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2007 APR -9 AM 9:19
INDEPENDENT REGULATORY
REVIEW COMMISSION

RE: Comments on the Department of Revenue Proposed Regulations, 61 Pa. Code Ch. 1001 ("Pennsylvania Gaming Cash Flow Management").

Dear Ms. Sprunk:

Thank you for the opportunity to comment on the draft regulations proposed for 61 Pa. Code 1001. Sands Bethworks Gaming LLC offers the following comments:

A. 61 Pa. Code 1001.6(e)(3): Reimbursement of General Commonwealth expenses.

The proposed revision to § 1001.6(e)(3) wisely deletes the inequitable assessment of general administrative costs based on gross terminal revenue (GTR). Unfortunately, the proposed revision would provide no standards for the assessment of costs and would leave the formula to be applied "at the discretion of the Secretary or Revenue." This proposal would provide no notice to a licensee of the basis for the Secretary's action, would amount to a delegation of unbridled discretion by the Secretary to the Secretary and would be constitutionally infirm on a state and federal level on a number of bases.

The proposal should expressly preclude regulatory costs being assessed as a percentage of GTR. The Commonwealth should not penalize the more successful licensees for their greater capital investment in their projects, their superior business acumen or the foresight to select an optimal site. It is antithetical to the creation of a new, vibrant industry in the Commonwealth to oppressively assess expenses to the most successful participants to the benefit of their less adroit colleagues in the field. Regulatory cost should be assessed as incurred for each license and

unallocated general overhead should be split equally among the licensees. The legislative scheme, see infra, requires this result. Similarly, because the $50 million dollar license fees were determined by the legislature to be applied equally, the recovery of regulatory costs should be treated no differently.

Besides fundamental unfairness, any assessment of regulatory costs based on a percentage of gross revenue would turn the aim of the statute from a recovery of the costs of regulation from the licensees to a mixed system of recovery of costs and imposition of a tax. The cost recovery system would amount in actuality to the assessment of a tax against the more successful and larger licensees to the extent of the amount of the assessment in excess of the amount of a pro rata assessment. To the extent the assessment were in actuality a tax, the tax would go not to the benefit of the Commonwealth or its citizens, but as a subsidy to the smaller or less successful licensees. In other words, an assessment based on a percentage of GTR would amount to a tax applied as a subsidy of the smaller and less successful operators.

Therefore, any charge back system that calculates distribution of general administrative costs based on gross terminal revenue is effectively a disparate tax, in violation of due process as the tax would be assessed against some licensees for the benefit of other licensees. See Pa. Const. Art. VIII, § 1 ("All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws."); City of Harrisburg v. The School District of the City of Harrisburg, 551 Pa. 295, 303 (Pa. 1998) ("When there exists no legitimate distinction between the classes, and, thus, the tax scheme imposes substantially unequal tax burdens upon persons otherwise similarly situated, the tax is unconstitutional"), quoting Leonard v. Thornburgh, 507 Pa. 317 (1985).

Thus far, we have addressed only the infirmities if the basis for recovery of regulatory costs was a percentage of GTR once all licensees were open. However, there is also the interim period where some but not all of the licensees are open.

The legislative scheme creates a geographically balanced monopoly. See 4 Pa, C.S.A. §1304(b) (setting forth distance some restrictions between licensees). The open venues are benefiting from an artifact of the system that certain entrants will take time to be fully operational. The on-line venues have been wildly successful because they are in business with limited competition. PGCB Gaming Revenue Report, March 19, 2007. Yet the proposed regulations would permit the non-operational licensees to subsidize the operations of the on-line licensees through the payment of regulatory overhead.

Licensees such as Sands Bethworks, Mt. Airy, and the Pittsburgh and Philadelphia casinos may be over one year from operation, yet the proposal would permit the Secretary to require that each fund a portion of the regulatory cost for the open casinos, now enjoying high revenues in the absence of interim competition. The regulations should mandate that only on-line casinos will incur general administrative cost assessments other than the repayment of the initial loan as described below.

Assessment of general regulatory costs incurred prior to the opening of a licensee would also violate the statute. The entire legislative "charge-back" structure is established through the Section 1401 accounts, to be set up just 2 days before beginning operations. 4 P.S. § 1401(b). The intent of the Legislature is clear that expenses for regulation are to be drawn beginning with the establishment of the § 1401 accounts at the outset of operations. Likewise, Section 1401(b), provides that each licensee is required to deposit $5,000,000 in an account with the State

Treasurer not later than two (2) days before operations commence. This deposit amounts to an imprest fund because 4 Pa. C.S.A. § 1401(c) provides that the licensee must replenish the account on a weekly basis with an amount equal to the deductions made by the Department from the account as authorized by 4 Pa.C,S.A. § 1402. In turn, § 1402 authorizes deductions for appropriate assessments by the Department for specifically delineated costs only: (1) costs incurred by the Department attributable to a specific licensee, (2) the other costs and expenses of the Department within the budget approved by the Board, (3) sums necessary to repay loans from the general fund to the Department in carrying out its responsibilities including the acquisition of the central computer, (4) the costs and expenses of the State Police and the Attorney General and not otherwise reimbursed to them and in accordance with an approved budget, (5) sums necessary to repay loans to the State Police from the general fund, (6) the costs and expenses of the Board based on the budget of the Board approved by the Board, and (7) sums necessary to repay loans from the general fund to the Board.

