IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW MEXICO

THE PUEBLO OF ISLETA, a federally-recognized Indian tribe, THE PUEBLO OF SANDIA, a federally-recognized Indian tribe, and THE PUEBLO OF TESUQUE, a federally-recognized Indian tribe,

Plaintiffs,

PUEBLO OF SANTA ANA, a federally-recognized Indian tribe, and PUEBLO OF SANTA CLARA, a federally-recognized Indian tribe, PUEBLO OF SAN FELIPE, a federally-recognized Indian tribe,

Plaintiffs-in-Intervention,

v.

SUSANA MARTINEZ, in her official capacity as Governor of the State of New Mexico, JEFFREY S. LANDERS, in his official capacity as Chair of the Gaming Control Board of the State of New Mexico, RAECHELLE CAMACHO, in her official capacities as State Gaming Representative and as a member of the Gaming Control Board of the State of New Mexico, and SALVATORE MANIACI, in his official capacity as a member of the Gaming Control Board of the State of New Mexico,

Defendants.

No. 1:17-cv-00654-KG-KK

MEMORANDUM IN SUPPORT OF PLAINTIFFS-IN-INTERVENTION SANTA ANA, SANTA CLARA AND SAN FELIPE'S AND PLAINTIFF TESUQUE'S MOTION FOR SUMMARY JUDGMENT

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Plaintiffs-in-Intervention Pueblo of Santa Clara, Pueblo of Santa Ana, and Pueblo of San Felipe and Plaintiff Pueblo of Tesuque (collectively, the "Pueblos") hereby submit this Memorandum in support of their Motion for Summary Judgment.

I. INTRODUCTION

The Pueblos are federally-recognized Indian tribes that operate casinos in New Mexico pursuant to identical gaming compacts with the State of New Mexico (the "State"). The compacts require the Pueblos to make quarterly payments to the State, referred to as "revenue-sharing," which are calculated based on a percentage of the "Net Win" from the Pueblos' gaming machines. In 2017, the Defendants in this action, acting on behalf of the State, sent letters to the Pueblos asserting that under the Pueblos' prior gaming compacts, which were approved in 2007, the value of "free play" credits[1] played on the Pueblos' gaming machines should have been included as part of each Pueblo's Net Win in the calculation of the revenue-sharing payments owed to the State, or alternatively that prizes won from free play credits should not have been deducted in the calculation of Net Win. The Defendants demanded that the Pueblos retroactively make revenue-sharing payments based on the value of free play credits played on their gaming machines from April, 2011, to the date on which their new 2015 compacts took effect.[2]

In response to the Defendants' demands, the Pueblos explained that the Defendants' proposed method of accounting for free play credits in the calculation of Net Win would violate both federal law and the express terms of the 2007 gaming compacts. Federal

[1] Free play credits are a promotional tool used by the Pueblos' gaming establishments that are distributed to select customers and allow the customer to play a gaming machine without inserting the customer's money, but the credits are not redeemable for cash or merchandise.

[2] The 2015 compacts specify that free play credits are not considered part of Net Win, and that all prizes should be deducted in the calculation of Net Win, regardless whether they were based on free play or cash bets.

regulations promulgated under the Indian Gaming Regulatory Act ("IGRA") and the express terms of the compacts require the Pueblos to comply with generally accepted accounting principles ("GAAP") in all accounting in the Pueblos' gaming operations, including in the calculation of revenue-sharing payments to the State. In the gaming context, GAAP requires that free play credits not be treated as revenue, and that wins from free play credits must be deducted in the calculation of Net Win. That interpretation of GAAP is confirmed by the expert report of Andrew M. Mintzer ("Mintzer Report"), who was part of the AICPA task force that drafted the Gaming Guide, which report is submitted in support of this motion. *See* Declaration of Andrew M. Mintzer ("Mintzer Decl.") Ex. A. The Assistant Secretary – Indian Affairs, who is charged with approving compacts under IGRA, also concurs with the Pueblos' interpretation of the law and has repeatedly informed the Defendants that their attempt to collect revenue-sharing payments on free play credits is impermissible.

