

Senate Committee on Governmental Organization

Informational Hearing March 24, 2015

Confronting Shortfalls in Indian Gaming Funds: the Special Distribution Fund (SDF) and the Revenue Sharing Trust Fund (RSTF)

BACKGROUND INFORMATION

Indian Gaming Regulatory Act (IGRA)

In 1988, Congress enacted the Indian Gaming Regulatory Act (IGRA) to provide a statutory basis for the operation and regulation of gaming on Indian lands. IGRA provides that an Indian tribe may conduct gaming activity on Indian lands if the activity “is not specifically prohibited by federal law and is conducted within a State which does not prohibit such gaming activity.”

IGRA distinguishes between three classes of gaming (Class I, Class II, and Class III) and provides for different forms of regulation for each class. Class I gaming includes “social games” for minor prizes or “traditional forms of Indian gaming.” Class II gaming is defined to include bingo and card games that are explicitly authorized by the laws of the state, or that are not explicitly prohibited by the laws of the state and are played at any location in the State, so long as the card games are played in conformity with those laws and regulations. Class III gaming includes such things as slot machines, casino games and banked card games such as black jack and baccarat. Class III gaming may only be conducted under terms of a compact negotiated between an Indian tribe and a State.

IGRA was enacted against a legal background in which Indian tribes and individuals generally are exempt from state taxation within their own territory. IGRA provides that with the exception of assessments permitted under the statute, to defray the State’s costs of regulating gaming activity, IGRA shall not be interpreted as conferring upon a State authority to impose any tax, fee, charge, or other assessment upon an Indian tribe to engage in Class III activity. Nor may a State refuse to enter into negotiations based on the lack of authority to impose such a tax, fee, charge, or other assessment.

When a tribe requests negotiations for a Class III compact, IGRA requires the State to negotiate with the Indian tribe in good faith. IGRA provides a comprehensive process to prevent an impasse in compact negotiations, which is triggered when a tribe files suit alleging that the State has refused to negotiate or has failed to negotiate in good faith.

Before 2000, The California Constitution prohibited Class III gaming. In 2000, California voters approved Proposition 1A which had been proposed by the Governor and passed by the Legislature. Proposition 1A amended the California Constitution to permit the State to negotiate

compacts with federally recognized Indian tribes for certain Class III gaming activities. Because non-Indian parties were still forbidden from operating gaming facilities, Proposition 1A granted Indian tribes a “constitutionally protected monopoly on most types of Class III games in California.”

Rincon Decision

The U.S. Supreme Court in July 2011 refused to consider the decision of the Ninth Circuit Court rejecting a Class III Tribal-State Gaming Compact negotiated by Governor Schwarzenegger with the Rincon Band of Luiseno Mission Indians. The issue of this case's impact on Indian gaming throughout the country has been a topic of great debate.

As noted, IGRA authorizes states to receive compensation for costs related to tribal gaming such as regulation and gaming addiction, and to offset the effects of casinos on surrounding communities. However, states are prohibited from assessing taxes on tribal casino revenues, so unjustified payments to a state's General Fund are no longer permissible unless the tribes are getting something in return for the required payments, such as those authorized by IGRA.

Another vehicle for state receipt of casino payments above those payments must be in exchange for some benefit deemed "exclusive" to the tribe. To this end, it is fact that a number of other state Governors have attempted to create "exclusive grants" in favor of compact signatory tribes in return for payments to the state treasuries.

The Rincon Band challenged the legality of California's "second generation" compacts pursuant to which the signatory tribes would be entitled to increase their slot machine count in return for paying percentages of the new slot machine revenue to the state's General Fund. The Ninth Circuit had affirmed a lower court decision that the new financial concessions were nothing more than a state tax on tribal casino revenues which is prohibited by IGRA.

Rincon had refused to sign the amended compact which already had been executed by several other tribes choosing instead to demand that it be given the expanded gaming opportunity without making the new financial concessions. The Ninth Circuit Court concluded that a “non-negotiable, mandatory payment of 10% of net win into the State treasury for unrestricted use yields public revenue, and is [therefore] a tax, and that the court was therefore required to consider the State’s demand as evidence of bad faith under IGRA’s statutes.”

The court noted that “the State could rebut the presumption of bad faith by demonstrating that the revenue demanded was to be used for the public interest, public safety, criminality, financial integrity, and adverse economic impacts on existing activities, but the State’s need for general tax revenue was insufficient to demonstrate good faith.”

Special Distribution Fund (SDF)

Existing law creates the SDF in the State Treasury for the receipt of revenue contributions made by tribal governments pursuant to the terms of the 1999 model Tribal-State Gaming Compacts and authorizes the Legislature to appropriate money from the SDF for the following purposes: (a) grants for programs designed to address gambling addiction; (b) grants for the support of state and local government agencies impacted by tribal government gaming; (c) compensation for regulatory costs incurred by the California Gambling Control Commission (CGCC) and the Department of Justice (DOJ) in connection with the implementation and administration of compacts; (d) payment of shortfalls that may occur in the Indian Gaming Revenue Sharing Trust Fund (RSTF); (e) disbursements for the purpose of implementing the terms of tribal labor relations ordinances promulgated in accordance with the terms of the 1999 compacts; and, (f) any other purpose specified by law. (Pursuant to compact renegotiations that took place with several of the larger gaming tribes during the Schwarzenegger administration, revenue from those tribes is directed into the state General Fund, instead of the SDF.)

