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J. SCOTT KRAMER
DIRECT DIAL: 215.979.1122
E-MAIL: jskramer@duanemorris.com

www.duanemorris.com

June 19, 2007

VIA E MAIL AND FIRST CLASS MAIL

Arthur Coccodrilli, Chairman
Independent Regulatory Review Commission
333 Market Street
14th Floor
Harrisburg, PA 17101

Re: Comments on the Department of Revenue Proposed Regulations, 61 Pa. Code Ch. 1001.1-1001.11 ("Pennsylvania Gaming Cash Flow Management").

Dear Mr. Coccodrilli:

Thank you for the providing Sands Bethworks Gaming LLC ("Sands Bethworks") with a final opportunity for comment. We have arranged through your office for Frederick H. Kraus, Esquire, Vice President and General Counsel of Venetian Casino Resort, LLC, to present at the June 21, 2007 public hearing. We have attached our previous submissions and make the following additional comments on the form of the final proposed draft of the subject regulations.

The proposed regulations fail on the basis of multiple criteria set forth in the Regulatory Review Act at § 5.2, and are not in the public interest, as discussed below. The Department of Revenue does not have statutory authority for the proposed regulations, and the proposed regulations do not conform to the intention of the General Assembly, in violation of Regulatory Review Act § 5.2(a). Further, the regulations are not within the public interest, because they lack clarity, are ambiguous, and are unreasonable, in violation of Regulatory Review Act § 5.2(b)(3).

A. <u>The allocation of general expenses is improperly made on an undefined "pro rata" standard and the secretary has engaged in "rulemaking" outside of the requisite formal procedures.</u>

The Secretary of Revenue has engaged in unauthorized rule making, and seeks to promulgate a regulatory scheme that will continue to allow him to do so. The Secretary, and the Chairman of the Pennsylvania Gaming Control Board (the "Board"), sent a letter dated May 14, 2007 to all licensees, including Sands Bethworks, (attached as Exhibit "A") announcing the "method" the Secretary has established for the assessment of general regulatory assessments (the "Letter"). The Secretary announced his intention to effect a systematic "charge-back" of

unallocated costs from licensees' Section 1401 accounts: "We intend to continue the current procedure . . . of drawing a flat amount of $800,000 ... after they come on line. Additionally, the Secretary of Revenue ... (will) continue to draw against each licensee's account at the rate of 1.5% of gross terminal revenue during the next fiscal year.... The remaining fund ... will be covered by a loan ... which will be recovered from all licensees...." (Emphasis added).

This is a patent example of rulemaking, outside of the statutorily required procedures mandated by the Commonwealth Documents Law. 45 Pa.C.S. § 1101, *et seq,* see also Groce v. Dep't of Envtl. Prot., 921 A.2d 567 (Pa. Commw. Ct. 2007) ("a 'regulation' is any rule or regulation, or order in the nature of a rule or regulation, promulgated by an agency under statutory authority in the administration of any statute administered by or relating to the agency. The process for issuing regulations provides an important safeguard for potentially affected parties against the unwise and improper exercise of discretionary administrative power."). When a pronouncement by a Commonwealth agency creates a "binding norm," as the Secretary has done here, it is a regulation that must be properly promulgated. Eastwood Nursing & Rehab. Ctr. v. Dep't of Pub. Welfare, 910 A.2d 134, 144 (Pa. Commw. Ct. 2006) (holding that a Department of Public Welfare "standard operating procedure" was a binding norm, not a mere statement of policy, and was thus an unpromulgated regulation in violation of Pennsylvania law).