The Defendants' demand for revenue-sharing payments based on free play credits is therefore in violation of both federal regulations and the terms of the Pueblos' gaming compacts, which themselves constitute federal law. As a result, the Defendants' demand for such payments also constitutes a violation of the federal law prohibition against state taxation of Indian tribes. Accordingly, the Pueblos request that this Court issue a declaration that the Defendants' demand for revenue-sharing payments based on free play credits is in violation of federal law, and enjoin the Defendants from demanding such payments.

II. STATEMENT OF UNDISPUTED MATERIAL FACTS

1. The Pueblos are all federally-recognized Indian tribes. *See* Indian Entities Recognized and Eligible to Receive Services from the United States Bureau of Indian Affairs, 82 Fed. Reg. 4915, 4918 (Jan. 17, 2017).

2. The Defendants are Susana Martinez, in her official capacity as Governor of the State of New Mexico; Jeffrey S. Landers, in his official capacity as Chair of the State

Gaming Control Board; Salvatore Maniaci, in his official capacity as a member of the State Gaming Control Board; and Raechelle Camacho, in her official capacity as a member of the State Gaming Control Board and as Acting State Gaming Representative (collectively "Defendants"). ECF No. 1.

3. In 2007, the State and each of the Pueblos entered into a gaming compact under IGRA (the "2007 Compact"). *See* ECF No. 55 at 3.

4. The 2007 Compacts were executed on behalf of the State pursuant to the State's Compact Negotiation Act, NMSA 1978 §§ 11-13A-1–5 (1999), which provides that the State's Governor "shall approve and sign" a compact which is "identical to a compact . . . previously approved by the legislature except for the name of the compacting tribe . . . ." *Id.* § 11-13A-4(J). The terms of each Pueblo's 2007 Compact are thus identical except for the Pueblos' names. *See* ECF No. 55 at 3. The generic form of the 2007 Compact is attached as Exhibit A to the Declaration of Richard W. Hughes (the "Hughes Declaration").

5. The 2007 Compact was approved by the Assistant Secretary – Indian Affairs ("Assistant Secretary") under IGRA on July 5, 2007. *See* Indian Gaming, 72 Fed. Reg. 36,717 (July 5, 2007); ECF No. 55 at 3.

6. The 2007 Compact, at Section 4(C) "require[s] all books and records relating to Class III Gaming to be maintained in accordance with generally accepted accounting principles." Hughes Decl. Ex. A at § 4(C). It further requires each Pueblo to

> . . . require an audit and a certified financial statement covering all financial activities of the Gaming Enterprise, including written verification of the accuracy of the quarterly Net Win calculation, by an independent certified public accountant licensed by the State. The financial statement shall be prepared in accordance with generally accepted accounting principles and shall specify the total amount wagered in Class III Gaming on all Gaming Machines at the Tribe's Gaming Facility for purposes of calculating "Net Win" under Section 11. . .

Id.

7. In 2015, the State negotiated a new compact with several tribes that are not parties to this case (the "2015 Compact"), *see* Indian Gaming, 80 Fed. Reg. 35,668 (Jun. 22, 2015), and each of the Pueblos has since entered into the 2015 Compact with the State. *See* ECF No. 1-3; ECF No. 55 at 4.

8. The terms of each Pueblo's 2015 Compact are identical except for the names of the Pueblos. *Id.*

9. The 2015 Compacts superseded the 2007 Compacts. *See* ECF No. 55 at 4.

10. The 2015 Compact expressly excludes the value of free play and point play credits from the Net Win calculation required by the 2015 Compact. *See* ECF No. 1-3, Appendix, Section III(C) ("Under the terms of this Compact, Free Play and Point Play do not increase Net Win, and amounts paid as a result of Free Play or Point Play reduce Net Win for purposes of the revenue sharing calculation in Section 11(C).").

11. The Secretary did not approve or disapprove any tribe's 2015 Compact within 45 days of submission, *see, e.g.*, ECF No. 1-4, and so, under IGRA, each 2015 Compact is "considered to have been approved by the Secretary, but only to the extent the compact is consistent with the provisions of [IGRA]," 25 U.S.C. § 2710(d)(8)(C). *See* ECF No. 55 at 4.

