

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE MINNESOTA LAWFUL GAMBLING CONTROL BOARD

In the Matter of the Proposed
Adoption of the Minnesota Lawful
Gambling Control Board Rules
Relating to Lawful Purpose
Expenditures and Allowable
Expenses, Minnesota Rules,
Parts 7861.0010, 7861.0120,
and 7865.0025.

REPORT OF THE
ADMINISTRATIVE LAW JUDGE

The above-entitled matter came on for hearing before Administrative Law Judge Peter C. Erickson at 9:00 a.m. on Monday, December 14, 1992 in Room 15 of the State Capitol Building, St. Paul, Minnesota. This Report is part of a rule hearing proceeding held pursuant to Minn. Stat. §§ 14.131 - 14.20 to determine whether the Agency has fulfilled all relevant substantive and procedural requirements of law, to determine whether the proposed rules are needed and reasonable, to determine whether the Department has statutory authority to adopt the proposed rules, and to determine whether or not the proposed rules, if modified, are substantially different from the rules as originally proposed.

John Garry, Special Assistant Attorney General, 1100 Bremer Tower, Seventh Place and Minnesota Street, St. Paul, Minnesota 55101, appeared on behalf of the Minnesota Lawful Gambling Control Board (Board). Nan Connor and Lee Graczyk, Compliance Officers for the Board, appeared and testified in support of the proposed rules. The hearing continued until all interested groups and/or persons had had an opportunity to comment on the proposed rules.

The Board must wait at least five working days before taking any final action on the rules; during that period, this Report must be made available to all interested persons upon request.

Pursuant to the provisions of Minn. Stat. § 14.15, subd. 3 and 4, this Report has been submitted to the Chief Administrative Law Judge for his approval. If the Chief Administrative Law Judge approves the adverse findings of this Report, he will advise the Board of actions which will correct the defects and the Board may not adopt the rule until the Chief Administrative Law Judge determines that the defects have been corrected. However, in those instances where the Chief Administrative Law Judge identifies defects which relate to the issues of need or reasonableness, it may either adopt the Chief Administrative Law Judge's suggested actions to cure the defects or, in the alternative, if the Board does not elect to adopt the suggested actions, it must submit the proposed rule to the Legislative Commission to Review Administrative Rules for the Commission's advice and comment.

If the Board elects to adopt the suggested actions of the Chief Administrative Law Judge and makes no other changes and the Chief Administrative Law Judge determines that the defects have been corrected, then the Board may proceed to adopt the rule and submit it to the Revisor of Statutes for a review of the form. If the Board makes changes in the rule other than those suggested by the Administrative Law Judge and the Chief Administrative Law Judge, then it shall submit the rule, with the complete record, to the Chief Administrative Law Judge for a review of the changes before adopting it and submitting it to the Revisor of Statutes.

When the Board files the rule with the Secretary of State, it shall give notice on the day of filing to all persons who requested that they be informed of the filing.

Based upon all the testimony, exhibits and written comments, the Administrative Law Judge makes the following:

FINDINGS OF FACT

Procedural Requirements

1. On October 19, 1992, the Board filed the following documents with the Chief Administrative Law Judge:

- (a) A copy of the proposed rules certified by the Revisor of Statutes.
- (b) The Order for Hearing.
- (c) The Notice of Hearing proposed to be issued.
- (d) A Statement of the number of persons expected to attend the hearing and estimated length of the Agency's presentation.
- (e) The Statement of Need and Reasonableness.

2. On November 9, 1992, a Notice of Hearing and a copy of the proposed rules were published at 17 State Register pp. 1122 - 1128.

3. On November 10, 1992, the Board mailed the Notice of Hearing to all persons and associations who had registered their names with the Board for the purpose of receiving such notice.

4. On November 20, 1992, the Board filed the following documents with the Administrative Law Judge:

- (a) The Notice of Hearing as mailed.
- (b) The Agency's certification that its mailing list was accurate and complete.
- (c) The Affidavit of Mailing the Notice to all persons on the Agency's list.
- (d) An Affidavit of Additional Notice.
- (e) The names of Board personnel who will represent the Agency at the hearing together with the names of any other witnesses solicited by the Agency to appear on its behalf.
- (f) A copy of the State Register containing the proposed rules.
- (g) All materials received following a Notice of Intent to Solicit Outside Opinion published at 16 State Register pp. 2248-49 (April 13, 1992) and a copy of the Notice.

The documents were available for inspection at the Office of Administrative Hearings from the date of filing to the date of the hearing.