The proposed regulation, permitting assessment of general administrative costs "on a pro rata basis at the discretion of the Secretary of Revenue" will permit, and invite, the Secretary to continue to establish binding, unpromulgated rules. Just as bad, a "rule" purporting to make assessments against licensees based on the "discretion" of the Secretary is the antithesis of what a properly drafted rule should be designed to achieve: a description of the norm that enables a person to assess the conduct against the required norm. No one can determine if the Secretary has complied with a rule requiring only that the Secretary to exercise discretion in making financial assessments. Therefore, the proposal is unlawful because it permits the Secretary to continue to promulgate rules through the exercise of his discretion without going though the rule making process and because the rule sought to be established through the rule making process is hardly a rule at all.

Besides being fatally flawed as contrary to the requirements of the rule making process, the proposal to assess general regulatory costs, i.e., the amount of regulatory costs that can not be tied to the operations of a licensee and billed to it directly, as a percentage charge against gross revenue has no support in the statute. 4 Pa. CSA § 1401(b) requires each licensee to make a deposit to cover regulatory costs two days prior to opening. So the statute, unlike the Letter, provides no basis for an assessment of general regulatory costs against a licensee for periods before the licensee opens.[1] The Letter contravenes the statute because the Letter advises that

[1] A limited exception is the initial loan from the General Fund of $36,000,000 authorized at 4 Pa. CSA §1901. Pursuant to 4 Pa. CSA § 1901.1, the repayment of this loan commences once all licensees are open (the "All Open

general regulatory costs prior to opening will be collected from all licensees based on the proceeds of another loan. Second, there is no authority in the statute to assess general regulatory costs against a licensee as a percentage of gross revenue once the licensee opens. Third, and for the reasons stated in our April 2, 2007 comment letter, recovery of general regulatory costs from licensees based on a percentage of gross revenue, including those who invest significantly more money in their facilities in order to generate more revenue, amounts to an unlawful tax against the higher grossing licensees because such a method acts as a tax and subsidy in favor of the smaller grossing and smaller investing licensees to the extent that their diminished assessment of general regulatory costs would become less than their true pro rata share or their share based on dividing the general regulatory costs by the number of licensees. .

B. <u>The distribution of local share assessments to municipalities based on the municipality's fiscal year is fundamentally flawed and inconsistent with the Gaming Act.</u>

The proposed regulations would change the annual assessment contemplated by the Gaming Act to a non-annual assessment. The Gaming Act calls for a local share assessment of "2% of the gross terminal revenue or $10,000,000.00 annually." 4 Pa.C.S. § 1404(c)(3)(iii). This annual assessment, by its plain language, should be based on a yearly basis starting from the <u>opening of the licensee</u>, not based on the municipality's fiscal year. The term "annually" describes the frequency of the "assessment," and the "assessment" is of the licensee. This language makes clear that the assessment should be made on an annual basis, with reference to the licensee's year, not the fiscal year of the municipality. An assessment based on less than a year of operation is contrary to the Act's plain intent.

When this calculation is performed incorrectly for the first year, it will always be performed incorrectly. For example, the fiscal year in Bethlehem is the same as the calendar year. If Sands Bethworks goes online in July of a particular year, its year and Bethlehem's fiscal year will never match. Therefore, the licensee will always be forced to pay its local share assessment based on an incorrect calculation of its annual performance.

A significant risk exists of an unduly high assessment and inaccurate calculations of projected gross terminal revenue to licensees in their first year. The "pro rata" assessment made with reference to the number of days of the host municipality's fiscal year, during which a licensee is open during its first year, fails to appreciate several realities. Principally, there is significant seasonal fluctuation in gross terminal revenue. Extrapolating an annual assessment based on just a portion of the year may result in a disproportionate assessment and trigger the default to $10,000,000 payment instead of a 2% charge. Example attached as Exhibit "B".

Date") and is based on the proportion of a licensee's gross revenue earned prior to the All Open Date to total gross revenue earned prior to the All Open Date.