The law establishes a method of calculating the distribution of appropriations from the SDF for grants to local government agencies impacted by tribal gaming. This method includes a requirement that the State Controller, in consultation with the CGCC, deposit funds into County Tribal Casino Accounts and Individual Tribal Casino Accounts based upon a process that takes into consideration whether the county has tribes that pay, or not pay, into the SDF. The distribution formula "sunsets" on January 1, 2021.

Existing law also establishes an Indian Gaming Local Community Benefit Committee in each county in which gaming is conducted, specifies the composition and responsibilities of that committee, and requires that committee to make the selection of grants from the casino accounts. Among other things, the committee is responsible for establishing all application policies and procedures for grants from the casino accounts.

Additionally, existing law requires the State Auditor to conduct an audit every three years and report its findings to the Legislature regarding the allocation and use of SDF grant monies.

Revenue Sharing Trust Fund (RSTF)

Existing law also creates in the State Treasury the RSTF for the receipt and deposit of moneys derived from gaming device license fees that are paid into the RSTF pursuant to the terms of specified tribal-state gaming compacts for the purpose of making distributions to non-compacted Tribes (e.g., federally-recognized non-gaming and tribes that operate casinos with fewer than 350 slot machines). Revenue in the RSTF is available to CGCC, upon appropriation by the Legislature, for making distributions of \$1.1 million annually to non-compact tribes. The RSTF was created as part of the 1999 compacts, which, in conjunction with the passage of Proposition

1A, created gaming compacts with approximately 60 California tribes. Non-compact tribes are considered third-party beneficiaries of the 1999 compacts.

Tribal Nation Grant Fund (TNGF)

This particular fund was created to complement the RSTF and provides for the distribution of funds to non-gaming tribes, upon application of such tribes for purposes related to effective self-governance, self-determined community, and economic development. The designated purpose of the RSTF is rigid and formulaic. This new fund is designed to be fluid and payments are intended to be made to non-gaming tribes on a “need” basis, upon application by non-gaming tribes.

Prior Related Informational Hearing

In 2004, the Legislature ratified amendments to five Indian gaming compacts (AB 687 – Nuñez, Chapter 91, pertaining to the Pala Band of Mission Indians; the Pauma Band of Luiseno Mission Indians of the Pauma and Yuima Reservation; the Rumsey Band of Wintun Indians; the United Auburn Indian Communities; and, the Viejas Group of Kumeyaay Indians) which eliminated the cap on the number of slot machines that could be operated by any of the compacted tribes. Under these compacts, the tribes agreed to make payments directly to the State in exchange for the exclusive right to conduct class III gaming from non-tribal interests. The amended compacts also provided for a payment of up to \$1.5 billion to the state for transportation improvement projects, to be financed by a bond securitized by gaming revenues which would be repaid over 18 years. Additionally, the amended compacts provided a graduated scale of progressively higher annual fees for additional slot machines above the existing limit of 2,000 machines, reaching up to \$25,000 per additional machine. The fees represented approximately 15% of the net win of the additional machines on average and were estimated to provide as much as \$150-\$200 million in annual revenue to the state over time from these tribes alone.

Furthermore, under the 2004 amended compacts, among other things, the tribes agreed: (1) to make annual payments in the amount of \$2 million per tribe for a total of \$10 million annually to the RSTF; (2) to allow the state to inspect the slot machines and submit patron disputes to binding arbitration; (3) to prepare an Environmental Impact Report for new projects and to negotiate mitigation of off-reservation impact and increased demand for services with local governments, with binding arbitration if negotiations reach impasse; (4) to meet or exceed California Building Code and Public Safety Code on new construction and to allow the state to inspect construction in progress; and, (5) to modify their Tribal Labor Relations Ordinance to provide workers with enhanced organizing rights in exchange for a no-strike clause.

The accuracy of the Schwarzenegger Administration’s predicted and actual revenues and expenditures, as they related to the new revenue stream from gaming, and issues raised by litigation (*Glendon B. Craig, et al. v. Schwarzenegger, et al.*) challenging the validity of the

bonds and the source of repayment led the Chairman of the Senate Committee on Governmental Organization to convene an informational hearing in February of 2005 entitled, “*Forecasting Revenues: A Look at Indian Gaming Compacts and State Budget Revenue Estimates*” to give the members of the Legislature and the general public a better understanding of this complex matter and related issues that essentially stalled the issuance of the bonds and the transportation projects they were meant to finance.

Witnesses at this hearing included state finance and gambling officials, the State Treasurer, representatives of the Governor, as well state gaming interests. In general, the witnesses agreed that without a swift resolution of the issues discussed, the bonds would unlikely be sold in a timely manner and construction of the transportation projects would be jeopardized. (It should be noted that the transportation bonds in question were never issued by the Treasurer’s Office.)

Pauma Band of Luiseno Mission Indians Lawsuit

In 2010, the Pauma Band of Luiseno Mission Indians ceased payments to the State and brought suit against the State in federal court claiming that the State acted in bad faith by misrepresenting significant information relative to the number of gaming machines available for licensure. Prior to its 2004 amended compact, the Tribe was paying approximately \$315,000 a year to the state (into the SDF and RSTF) under terms of its 1999 compact. The payment rose to \$7.75 million a year (initially for securitizing the proposed transportation bond and subsequently deposited directly into the general fund) under the tribe’s 2004 amended compact. In 2013, the court sided with Pauma and, thus, the state no longer receives payments from the Pauma Tribe. The State has appealed that decision.

The Rincon decision as well as the Pauma case, have limited some of the state's options when negotiating and renegotiating compact agreements.