12. In materially similar letters sent to each of the New Mexico gaming tribes, including the Pueblos, the Assistant Secretary stated,

> We wish to commend the Tribe and the State for the successful resolution of the free play and point play issue. Free play and point play will now be treated according to industry standards and Generally Accepted Accounting Principles (GAAP) by excluding both from the definition of "net win," which forms the basis for revenue sharing calculations. We note, however, that Section 7 of the 2015 Compact reserves a two-year period from its effective date for the State to pursue its assertion that the Tribe's net win—and thus their revenue sharing payments—should include wins and losses arising from free play or point play. In light of its conflict with industry standards and GAAP, it is our view that such an assertion by the State to include such sums in revenue sharing calculations would constitute an impermissible tax on tribal gaming revenues in violation of IGRA.

See, e.g., Hughes Decl. Ex. B at 3.

13. The Secretary recently re-affirmed this position in another review of the 2015 Compact for the Pueblo of Pojoaque. *See* Hughes Decl. Ex. C. The Secretary explained that his position on GAAP and free play "remains the same. Free play and point play must be treated according to industry standards and Generally Accepted Accounting Principles (GAAP) by excluding both from the definition of 'net win,' which forms the basis of revenue sharing calculations." *Id.* at 2. He also reiterated his position that the State's demand for a percentage of free play constitutes a tax that violates IGRA. *Id.* at 2 n.6.

14. On April 13, 2017, the Defendants sent materially similar letters to each of the Pueblos with the subject line "Notice of Noncompliance." *See, e.g.*, Hughes Decl. Ex. D. Those letters assert that each Pueblo had "failed to comply with the requirements of Section 11 of the 2007 Compact related to the computation of 'Net Win' and the payment of revenue sharing," and that "prizes awarded as a result of the use of 'free play' are not deductible unless the face value of the 'free play' is included in the calculation of the total amount wagered." *Id.* at 1. The letters also demanded additional revenue-sharing payments from each Pueblo on this basis. *Id.* at 1–2.

15. On May 19, 2017, the Pueblos sent a letter to the Defendants objecting to the Defendants' demand for additional revenue-sharing payments and explaining why such payments were in violation of the law and the terms of the 2007 and 2015 Compacts. *See* Hughes Decl. Ex. E at 1–5.

16. On May 31, 2017, the Defendants sent materially similar letters to each of the Pueblos with the subject line "Notice to Cease Conduct." *See, e.g.*, Hughes Decl. Ex. F. These letters demanded that the Pueblos either "pay all sums due or . . . invoke arbitration." *Id.* at 2.

17. For the Pueblos to calculate Net Win in either fashion that the State claims they should—by counting free play credits played on their gaming machines as revenue, or

by not deducting prizes won with free play credits—would violate generally accepted accounting principles. *See generally*, Mintzer Report.

18. The Pueblos of Sandia, Isleta and Tesuque commenced this action on June 19, 2017, *see* ECF No. 1, and the Pueblos of Santa Ana and Santa Clara joined on June 29, 2017, and the Pueblo of San Felipe joined on July 28, 2017. *See* ECF Nos. 11 and 36.

III. SUMMARY OF THE ARGUMENT

The Defendants' demand that the Pueblos make revenue-sharing payments based on free play credits is in violation of the requirements both of federal law and the express terms of the 2007 Compact, that accounting of tribal gaming revenues, including the calculation of Net Win, must comply with GAAP. Federal regulations promulgated under IGRA expressly provide that all accounting records for a tribal gaming facility must comply with GAAP, including records identifying revenues. *See* 25 C.F.R. § 542.19(b). Federal regulations also provide that tribes must prepare an annual outside audit of tribal gaming facilities in compliance with GAAP. *See* 25 C.F.R. § 571.12(b). Consistent with these regulations, the 2007 Compact requires that all of a tribal gaming facility's books and records must be maintained in accordance with GAAP, and that the tribe must annually have an independent audit of its financial statements, prepared in accordance with GAAP, that specifies the total amount wagered on Class III gaming machines for purposes of calculating Net Win under the compact. *See* 2007 Compact, § 4(C).

The authoritative source of GAAP for tribal gaming facilities is the AICPA Gaming Guide, which provides that free play credits are not treated as revenue – or as part of "total amount wagered" – when calculating Net Win, and that wins from free play credits should be deducted in the calculation of Net Win. The Mintzer Report confirms that interpretation of GAAP. The Department of the Interior also agrees with the Pueblos' interpretation of the law and has repeatedly informed Defendants that their attempts to collect revenue-sharing on free

play credits are impermissible as a matter of federal law. The Defendants' demand for revenue-sharing payments is thus in violation of federal regulations and the terms of the 2007 Compact, and, consequently, it amounts to an illegal tax, that is not allowed by IGRA. 25 U.S.C. § 2010(d)(4). The Pueblos are therefore entitled to a declaration that the Defendants' demands are in violation of federal law, and an injunction prohibiting them from seeking to require that the Pueblos make such payments.