Further, this system punishes those licensees that plan to ramp up from 3,000 to 5,000 slot machines within its first twelve months in operation. A licensee that intends to go up to 5,000 slot machines after six months in operation has a significantly higher probability of exceeding the $10,000,000.00 minimum local share assessment, and having its assessment based on 2% GTR, than a licensee staying at 3,000 slots. If the assessment is made before the licensee has an opportunity to expand to 5,000 slots, it will not have a fair chance to exceed the $10,000,000.00 minimum assessment, and cap its local share assessment at 2%, thus neutralizing one incentive to expand to 5,000 slots as soon as possible.

C. **Section 1001.6(e)(2) should provide for detailed assessment notices that explain how amounts attributable to each licensee and withdrawn from each licensee's § 1401 account were calculated.**

Sands Bethworks agrees with the suggestion of the Independent Regulatory Review Commission ("IRRC"), proposing an open accounting of the assessments made to each licensee's § 1401 account. An open and detailed disclosure of the calculation of each assessment is necessary to ensure statutory compliance, and will avoid any appearance of unfair assessment. An open process such as this will lead to greater communication and understanding between the Department, the Board, and the regulated licensees.

Even though fundamental fairness requires nothing less than a detailed statement of the basis for the assessment, adding such a requirement consistent with the comment of the IRRC creates no burden for the Secretary. The Secretary has to perform detailed calculations to arrive at an accurate assessment. So adding a requirement that the detailed statement must accompany the assessment adds an important safeguard, permitting the licensee to challenge the accuracy of the assessment, without requiring the Secretary to perform any additional work.

We appreciate the consideration of these comments.

Respectfully submitted,

J. Scott Kramer

J. Scott Kramer, Esquire

Frederick H. Kraus

Frederick H. Kraus, Esquire

JSK/lmb
Enclosures
Cc: Patrick M. Browne, Senate Finance Committee Chair
Jane M. Earll, Chair of Senate Committee on Community, Economic

Gerald J. LaValle, Minority Chair of Senate Committee on Community, Economic & Recreational Development
Harold James, Majority Chairman House Gaming Oversight Committee
Paul Clymer, Minority Chairman House Gaming Oversight Committee
David K. Levdansky, House of Representatives Finance Committee Chair
Steven R. Nickol, House of Representatives Finance Committee Minority Chair
John W. Wozniak, Senate Finance Committee Minority Chair
Frank T. Donaghue, Chief Counsel, Pennsylvania Gaming Control Board

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Local Assessment Tax – Example (Exhibit "B")

(Greater of 2% GTR or $10,000,000)

Assumptions:

1) Licensee opens in last quarter of 2008 with 3,000 slot machines.
2) Municipality operates under a calendar year fiscal year.
3) Licensee increases to 5,000 machines by first quarter 2009 (40% revenue increase)
4) Seasonal differences impact revenue with fourth quarter showing lowest revenue (20% difference),
5) Quarterly revenue as below:

	4th Quarter 2008	1st Quarter 2009	2nd Quarter 2009	3rd Quarter 2009	Total Revenue for first year in operation
Revenue	$87,500,000	$139,400,000	$139,400,000	$139,400,000	$ 505,700,000

The licensee's local share assessment will be assessed at a .86% higher rate if a pro rata calculation is used to project the annual revenue for local share assessment purposes, rather than actual revenue generated during the licensee's first 12 months in operation:

	Pro-Rata Annual Assessment Based on 4th Quarter 2008	Annual Basis
Total Revenue for assessment	$87,500,000	$505,700,000
Amount of Assessment	$2,500,000[1]	$10,114,000[2]
Annual Assessment Tax Rate	Tax Rate 2.86%	Tax Rate 2.0%

*The statutory assessment is the greater of 2% of gross terminal revenue, or $10,000,000.

Total Additional Tax Cost = $752,500
(.86% x $87,500,000)

[1] The statutory minimum assessment is $10,000,000, which would be a pro-rata minimum assessment of $2,500,000 if the licensee is open for one quarter before the assessment is made, and if 2% of the projected gross terminal revenue is less than $10,000,000.

[2] A 2% assessment of $505,700,000 is $10,114,000.