Update on the Proposed Class II Gaming Regulations

The National Indian Gaming Commission, in the interest of establishing a "clear, bright line" between Class II and Class III gaming machines, has recently issued a set of proposed regulations for Class II machines. If enacted, these regulations will have a significant impact on Class II machines, the tribes who operate them, and vendors who manufacture them. In the following articles we hear from Norm DesRosiers, Vice Chairman of the NIGC, Knute Knudson, Vice President of Native American Development for IGT, and D. Michael McBride, III, Chair of Indian Law & Gaming Practice Group for Crowe & Dunlevy, P.C., with their viewpoints on the proposed regulations.

Economic Impact of NIGC's Proposed Class II Gaming Regulations

by Norm DesRosiers

Without going into a great deal of historical detail, the National Indian Gaming Commission (NIGC) has been in the process of developing regulations for Class II electronic bingo systems for nearly four years.

The first regulations, including a revised definition of "electronic or electromechanical facsimile" and game classification regulations were published as proposed rules in May of 2006. Subsequently the NIGC commissioned an economic impact study conducted by Dr. Alan Meister of the Analysis Group, Inc.

As a result of extensive public comment from tribes, operators and manufacturers, coupled with the results of the economic impact study at that time, the NIGC withdrew the proposed regulations in February 2007. The NIGC decided as well to approach the task more all encompassing, focusing on the entire electronic bingo system collectively as opposed to its major components.

With the valuable assistance of two Tribal Advisory Committees (one for technical specifications and the other for minimum internal controls) and input from a working group consisting of representatives from operators, manufacturers and designers of games, the NIGC started over. After a herculean effort by those involved, technical specification regulations and minimum internal control standards (MICS) were written in a fashion that had consensus in nearly all aspects. Simultaneously, NIGC staff was consistently revising game classification regulations resulting in a product significantly different and less restrictive than those originally proposed.

In October 2007 the above referenced regulations along with a modified proposed definition change for electronic facsimile were published. In concert with this effort, the Analysis Group, Inc. was contracted to do an updated economic impact study on the newly proposed regulations. This updated study is the subject of much current discussion and putting it in context is the aim of the balance of this commentary.

Dr. Meister clearly points out in his executive summary that he was commissioned to do a "...study of the potential economic impact of the proposed Class II regulations…" It is important to note that the study sets forth numerous potential "scenarios" with wide ranges of "estimated" potential economic impact, expressed in "estimated" ranges of low, medium, and high or worst case revenue losses and costs, and estimated tribal member jobs lost.

It is unfortunate that critics of those proposed Class II regulations have focused on the worst case potential "scenarios" and lost revenue estimates. It is also unfortunate that these extreme worst cases are seemingly referred to as "certainties" rather than "potentials."

In truth, actual current events provide a factual basis to conclude that the actual economic impacts will be significantly less than any of the worst case scenarios presented in the study. A summary follows.

The study makes clear that three states, California, Florida, and Oklahoma, account for over 84% of the total of Class II gaming machines in use in the country.

In California there are over 4200 machines operated by six tribes. Four of those six tribes have newly approved compacts that raise the limit the number of Class III machines they may operate. As a result these tribes are eliminating all of their Class II machines and replacing them with Class III devices. A fifth tribe which accounts for approximately 25% of all California Class II machines, happens to be in a market where the revenues from their Class II machines well exceed the state average revenues for Class III machines. One can reasonably conclude that California will experience virtually no negative economic impact should the proposed rules go into effect.

In Florida there are approximately 8,600 Class II machines. One of the tribes which accounts for almost half of those machines has recently compacted for Class III machines. That tribe is rapidly replacing all of its Class II machines with Class

III. Despite some Class III revenue sharing with the state, indications are that tribal revenues will actually significantly increase.

Finally, in Oklahoma where compacts now allow the option of Class III machines, the number of Class II machines in play has diminished from over 37,000 machines in 2006 less than 25,000 now (the balance having been replaced with Class III devices.) This migration from Class II to Class III began before the proposed Class II regulations. Indications are that the migration will continue, as confirmed in testimony before the House Resources Committee Field Hearing in Miami, Oklahoma on February 2, 2008. Again, a fair conclusion is this trend will significantly reduce or minimize the economic impact of the proposed Class II regulations in Oklahoma.

In fairness, anyone genuinely interested in the real or likely economic impact of the proposed Class II regulations should thoroughly familiarize themselves with the entire study published by Dr. Meister. That in depth analysis should be done with consideration of the context of the entire document and the above referenced facts and current events. If so done, it is believed that you will conclude the most reasonably likely economic impact is far different from the worst possible case scenarios being touted as the real economic impacts.