IV. ARGUMENT

A. Summary Judgment Standard.

Summary judgment is appropriate only if "there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P 56(a). When ruling on a motion for summary judgment, the court must "view all facts and evidence in the light most favorable to the party opposing summary judgment." *Schrock v. Wyeth, Inc.*, 727 F.3d 1273, 1279 (10th Cir. 2013).

B. Tribal Gaming Under IGRA.

The purpose of IGRA 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." 25 U.S.C. § 2702(1). IGRA divides Indian gaming into three categories. Class I gaming is comprised of social games played for prizes of minimal value and traditional forms of Indian gaming, 25 U.S.C. § 2703(6); Class II gaming consists of bingo and similar games, *id.* § 2703(7); and Class III gaming includes all other games, *e.g.*, slot machines, banking card games, pari-mutuel betting, blackjack, and roulette, *id.* § 2703(8).

In order to engage in class III gaming on Indian lands, an Indian tribe must have a tribal-state gaming compact. *See* 25 U.S.C. § 2710(d)(1)(C). Class III gaming compacts do not become effective until the Secretary publishes a notice of approval in the Federal

Register. 25 U.S.C. § 2710(d)(3)(B). All class III gaming compacts and amendments to class III gaming compacts must therefore be submitted to the Secretary for approval. *See* 25 C.F.R. § 293.4. The Secretary has delegated his authority to approve or disapprove gaming compacts to the Assistant Secretary—Indian Affairs. Once a compact is submitted for approval, there are three actions the Assistant Secretary can take: he can (1) approve the compact, (2) disapprove the compact, or (3) take no action, in which case the compact is deemed approved after forty-five days, but only to the extent the compact is consistent with the provisions of IGRA. *See* 25 U.S.C. § 2710(d)(8).

C. Federal Law Requires Tribal Gaming Accounting Records to Comply with GAAP.

Federal regulations promulgated under IGRA require that all accounting records for tribal gaming operations comply with GAAP. Specifically, the federal regulation setting the "minimum internal control standards for accounting" for tribes specifically states that "[e]ach gaming operation shall prepare general accounting records *according to Generally Accepted Accounting Principles* . . ." 25 C.F.R. § 542.19(b) (emphasis added). This regulation also specifies that the records that must be maintained according to GAAP include "records identifying revenues, expenses, assets, liabilities and equity for each gaming operation." *Id.* at § 542.19(b)(1). This regulation has been in effect since 2006. *See* Minimum Internal Control Standards, 71 Fed. Reg. 27,385, 27,392 (May 11, 2006).[3]

[3] In *Colo. River Indian Tribes v. Nat'l Indian Gaming Comm'n*, 466 F.3d 134, 136–39 (D.C. Cir. 2006), the D.C. Circuit found that NIGC exceeded its authority when it promulgated "Minimum Internal Control Standards" governing Class III gaming, which are codified at 25 C.F.R. Part 542. The regulation cited in the text is located within Part 542, but it was not at issue in that decision. In *Colo. River Indian Tribes*, the tribe was contesting the validity of the regulations as part of a challenge to a fine it received from NIGC in 2001. The cited regulation requiring compliance with GAAP, 25 C.F.R. § 542.19(b), was not promulgated until 2006, and thus was not even in existence at the time of the fine or when the tribe filed its lawsuit. The rationale of the D.C. Circuit's decision is also inapplicable to Section 542.19(b). The decision was based on the court's conclusion that NIGC has not been given authority to impose "operational standards" on Class III gaming. *Id.* at 137. The court

Federal regulations also require tribes to maintain accounting records in compliance with GAAP in order to satisfy the auditing requirements of IGRA. IGRA requires tribes to submit annual "outside audits" to NIGC for all class III gaming activities. 25 U.S.C. §§ 2710(b)(2)(C), (d)(1)(A)(ii). NIGC's regulations governing the audit standards require that the "tribe shall engage an independent certified public accountant to provide an annual audit of the financial statements of each class II and class III gaming operation on the tribe's Indian lands for each fiscal year . . . [and the] [f]inancial statements prepared by the certified public accountant *shall conform to generally accepted accounting principles* and the annual audit shall conform to generally accepted auditing standards." 25 C.F.R. § 571.12(b) (emphasis added). This regulation has been in effect since 1993. *See* Compliance and Enforcement Procedures Under the Indian Gaming Regulatory Act, 58 Fed. Reg. 5833, 5843 (Jan. 22, 1993).