5. The period for submission of written comment and statements remained open through January 4, 1993, the period having been extended by order of the Administrative Law Judge to 20 calendar days following the hearing. The record closed on January 11, 1993, the third business day following the close of the comment period.

Statutory Authority

6. Except as specifically modified below, statutory authority to adopt the proposed rules is contained in Minn. Stat. § 349.151, subd. 4(a).

Small Business Requirements

7. The Board has addressed the impact of the proposed rules on small business in its Statement of Need and Reasonableness on page 17. The Board has considered the methods for reducing the impact of the proposed rules on small businesses as required by subdivision 2 of that section and determined that: (1) the proposed rules do not unduly burden small businesses; and (2) because of the importance of maintaining integrity in the industry, the Board cannot be less rigorous in the regulation of one size or type of business over another.

Nature of the Proposed Rules

8. In an effort to improve the regulation of lawful gambling in this state, the Board has proposed to amend existing rules to clarify what expenditures by organizations that conduct lawful gambling qualify as lawful purpose expenditures and/or allowable expenses. It is the Board's intent that these proposed rules will result in a clearer understanding of expense parameters and thus result in better compliance by licensed organizations.

9. Some of the proposed rule provisions received no negative public comment and were adequately supported by the Statement of Need and Reasonableness (SONAR). The Administrative Law Judge will not specifically address those provisions in the discussion below and specifically finds that the need for and reasonableness of those proposed rules has been demonstrated.¹ The discussion which follows the modifications will only address substantive issues of need, reasonableness or statutory authority.

¹In order for an agency to meet the burden of reasonableness, it must demonstrate by a presentation of facts that the rule is rationally related to the end sought to be achieved. Blocher Outdoor Advertising Co. v. Minnesota Dep't of Transp., 347 N.W.2d 88, 91 (Minn. Ct. App. 1984). Those facts may either be adjudicative facts or legislative facts. Manufactured Housing Institute v. Pettersen, 237 N.W.2d 238, 244 (Minn. 1984). The agency must show that a reasoned determination has been made. Manufactured Housing Institute at 246.

Modifications to the Proposed Rules Made by the Board

10. At the time of, and subsequent to the hearing after a review of all the written submissions, the Board has modified the proposed rules additionally as follows:

A. Modifications Made at the Hearing

7861.0010 DEFINITIONS.

* * *

Subp. 3b. Gambling bank account. "Gambling bank account" means all the accounts maintained by an organization at any banks, savings and loans, or credit unions located within Minnesota in which the organization deposits all gambling receipts and over which the organization has any control, including checking and savings accounts, certificates of deposit and trust and escrow accounts.

* * *

7861.0120 ORGANIZATION OPERATIONS ACCOUNTS, AND REPORTS.

Subp. 3. Records and reports required. The following items apply to records and reports:

* * *

E. When an organization has a fund loss by questionable means of its inventory or cash, the organization may apply to the board, on a form prescribed by the board, for an adjustment of its ~~gambling-bank account~~ profit carryover. . . .

* * *

(2)(f) a description of how the loss was verified using schedule B or B-2 if necessary;

* * *

(3) all fund losses by questionable means must be reimbursed to the gambling bank account from nongambling funds, unless an adjustment to the ~~gambling-bank-account~~ organization's profit carryover is approved by the board.

* * *

Subp. 4. Bank accounts. The following items apply to bank accounts:

A. Each organization must maintain a separate gambling bank account at a banks, savings and loans, or credit unions located within Minnesota.

(1) All expenditures of gambling funds must be made from the checking account or accounts included in the separate gambling bank

account, except in case of expenditures previously approved by the organization's membership for emergencies. . . .

(2) The checking account or accounts included in an organization's gambling bank account must consist of one of the following:

* * *

(c) a checking account for each permitted premises as described in unit (b) and one additional checking account into which the organization transfers all or a portion of its gambling receipts from the other checking accounts and from which the organization makes all or a portion of its expenditures of gambling gross profits. This ~~unit~~ subitem does not prevent an organization from transferring gambling gross profits to a nonchecking account included in its gambling bank account in the period between the deposit and expenditure of the gambling gross profits.

* * *

Subp. 5C. "Lawful purpose" means any one of the following:

(1) A contribution to an organization which:

* * *

(b) spent in its most recently completed calendar or fiscal year, whichever is the year basis on which its books are kept, 30 percent or less of its total revenue on fundraising costs and management and general costs, provided that for purposes of this subitem, total revenue shall not include ~~that portion of~~ the organization's own gambling gross profits, if any, ~~which it spent for allowable expenses;~~

* * *

Subp. 5 H. An organization shall maintain documentation sufficient to show that each of its expenditures of gambling gross profits constitute either an allowable expense or a lawful purpose under this subpart.

