impose significant limits on the ability of non-tribal entities to control and profit from gaming conducted on Indian lands. See, e.g., 25 U.S.C. 2711(c).

3. No Basis to Include Horse Racing Interests. The bill would permit both associations licensed by the California Horse Racing Board and operators of online advance deposit wagering sites to offer internet poker, even though neither type of entity presently has the authority to offer real money poker. Sec. 19990.21(b)(3)-(4). There is no justification for allowing such entities, which have no experience operating poker games, to offer poker online.

4. Tribes May Not Receive Any Licenses. Although certain tribes are eligible to apply for a license to offer internet gaming, the bill provides the State with significant discretion to decide which entities to license through a process to determine the "suitability" of potential licensees. The process, set forth in Sec. 19990.23, requires investigation of the "owners," "officers" and "affiliates" of any license applicant. It is not clear how this would work in the context of an Indian tribal government. Further, the bill requires that one of the factors to be considered by the State in evaluating a license is the "financial viability" of the applicant. Sec. 19990.22(a). In addition to being an affront to tribal sovereignty (discussed below), this could result in the exclusion of tribes that have suffered financial difficulties in recent years. Due to this and other aspects of the suitability process, there is no guarantee that any tribe would actually receive a license from the State. For these reasons, Lytton believes that the bill should be amended to allow any federally recognized California Indian tribe with an NIGC-approved gaming ordinance that authorizes poker to receive a license to offer internet poker

Tribal Sovereignty

5. Unreasonable Access to Tribal Facilities and Records. As drafted, the bill would appear to give the State the ability to inspect all tribal facilities and records.

> "Ensure that all applicable state agencies will have unrestricted access to the premises and records of each licensee to ensure strict compliance with state law concerning credit authorization, account access, and other security provisions." Sec. 19990.03(o).

Such unrestricted access would constitute a serious infringement on tribal sovereignty and must be removed.

6. Tribes are not Subject to State Taxation. Although the bill would require the payment of license fees to the State, it also provides that all licensees are subject to State taxation.

> "A license applicant, and all subcontractors of the applicant, shall be a resident of California, or an entity organized in California, and subject to state taxation, auditing, and enforcement." Sec. 19990.22(b)(1).

Tribes, however, are not subject to State taxes. Thus, while the intent of this provision is unclear, it appears to suggest that a tribe must consent to state taxation in order to receive a license.

7. Unreasonable Requirement to Waive Tribal Sovereignty. The bill would require any tribe seeking a license to broadly waive its sovereignty and submit to state jurisdiction.

> "A federally recognized California Indian tribe, including, but not limited to, the governing body of that tribe or any entity that is an affiliate of that tribe, that applies for a license pursuant to this chapter shall waive its sovereignty for the purpose of evaluation of its application. The application shall affirmatively declare that the license applicant is subject to the state's jurisdiction as set forth in this chapter and in the regulations adopted by state agencies. Any license issued pursuant to this chapter to a federally recognized California Indian tribe shall include that tribe's affirmative agreement, in a form acceptable to the department, to be subject to the jurisdiction of the state for all purposes under this chapter." Sec. 19990.22(e)(emphasis added).

The insistence on such a broad waiver of tribal sovereign immunity is unreasonable and a clear case of overreaching by the State.

8. Overly Intrusive Review of Tribal Finances and Personnel. The bill would allow the state to investigate a tribe's "financial status, which shall include the required submission of income statements and balance sheets for the prior 12-month period." Sec. 19990.23(b). The bill also would permit the State to investigate an applicant's "owners" and "officers," which could include tribal officials and members. Sec. 19990.23(c). See also Sec. 19990.24. These provisions are unreasonable in the context of a tribal government and should be removed from the bill.

9. Failure to Include Tribal Regulators. The bill fails to give any role to tribal regulators, even though the internet gaming operations could be located on tribal lands. Instead, the bill gives the Department of Justice the power to license and regulate internet gaming, to the exclusion of tribal regulatory authorities, which have no meaningful role under the framework set forth in the bill.

> "The Department of Justice, in conjunction with other state agencies and private partners, has the expertise to evaluate the qualifications of applicants for a license to conduct intrastate Internet gambling services, and to license the best qualified and most responsive applicants to meet the needs of the state and its citizens." Sec. 19990.02(j).

Ironically, the bill would allow the State to "outsource" its regulatory functions to other entities, presumably including those in Nevada and New Jersey.

> "The department may outsource its regulatory functions under this chapter where optimal to provide efficient, effective, and robust

regulation with access to worldwide expertise tested and proven in the gambling industry." Sec. 19990.72.