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NIGC's Proposed Class II Regulations: At Odds with the First Purpose of Indian Gaming?

by Knute Knudson

The NIGC is considering promulgating up to four regulations governing the operation of Class II games. The regulations, proposed in October 2007, include: classification standards for bingo, lotto, other games similar to bingo, pull tabs and instant bingo as Class II gaming when played through an electronic medium using "electronic, computer, or other technologic aids"; a definition for electronic or electromechanical facsimile; minimum internal control standards for Class II gaming (MICS); and technical standards for electronic, Ccomputer, or other technologic aids used in the play of Class II games.

The comment period for the proposed regulations closed on March 9th. Now the NIGC must decide whether to publish some or all of the regulations as proposed; publish some or all of the regulations with amendments; or publish no new Class II regulations.

At this stage it appears most likely the Commission will publish all four proposed regulations - possibly with amendments to what has been proposed. Publication of these regulations is a serious matter for tribes and for those of us who support tribal gaming.

The NIGC commissioned a study to gauge the economic impact of their proposed rules. That study (The Potential Economic Impact of the October 2007 Proposed Class II Gaming Regulations) was published in February of this year. Dr. Alan Meister, the author of the NIGC's study, concluded: "In general, the NIGC's October 2007 proposed Class II gaming regulations would have a significant negative impact on Indian tribes."

Dr. Meister identified specific negative impacts stemming from the proposed rules including: a decrease in gaming revenue; a decrease in non-gaming revenue; a decrease in the variety and quality of Class II gaming machines; gaming facility closures; an increase in capital, deployment, compliance, regulatory, training, revenue-sharing, and financing costs; a decrease in the number of tribal member jobs; and a decrease in innovation in the Class II gaming machine market. A decrease in leverage that tribes would have in the negotiation/renegotiation of Class III gaming compacts with states; restriction of new entry into the Class II machine market; and a change in the degree of competition experienced by Class III gaming facilities as Class II machines become less desirable substitutes for Class III games in the eyes of consumers and as more Class III gaming is introduced.

Many who support these proposed Class II regulations hang their hats on the notion that the NIGC must create a regulatory "bright line" between Class II and Class III games - a bright line that would bar tribes from using current technology in the operation of the game of bingo.

There are two problems with such thinking: While Congress never sought a "bright line" between Class II and Class III games, Congress did, in its complete and explicit definition of bingo, already define a clear difference between Class II and Class III games; and Congress intended that tribes have access to the most sophisticated Class II technology, not be shackled to outdated modes of game play.

The 9th Circuit Court, looking at what Congress did intend in IGRA in the case U.S. v. 103 Electronic Gambling Devices, 223 F. 3d 1091, determined that the three elements of bingo mandated in IGRA were the sole means to determine if a game was bingo and thus Class II. IGRA defines bingo as a game in which players: "(1) play for prizes with cards bearing numbers or other designations; (2) cover numbers or designations when objects, similarly numbered or designated, are drawn or electronically determined; and (3) win the game

by being the first person to cover a designated pattern on such cards."

The Court's opinion noted: "Whatever a nostalgic inquiry into the vital characteristics of the game as it was played in our childhoods or home towns might discover, IGRA's three explicit criteria, we hold, constitute the sole legal requirements for a game to count as class II bingo.

There would have been no point to Congress's putting the three very specific factors in the statute if there were also other, implicit criteria." Thus, a game that includes the three elements of bingo laid out in IGRA is Class II bingo.

As to technology, in creating the Indian Gaming Regulatory Act, Congress anticipated what it could not foresee regarding Class II games. The Committee Report accompanying IGRA at the time of enactment noted that: "The Committee specifically rejects any inference that tribes should restrict Class II games to existing game sizes, levels of participation, or current technology. The Committee intends that tribes be given the opportunity to take advantage of modern methods of conducting Class II games and the language regarding technology is designed to provide maximum flexibility." (Senate Select Committee on Indian Affairs - Committee Report, 1988 U.S.C.C.A.N. at 3079.)

The result of the clear definition of bingo in IGRA and

Congress' stated intent to allow tribes maximum technical flexibility is a mandate that sophisticated technical aides may be provided to assist in the play of games that are played within Congress' definition of bingo.

It is popular in some quarters to claim that such electronic bingo games are "indistinguishable" from Las Vegas style slot machines. However, that popular notion just isn't so. The fact is players, regulators, and every federal judge to take up the question have had no trouble distinguishing between Class II electronic bingo games and Las Vegas slot machines.