The federal regulations promulgated under IGRA, thus, unambiguously require that Indian tribes must maintain their accounting records for gaming operations, including records identifying revenues, and prepare annual financial statements, in accordance with GAAP, and these regulations were in effect throughout the term of the 2007 Compact.

Consistent with these regulations, the terms of the 2007 Compact also expressly require the Pueblos' accounting to comply with GAAP. Section 4(C) of the 2007 Compact "require[s] all books and records relating to Class III Gaming to be *maintained in accordance*

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emphasized that the regulations at issue sought to govern every "operational detail," such as setting the time periods that playing cards are to be removed from play and the number of employees who must be involved in the removal of a coin drop. *Id.* at 136. That rationale has no bearing on regulations concerning internal accounting practices, which are within NIGC's authority, rather than "operational standards" for Class III gaming. For all these reasons, the D.C. Circuit's decision should not be seen as having any effect on the continued validity of 25 C.F.R. § 542.19(b).

with generally accepted accounting principles." 2007 Compact, § 4(C) (emphasis added). That section also requires each Pueblo to

> require an audit and a certified financial statement covering all financial activities of the Gaming Enterprise, *including written verification of the accuracy of the quarterly Net Win calculation*, by an independent certified public accountant licensed by the State. The financial statement shall be prepared *in accordance with generally accepted accounting principles and shall specify the total amount wagered in Class III Gaming on all Gaming Machines at the Tribe's Gaming Facility for purposes of calculating "Net Win" under Section 11*[4] . . .

Id. (emphasis added). Thus, not only does the 2007 Compact require the Pueblos' accounting to be maintained in accordance with GAAP, it also requires that the Pueblos' independent audit confirming the calculation of Net Win under the agreement also be prepared in accordance with GAAP. Importantly, the Tenth Circuit Court of Appeals very recently ruled, in *Citizen Potawatomi Nation v. Oklahoma*, 881 F.3d 1226, 1238-39 (10th Cir. 2018), that "a gaming compact is similar to a 'congressionally sanctioned interstate compact the interpretation of which presents a question of federal law.'" (Quoting *Cuyler v. Adams*, 449 U.S. 433, 442 (1981).) Consequently, the requirements of the compact themselves amount to federal law requirements.

D. GAAP Does Not Permit Free Play to Be Treated as Revenue.

As explained in the Mintzer Report, GAAP does not permit free play credits to be recognized as revenue in the calculation of Net Win. Mintzer Report ¶ 6.[5] For governmental

[4] Section 11 of the 2007 Compact is the section that deals comprehensively with revenue-sharing.

[5] Mr. Mintzer is well-qualified to serve as an expert in this matter. He has been a Certified Public Accountant for over 39 years, and from 2003 to 2012, he served on the AICPA Task Force that was charged with revising the AICPA Gaming Guide. Mintzer Report ¶¶ 7–9. He is also a past member of the AICPA Auditing Standards Board, and he was a member of the Accounting Standards Executive Committee of the AICPA from 2001 through 2005, and he currently serves on the AICPA's Professional Ethics Executive Committee. *Id.* at ¶ 10. It might be noted that the Defendants did not identify any experts by the March 15, 2018 deadline. *See* Order Extending Case Management Deadlines, entered on

entities, which includes Indian tribes, the authoritative source of GAAP is the Governmental Accounting Standards Board ("GASB"). *Id.* ¶ 12. GASB identifies the AICPA Gaming Guide as the authoritative source of GAAP. *See id.* ¶¶ 13, 19–22 (citing GASB Statement Nos. 55 and 76); *see also Sault Ste. Marie Tribe of Chippewa Indians v. Granholm*, 475 F.3d 805, 813 (6th Cir. 2007) (finding that tribes are required to comply with the AICPA Gaming Guide under 25 C.F.R. § 571.12).