Other than the limited exception of participating in repayment of the initial loan prescribed in Section 1402, there is no statutory authority to assess licensees for general regulatory costs to licensees for periods of time when they are not open. This is especially true where the open licensees are being assessed regulatory costs as a percentage of gross revenue at a rate that is less than the rate predicted by the Secretary when all licensees are open. Thus, not only would the larger and more successful licenses be subjected to an impermissible tax in favor of the smaller and less successful licensees once all the licensees were open, but the later to open licensees would be assessed what amounts to a prohibited tax to the extent that the assessment rate for licensees now open is less than the rate planned when all licensees are open.

The legislature was also careful to provide a crediting system for the licenses if additional taxes were placed on GTR. 4 Pa. C.S.A. § 1209(c). That was a provision of the statute on which licensees were expected to rely. The system of recovering general regulatory costs not part of the original loan based on a percentage of gross revenue is, for the reasons expressed above, a tax that activates the credit provisions of Section 1209(c).

Therefore, while it is patently unfair to allocate such costs to licensees based on a percentage of GTR or attributable to periods of time when the venues are not open, it is also impermissible under the statute. Otherwise, the licensees that are not open would bear general regulatory costs with no offsetting revenue and with the result that the larger and more successful licensees would not only be subsidizing the smaller and less successful licensees in the form of a disguised tax after such licensees were open, but also would be doing so before they were open. Either situation would fall squarely within the prohibition of Section 1209(c).

We think that several conclusions follow from the statute. Until just prior to the commencement of operations, a licensee is not required to fund any regulatory costs that are not specific to the investigation of its application. As of the time it commences operations, a licensee may be assessed its appropriate share of costs to establish the system of regulation such as the initial loan to the Department from the general fund for its share of the central computer system. Non-operating licensees would have no legal obligation to reimburse regulatory cost deductions made from another licensees' § 1401 accounts. Sands Bethworks proposes the following language for 1001.6(e)(3):

> *General administrative costs of the Board, Department, Office of Attorney General, Pennsylvania State Police not specifically assessed to a licensed gaming entity under paragraph (1), shall be borne on an equal basis by each licensed gaming entity in operation at the time the general administrative cost is incurred.*

The General administrative costs assessed shall be under budgets approved by the Board and upon appropriations by the General Assembly, as required in Section 1402.1 of the Act and be collected from only those licensees in operation.

Section 1001(6)(e)(2) seems to be an attempt to permit any Commonwealth agency to try and recovery its costs/expenses on the recent gaming industry in Pennsylvania. The legislative plan only permits chargeback by the delineated agencies: the Board, the Department, Pennsylvania State Police, and the Office of the Attorney General. 4 Pa. C.S.A. § 1402(a).

B. **61 Pa. Code 1001.5(b)(5)(i), (iii): Administration and distribution of moneys held by licensed gaming entities and the Commonwealth: Distributions of local share assessments to municipalities.**

The proposed 61 Pa.Code 1001.5(b)(5)(iii) would link the 4 Pa. C.S.A. § 1403(c)(3) local share assessment to the host municipality's fiscal year. This proposal is fundamentally flawed.

The local share assessment is the greater of 2% or $10 million. Unless GTR is $500 million, the $10 million will be the larger of the two alternatives. However, the only time that that determination can be made is at the end of the licensee's fiscal year. For that reason, the statute simply says that if the local share assessment does not amount to $10 million the difference shall be remitted to the municipality.

The proposal would require payment of the shortfall within 15 days following the end of the municipality's fiscal year. The regulation should require the payment within 15 days following the end of the licensee's fiscal year. Quite simply, the municipality's fiscal year has nothing to do with the determination whether any tax is due.

The proposal at 61 Pa. Code 1001.5(i) speaks in terms of proration of the minimum assessment based on the municipality's fiscal year, but that is a murky and ill defined and completely unnecessary concept. It is unnecessary because the licensee need not prorate

anything when it pays the minimum assessment, if required, at the end of its fiscal year. It is murky and ill defined because there is no way to determine what the assessment ought to be. For example, if the municipality's fiscal year ends two months after the licensee's fiscal year commences, there is no rational basis after two months of operation of determining the amount of any minimum payment that might be required after another 10 months of operations.

Rather, the host fee should be assessed on an annual basis measured from the gaming entity's first day in operation, without reference to the host municipality's fiscal year. The Gaming Act supports this methodology. Section 1403(c)(3)(iii) states that the local share assessment for a Category 2 facility in a city of the third class be "2% of the gross terminal revenue or $10,000,000 annually" (emphasis added). A calculation of the local share assessment based on anything less than 12 months of operation is contrary to the plain meaning and intent of the Act and may fail to fully protect the licensee from an assessment greater then 2% despite an annual performance that would justify the 2% alternative once GTR reaches $500 million. Conversely, calculation of the local share assessment annually from the first day of operation embraces the plain meaning and intent of the Act.

We appreciate the consideration of these comments.

Respectfully submitted,

Frederick H. Kraus, Vice President and General Counsel

Venetian Casino Resort

J. Scott Kramer, Esquire