7865.0025 REIMBURSEMENT.

The Board may require any organization to deposit nongambling funds in the organization's gambling bank account to reimburse the account for unlawful expenditures or expenses, to otherwise bring the ~~account~~ organization into compliance with Minnesota Statutes, section 349.51, or to reimburse the account for gambling receipts that the organization failed to deposit in the account. Subject to parts 7861.0020, subpart 8, and 7861.0120, subpart 5, item B, subitem (5), reimbursement is a contested case under Minnesota Statutes, chapter 349 14. In determining the extent of the reimbursement to be required after a contested case hearing, the board shall consider ~~the factors in part 7865.0030, subpart 1, i~~

- A. the severity of the conduct as indicated by the potential harm to the integrity of lawful gambling;
- B. the culpability of the violator;
- C. the frequency of the violator's failure to comply with laws or rules relating to the deposit and expenditure of gambling receipts;
- D. the actual harm caused to the integrity of lawful gambling;
- E. the likelihood that the violation will occur again;
- F. the degree of the violator's cooperation during the course of the investigation into its activities; and
- G. any other factor related to the violation that the board considers crucial to its determination of the extent of the reimbursement as long as the same factors are considered with regard to all violators.

B. Modifications Made Subsequent to the Hearing.

Part 7861.0120 ORGANIZATION OPERATIONS, ACCOUNTS, AND REPORTS.

* * *

Subp. 5. Expenditures. The following items apply to expenditures of gambling funds:

* * *

B. Allowable expenses:

* * *

5. Percentage of profit to be used for allowable expenses:

(a) Not more than 60 percent of the gross profit, less the tax imposed by Minnesota Statutes, section 349.212, subdivision 1, from bingo, and not more than 50 percent of the gross profit may be expended for allowable expenses related to lawful gambling.

(b) Compliance with the maximum percentage of profits expended for allowable expenses must be determined annually, as provided in this item and part 7861.0020, subpart 8, for the organization as a whole based on the organization's cumulative past expenditures for allowable expenses. Compliance is not determined by each premises.

(c) A licensed organization must file with the board an allowable expense calculation report, on a form prescribed by the board, covering the period ending with the 12th month after the effective date of the organization's current license, every ~~12-months-from-the-start-of-the-third-month-before-the-~~

~~effective date of the organization's license. The report must be filed on or before the 20th day following the last day of the period.~~ If the report shows that the organization is not in compliance with the maximum percentage of profits that may be expended for allowable expenses, then beginning on the day the report is filed first day of the organization's next 12-month reporting period, the organization must cease its conduct of lawful gambling until it has deposited sufficient nongambling funds in its gambling bank account to bring the organization into compliance with the percentage limits on allowable expenses.

(d) The allowable expense calculation report filed with an organization's license renewal application under part 7861.0020, subpart 8, must cover the period ending with the 21st month after the effective date of the organization's current license.

11. The modifications set forth above were made, in large part, in response to concerns raised by the public both at the hearing and in written submissions. The Judge finds that none of these modifications constitute a substantial change to the rules as initially proposed and that there is evidence in the record to support the need for and reasonableness for the modifications made.

Discussion of the Proposed Rules

12. Minn. Rule 7861.0120, subp. 5F. -- This proposed rule provision permits a licensed organization to contribute gambling profits to a "parent organization at the Minnesota state level" if the parent organization has submitted to the Board a list of lawful purposes for use of contributions and the parent organization uses the entire amount of the contributions for one or more lawful purposes. Vern Seipkes, gambling manager for the Staples Lions Club #1785, objected to the "state level" requirement in the rule because the Lions Club is organized on a smaller district basis rather than on a "state level". Mr. Seipkes expressed his concerns as follows:

. . . We have 10 districts in Minnesota composed of 576 clubs and 23,000 members. These Districts have projects that are unique to their area and since many of the clubs are small they cannot handle a project in their city so we set up a District pool of money that is used to fund district-wide projects. One example is a District has a Med Van that travels the district testing and screening. The district asks for money from all the clubs to pay for this van. The clubs also may give to a Diabetes fund and then sponsor health screenings in various cities and give money for Diabetes research and education. Some of the other projects that Districts do are, Childrens Camps, Youth Exchange, Hearing Dogs, International Baseball assn for Youth in Third World countries, Lions Quest, Drug Awareness, Handicapped camps.

All projects meet the requirements of lawful Purpose. No funds are used for administration. No clubs receive any funds back from the district. All projects are paid from District Project funds.

I would hope that someday could be worked out so that Districts may continue to fund these charitable projects from gambling funds. As I see it now under Section F lions clubs could not qualify because we are not organized on a state level.