Financing

10. Unreasonable Upfront Licensee Fee. The bill would impose an upfront nonrefundable license fee of $30 million. Sec. 19990.58. This amount would be credited against the 10 percent license fee to be paid by the licensee, but only for the first three years. In this case, the value of the license is uncertain due to the potentially large number of licenses and the fact that the State is asserting the right to alter both the terms of the license after three years and the competitive framework by opting into a federal or interstate system. Sec. 19990.71. If a licensee fails to generate at least $30 million in license fees during the first three years of operation, then it appears that the licensee would forfeit the remainder of the upfront fee.

11. Investment Uncertainty. Establishing an internet gaming operation will require an enormous capital investment, especially during the first few years of the operation. However, the bill includes provisions that would chill investment by creating tremendous uncertainty about the value of the license. While the bill would authorize licenses with a term of 10 years, the bill would allow the State to unilaterally alter the terms of the licenses after only three years. If a licensee fails to agree to the new terms, then it would be required to forfeit its license and presumably lose its investment.

> "The state reserves the right to make reasonable modifications to the terms and conditions of the license after a three-year review, and, at any time thereafter, to balance the relationship between the licensee and the state, and offer existing licensees the opportunity to agree to these modifications and continue in partnership with the state, subject to the statutory approval of those terms and conditions by the Legislature." Sec. 19990.03(c).
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> "An acknowledgment by the license applicant that the terms and conditions of the license issued by the state may be modified by the state after three years, and at any time thereafter, at which point the licensee may either agree to be subject to that modification or relinquish the license." Sec. 19990.24(l).

The bill also creates uncertainty about the future competitive environment by preserving the State's right to opt into a federal regulatory scheme or to enter into agreements with other states:

> "Preserve the authority of the state to opt out of, or opt into, any federal framework for Internet gambling, or to enter into any agreement with other states to provide Internet gambling." Sec. 19990.03(s).

> "The Legislature may, by a statute adopted by a majority vote of both houses, do either of the following:
> (a) Opt out of, or opt into, any federal framework for Internet gambling.
> (b) If the United States Department of Justice notifies the department in writing that it is permissible under federal law, enter into any agreement with other states to provide Internet gambling." Sec. 19990.71.

Unless these uncertainties are removed, it will be impossible for tribes and other licensees to make the investments in game development and marketing that will be necessary to maximize the revenue to be received by the State.

Operational Concerns

12. Failure to Prohibit Internet Cafes. While the bill purports to prohibit internet cafes, the language is ambiguous since it only prohibits devices aggregated "principally for the purpose of playing gambling games on the Internet ... ." Sec. 19990.12(c) (emphasis added). As written, the bill would require a case-by-case determination by enforcement authorities as to whether the devices were set up "principally" for internet gambling. This likely would be an enforcement nightmare that could result in years of litigation, during which time hundreds of de facto internet cafes could be allowed to operate. The bill should be amended to include a flat prohibition against the use of computer terminals to access internet gaming sites at any place of public accommodation.

13. The Bill Would Authorize Games Other than Poker. After two years, the State could allow games in addition to poker, which is unacceptable.

> "For the first two years following the initial issue date of any license pursuant to this chapter, only games commonly referred to as poker, the play of which is permitted as a controlled game pursuant to Chapter 5 (commencing with Section 19800), shall be authorized. After that two-year period, the department may phase in other games allowed under the California Constitution and the Penal Code." Sec. 19990.14(b).

Lytton strongly believes that the bill must be limited to poker-only. Expanding the scope of permitted games beyond poker could have a serious negative impact on revenue from tribal brick-and-mortar casinos and likely would raise significant compact issues. Moreover, it would be wholly inappropriate to allow a decision to expand gaming to be made by the Department rather than by the Legislature, which will be in much better position to balance the competing public policy considerations.

14. Failure to Prohibit Entertaining Displays. The bill fails to prohibit games where the outcomes from one or more hands of poker or the redemption of winnings from such games are depicted using entertaining displays such as video or mechanical slot reels or other casino

game themes. This issue is particular serious, since the bill would allow a player to simultaneously participate in multiple games, which could make it easier to generate the range of outcomes necessary for a slot-style display. Sec. 19990.57.

15. Failure to Clearly Prohibit Robotic Play. While the bill provides that controls shall be adopted to minimize activities such as robotic play (defined at Sec. 19990.05(z)), the bill fails to include an absolute prohibition against the use of robotic play.

> "A licensee shall deploy controls and technology to minimize fraud or cheating through collusion, including external exchange of information between different players, robotic play, or any other means." Sec. 19990.37(d).

Such a prohibition is critical to protect players and prevent the development of games that use high speed poker games to generate outcomes to drive slot-style displays.

Conclusion

We appreciate you taking the time to consider the views of the Lytton Rancheria and would be happy to meet with you to discuss these issues and provide specific language for your consideration. We look forward to working with you on this matter, which is of such critical importance to tribes and the State of California.

Sincerely,

Margie Mejia
Tribal Chairperson