Tribes today have negotiated agreements to pay as much as a 25% of their slot machine revenue to states for the exclusive right to offer Class III slot machines to their customers rather than offer Class II games with electronic aids. Tribes pay this premium for Class III game operation despite the fact that operation of Class II games requires payment of no premium by tribes to states. Why do tribes agree to this? Because, even given the most advanced Class II technologic aids, the player, the customer, can easily detect the difference between a Class II game and a Class III game. And, given the option, players will choose the more appealing Class III game.

The Declaration of Policy of the Indian Gaming Regulatory Act notes several purposes to the Act. Foremost among those is "to provide a statutory basis for the operation of gaming by Indian tribes as a means of promoting tribal economic development, self-sufficiency, and strong tribal governments;" The secondary purpose of the Act is to shield Indian gaming from corrupting influences. The third purpose of the Act includes the "establishment of a National Indian Gaming Commission...to meet congressional concerns regarding gaming and to protect such gaming as a means of generating tribal revenue."

At the National Indian Gaming Association's Tribal Leaders Meeting last December in San Diego NIGC Chairman Hogen commented about Class II rules, saying, "I don't want to leave the tribes in a less legally defensible position." That's an admirable goal in the proper context.

However, in the context of the IGRA and in the context of every federal court ruling on Class II games, tribes operating Class II games are already in a very strong legal position. There is not a demonstrated need to shore up the legal defensibility of tribes operating Class II games. This is particularly so given that every regulatory provision that forces tribes to operate games that are less appealing and thus, possibly, more legally defensible, also makes compliant games less valuable as a means to promote tribal economic development and so less consistent with Congress' intent in IGRA.

The ultimate result of attempting to put tribes in a more legally defensible position on Class II games would be to limit tribal Class II bingo to only games played by hand on paper cards - as it was played in our childhoods or home towns.

However, I believe tribes (and Congress' intent in IGRA) will be best served if there is a balance between the legal defensibility of tribal gaming on the one hand and the first

policy of IGRA - promoting tribal economic development, self-sufficiency, and strong tribal governments on the other hand.

It is critical that the NIGC not chase a goal never annunciated by Congress for a "bright line" and, in so doing, compromise a goal explicitly stated by Congress. Congress rejected "any inference that tribes should restrict Class II games to existing game sizes, levels of participation, or current technology." and instead intended "...that tribes be given the opportunity to take advantage of modern methods of conducting Class II games...with legislative language regarding technology "designed to provide maximum flexibility."

If NIGC publication of Class II regulations is for real, published regulations must be consistent with the first purpose of IGRA "as a means of promoting tribal economic development, self-sufficiency, and strong tribal governments." That was foremost among Congress' purposes in establishing the Indian Gaming Regulatory Act and should remain foremost in the NIGC's vision as the Commission seeks to meet the balance of Congress' purposes in the Act.

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Proposed Federal Gaming Rules Will Hurt Oklahoma and the Country

by D. Michael McBride III

We can all envision the tremendous harm the National Indian Gaming Commission's proposed rules to restrict Class II gaming will cause tribal economies. Dr. Alan Meister's recent report from the Analysis Group, commissioned by the NIGC, quantifies a portion of that hurt, conservatively estimating a $1.2 billion impact on tribal revenues, with that figure rising to $2.6 billion if tribes have no viable alternative to the games newly outlawed by the NIGC.

The untold story is the broader impact these ill-advised rules will have. A University of Oklahoma, Price College of Business study has estimated that the proposed rules will inflict over $3 billion of indirect damage on jobs, services, and businesses that rely on Class II gaming. Damaged industries run the gamut from construction ($30 million) to finance and insurance ($171 million) to manufacturing ($391 million). It is not just tribes and private industry-states and local governments will hurt badly as well.

A recent federal hearing has highlighted these dangers. On February 20, U.S. Reps. Dan Boren and Tom Cole held congressional oversight hearings in Miami, Okla., to investigate the economic impact of the proposed rules. The testimony was dramatic. Tribal and local government leaders testified to the tremendous economic advantages Indian gaming has brought to Oklahoma-highlighting how far state-tribal relationships have come in recent years.

Class II gaming has long been present in Oklahoma and across the country. Innovative tribes and manufacturers took to heart Congress' intent that they have "maximum flexibility" in applying technology to Class II games and that those games not remain stuck in time. Indeed, the success of Class II electronically aided bingo in Oklahoma paved the way for that state's 2004 voter-approved tribal-state compact, allowing additional Class III gaming devices.

The compact has worked well, and Oklahoma has received more than $80 million for use in education and increased teacher pay. But, Class III shared revenues are only a small part of the story.