The SONAR states that the purpose of the contribution limitation to state level parent organizations is so the Board can more easily determine that the expenditures made by the licensed organization are allowable as lawful purpose expenditures. The Director of the Lawful Gambling Board responded to Mr. Seipke's objections as follows:

. . . It is the Director's understanding that district-level organizations of the sort described frequently do not constitute separate legal entities and, unlike parent organizations at the state level, are not required to file an annual audit with the Charities Division of the Attorney General's Office. It is anticipated that these audits will be useful to both the Board and licensed organizations in the administration and implementation of the proposed rule. Finally, the programs identified in Mr. Seipke's letter as funded on the district level, e.g., camps for the handicapped, could under current Board rule receive contributions of gambling funds made directly to them by licensed lawful gambling organizations.

The Director also stated that allowing licensed organizations to contribute funds to "district" level organizations would create a less centralized system under the proposed rules and, therefore, make it more difficult to ensure compliance with the "lawful purpose" rule provisions.

The Judge finds that the need for and reasonableness of the proposed rule has been demonstrated by the Board. Obviously, a "parent" organization reporting mechanism will allow the Board to both monitor and verify that money is being spent for lawful purposes. It would not seem terribly difficult, however, for either the Board to develop a reporting mechanism which the Lions Clubs could follow or for the Lions to create a "straw" state level organization only for the purpose of functioning as an intermediary for lawful purpose contributions. As written, the proposed rule implements the purpose of verifying that the contributions made by licensed organizations go only to lawful purposes.

13. Minn. Rule 7861.0120, subp. 5B.(2)(4) -- These rule provisions specify what are and are not allowable expenses pursuant to the definition of allowable expense contained in Minn. Stat. § 349.12, subd. 3a. In December of 1991, the Board proposed to adopt similar rule provisions which specified

types of allowable and not-allowable expenses (specifically stating that advertising expenses are not allowable expenses). Subsequent to the 1991 rule hearing, this Judge issued a Report dated January 10, 1992 which contains the following Finding:

Pursuant to Minn. Stat. § 349.151, subd. 4(a)(5), the Board has power to "make rules authorized by this chapter". Prior to the 1991 legislative session, there was no definition for the term "allowable expense" contained in chapter 349. Additionally, Minn. Stat. § 349.15(b) stated that "the Board shall provide by rule for the administration of this section, including specifying allowable expenses". During the 1991 session, the Legislature defined "allowable expense" and deleted specific statutory authority for the Board to promulgate rules enumerating what constitutes an "allowable expense".

The Board clearly is empowered to promulgate rules authorized by chapter 349. However, there is no longer any statutory authority for the Board to specify allowable expenses and the legislature has taken it upon itself to enact a statutory definition of "allowable expense". Absent legislative history for these changes in the record, the Judge is compelled to interpret legislative intent as removing any authority for the Board to establish, by rule, what constitutes an allowable expense. The Legislature must have wanted its statutory definition to control that determination. Consequently, the Judge finds that the Board does not have statutory authority to promulgate proposed Rule 7861.0120, subpart 5B.(2).² In order to correct this defect, the Board must delete proposed Rule 7861.0120, subpart 5B.(2).

²The result of the legislative action is that a series of contested cases or district court actions may be required before a uniform policy is established concerning the interpretation of what constitutes an "allowable expense". If the Legislature had wanted the Board to make those policy decisions by rule, it would not have removed the statutory authority contained in Minn. Stat. § 349.15(b) (1990). The Judge cannot conclude that the legislative action was mere inadvertence or that the Legislature intended the Board to continue rule promulgation concerning the definition of "allowable expense" without specific authority.

As part of the record in this proceeding, the Board submitted tapes of proceedings in legislative committees which heard the amendments made to chapter 349 in 1991. However, the testimony of Tom Anzelc (then director of the Gambling Control Board) indicates that the Board favored the adoption of a statutory definition of "allowable expense" so the Board would not have to

"overly prescribe" the business activities of licensed organizations. When the issue of authority to adopt rules was raised, the Senate counsel testified that the Board had broad rulemaking authority despite the deletion of the specific authority proposed to be deleted. However, later in the same meeting, Senate counsel seemed to change his mind and suggest that rulemaking authority for the Board to adopt rules "for the administration of this section" be reinstated. The bill went to conference committee and came out in a format which was significantly different than the bill that was passed out of the Senate committee discussed above. During the last legislative session, the Board's legislative package did not contain any language which would give it specific statutory authority to promulgate rules defining "allowable expenses" despite the results of the 1991 rulemaking proceeding.²

Nothing has been presented in this proceeding which would suggest that a different analysis than the one done in 1991 is appropriate herein. No change has been made to the Board's statutory authority and the Board is still proposing to specify what constitutes an allowable expense and what does not. The Legislature removed the Board's statutory authority to promulgate rules on that subject in 1991 when it saw fit to statutorily define what was an allowable expense. Consequently, the Judge finds that the Board does not have statutory authority to promulgate the proposed rule provisions which specify what are and what are not allowable expenses. In order to correct this defect, the Board must delete those proposed rule provisions.³

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

²The Board did, however, issue a policy statement in December of 1991 (before the rule report was issued) which was printed in the January issue of Gaming News stating that advertising expenses would not be considered as an allowable expense. That policy was not retracted after the issue of statutory authority was resolved in the report issued January 10, 1992. According to the Board (its attorney, John Garry), the policy issued by the Board concerning advertising was merely its interpretation of the statute. The Judge refers the Board to the case of Donovan v. Minnesota DOT, 447 N.W.2d 1 (Minn. App. 1989), in which the court states that if agency policy statements go beyond announcing a statutory requirement and actually include an interpretation of the statute, then that policy statement is in fact a rule which is subject to the rulemaking process. Donovan at 4.

³The Judge points out additionally that the SONAR states merely that the "allowable expense" rules are necessary to clarify what is meant by the statutory definition referenced above. The major dispute herein and in 1991 is that the Board does not consider advertising expenses by licensed organizations as allowable expenses. However, the SONAR did not support the prohibition of advertising expenses as allowable expenses by offering any evidence to show why advertising is not "directly related to the conduct of lawful gambling". Minn. Stat. § 349.12, subd. 3a. In fact, King Wilson, Executive Director of Allied Charities of Minnesota, testified at the hearing that "it would be very easy to show that advertising is directly related to the conduct of gaming if it ever came down to it." Tr. p. 20. Even if the Board did have statutory authority to prescribe allowable and not-allowable expenses pursuant to the statutory definition, an evidentiary basis for each would be required to demonstrate compliance with the definition.

CONCLUSIONS

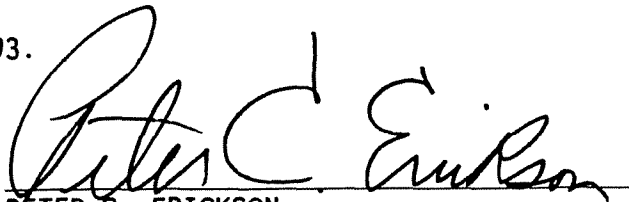
1. That the Board gave proper notice of the hearing in this matter.
2. That the Board has fulfilled the procedural requirements of Minn. Stat. §§ 14.14, subds. 1, 1a and 14.14, subd. 2, and all other procedural requirements of law or rule.
3. That the Board has demonstrated its statutory authority to adopt the proposed rules and has fulfilled all other substantive requirements of law or rule within the meaning of Minn. Stat. §§ 14.05, subd. 1, 14.15, subd. 3 and 14.50 (1)(11), except as noted at Finding 13.
4. That the Board has documented the need for and reasonableness of its proposed rules with an affirmative presentation of facts in the record within the meaning of Minn. Stat. §§ 14.14, subd. 2 and 14.50 (111).
5. That the amendments and additions to the proposed rules which were suggested by the Board after publication of the proposed rules in the State Register do not result in rules which are substantially different from the proposed rules as published in the State Register within the meaning of Minn. Stat. § 14.15, subd. 3, and Minn. Rule 1400.1000, Subp. 1 and 1400.1100.
6. That the Administrative Law Judge has suggested action to correct the defects cited in Conclusion 3 as noted at Finding 13.
7. That due to Conclusion 3, this Report has been submitted to the Chief Administrative Law Judge for his approval pursuant to Minn. Stat. § 14.15, subd. 3.
8. That any Findings which might properly be termed Conclusions and any Conclusions which might properly be termed Findings are hereby adopted as such.
9. That a finding or conclusion of need and reasonableness in regard to any particular rule subsection does not preclude and should not discourage the Board from further modification of the proposed rules based upon an examination of the public comments, provided that no substantial change is made from the proposed rules as originally published, and provided that the rule finally adopted is based upon facts appearing in this rule hearing record.

Based upon the foregoing Conclusions, the Administrative Law Judge makes the following:

RECOMMENDATION

It is hereby recommended that the proposed rules be adopted except where specifically otherwise noted above.

Dated this 22 day of January, 1993.


PETER C. ERICKSON
Administrative Law Judge