Dr. Meister's NIGC-commissioned report shows that Indian gaming generates over $26 billion annually for tribal governments, as of 2006. In Oklahoma, 33 tribes have Class III compacts , about 94 casino locations, and approximately 30,000 Class II gaming devices. Again as of 2006, Oklahoma, California, and Florida tribes own 84% of all the Class II gaming devices in nationwide, with Oklahoma tribes making up the majority at 59%.

In 2007 alone, Oklahoma Indian gaming generated nearly $2.5 billion of tribal government revenue and grew by 25%. Non-Indians and local businesses have also benefited. Around 75% of all tribal gaming employees are non-Indian and many are female. Chief Glenna Wallace of the Eastern Shawnee Tribe has written that women hold 65% of jobs within gaming operations and many are single parents. She also wrote that her local community had an unemployment rate of nearly 25% before Indian gaming. Now it is less than 5% - statistically, anybody that wants to work has a job. As the oversight committee heard, for every $100 the tribe generates, an additional $2,500 is pumped into the local community purchases.

Moreover, for every 10 casino jobs created by Indian gaming in Oklahoma, 25 are created in the non-Indian community. Local leaders testified to these benefits. For example, Ottawa County, Oklahoma, is the country's largest environmental disaster Superfund site and lost 2,000 jobs when the B.F. Goodrich plant closed in 1986. Things got so bad that a sign on Main Street once read, "the last one to leave Miami, turn out the lights." If it were not for area tribes and their entrepreneurial spirit, leaders testified, Miami might not have survived.

No doubt, gaming stirs passion, both for and against. The debate has always involved questions of morality and societal preferences. But, Indian gaming is not "commercial" and is already regulated in ways intended to address societal concerns. Indian tribes, by law, can use gaming revenue only for public purposes. Tribal casinos are not "for-profit"; they use gaming to fund tribal government where taxation is not allowed.

When passing the Indian Gaming Regulatory Act in 1988, Congress encouraged Indian gaming as a means of promoting tribal self-sufficiency and reversing the deplorable socioeconomic conditions of many tribes.

Why then does the federal government want to limit the most effective economic development engine ever promoted by the United States Congress for tribes and their surrounding communities? The NIGC believes that technology has blurred the lines between Class II and Class III games and wants more stringent rules to limit technologic aids in playing bingo, pulltabs, and other Class II games. Most tribes, on the other hand, believe that the commission is making rules that conflict with the plain language of the Indian Gaming Regulatory Act's definitions and contravene what Congress intended. The tribes are right. The NIGC has stepped way beyond its regulatory powers.

Representative Cole described the commission's rule making as "destructive, highly unjust and deeply troubling" and found that the proposed rules will "cripple economic development in Indian country." As Cole noted, the Commission's efforts are "a solution in search of a problem."

This dire prediction is supported by the numbers. Dr. Meister's report analyzed the impact of the proposed rules on Class II gaming revenues. Although Meister estimates that a state like Oklahoma might increase its annual Class III "revenue share" from about $54 million to $122 million, tribes within the state could lose more than $2.8 billion and 3,336 jobs will vanish. Once the indirect economic impact of the proposed rules are considered, as they were in the University of Oklahoma study, the losses climb to over $5 billion. This loss affects all who live within a state. Oklahoma, with 65% of its gaming devices invested in Class II games, will be particularly devastated by the proposed rules. Tribes residing in Alabama, Montana, Florida, and California will also be greatly affected by the commission's abrupt attempt to legislate Indian gaming.

Under the proposed rules, almost all of the 22,000 Class II bingo devices in Oklahoma - nearly half of all tribal games - would have to be modified or discontinued. Large tribes may weather the storm; many have already migrated to Class III devices at their larger casinos. But, it would be devastating for small tribes and rural economies in the short term, with their razor-thin margins. In the long term, large tribes will also suffer when Class III compacts expire.

Even though the Constitution says "Indians are not taxed" and the IGRA declares that Indian gaming revenue "shall not be taxed," over the past decade and a half, states have increasingly required that tribes "share" revenue with the state as part of the Class III compact. Tribes need Class II gaming to protect their ability to negotiate the fairest possible Class III compacts. Tribes need Class II as a "fall back" in case states choose not to negotiate in good faith. If there is no meaningful Class II game alternatives, tribes will be in a tremendously weakened bargaining position for future compacts. It is likely that states will have an even greater appetite for tribes to "share" revenue in future compacts.

The proposed rules could wreck an otherwise flourishing tourism and recreation industry in Oklahoma and in other parts of the country. If Indian gaming sneezes, Oklahoma and many other states and local governments will catch a cold.

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