The AICPA Gaming Guide specifically addresses the treatment of free play in Section 6.13, which provides:

> The economic effect of free play is to provide cashable benefits that increase the customer's odds of winning, changing the basic odds of the game. Furthermore, the use of free play will not trigger accounting recognition because revenue is measured based on an aggregate daily (or shift) basis, rather than on a per bet or per customer basis. Because revenue is the net win from gaming activities, the use of the benefit has no effect on the reporting of net win or loss from gaming activities. For example, if a customer bets $5 of his or her own cash and wins $1, the gaming entity reports revenue of $4. If a customer bets $5 of his or her own cash, uses $5 of credits from his or her club card, and wins $1, the gaming entity reports revenue of $4. In each transaction, the net win is $4, but the hold percentages are different in the two transactions. Also, pursuant to FASB ASC 605-50-45-2, cash consideration given as a sales incentive is presumed to be a reduction in selling price.

AICPA Gaming Guide § 6.13; *see also* Mintzer Report ¶ 35.

This provision makes clear that free play should not be counted as revenue in calculating Net Win. It expressly states that the use of free play "has no effect on the reporting of net win or loss from gaming activities." *Id.* This provision also makes clear that the wins from free play credits are deducted in the calculation of Net Win. The example provided in Section 6.13 states that the $5 in free play credits used by the customer are *not*

December 18, 2017, ECF No. 54, at 2. Thus, the Mintzer Report's conclusions are undisputed.

counted as revenue, but the $1 win (regardless of whether it was from the free play credit or the customer's own cash), is deducted from the revenue calculation.

Mr. Mintzer, who was involved in the AICPA Task Force that revised the Gaming Guide in 2011, confirms this interpretation of GAAP, stating, "it is my opinion that GAAP does not permit the recognition of free play in the amount of 'net win' (gross gaming revenue) yet it does require that all monetary payouts, including those from free play, reduce 'net win.'" Mintzer Report ¶ 6. Specifically, with regard to Section 6.13 of the AICPA Gaming Guide, Mr. Mintzer states that "GAAP does not permit gross gaming revenue (win), or 'net win,' to be increased as a result of free play incentives." *Id.* at ¶ 35. He reiterates that these standards "permit ***no recognition*** in revenue for free play and were established so that the gaming entities would not *overstate* gross gaming revenue." *Id.* at ¶ 36 (emphasis in the original). The Defendants have not offered any expert in this lawsuit to dispute any of these conclusions in Mr. Mintzer's report.

The Mintzer Report also explains the rationale that underlies these principles in the AICPA Gaming Guide. Specifically, he explains that revenues for gaming entities, similar to other businesses, are "essentially the sum of the sales prices it receives from all of its customers." Mintzer Report ¶ 28. Financial Accounting Standards Board ("FASB") Concept Statement No. 6 explains that "[r]evenues represent actual or expected cash in-flows (or the equivalent) that have occurred." *Id.* Free play is not revenue, and thus it does not represent "actual or expected cash in-flows" to the gaming facility. *Id.* at ¶ 29. But payouts for prizes won on gaming machines, whether won with free play credits or the customer's own money, are cash outflows, and thus must be deducted in the calculation of Net Win.

The Mintzer Report further explains that when a gaming establishment provides a free play credit to a customer it "is providing a chance for the customer to win a slot machine outcome for no cost (i.e. 'free')." *Id.* at ¶ 36. The provision of a product or service to a

customer for free "does not create revenue," just as a grocery store that gives out "free samples" of food does not create revenue for the grocery store. *Id.* at 37. If it did create revenue, business entities could claim to increase their revenues simply by giving away more products or services. *Id.*

The authoritative source of GAAP for the Pueblos' casinos, thus, unambiguously provides that free play credits may not be treated as revenue for purposes of determining Net Win, and that all prizes won on gaming machines must be deducted from Net Win, regardless of how the winning bet was made.

E. The Defendants' Demand for Revenue-Sharing Payments on Free Play Credits Violates Federal Regulations and the 2007 Compact, and Amounts to an Illegal Tax in Violation of Federal Law.

In 2017, the Defendants, acting on behalf of the State, formally demanded that the Pueblos make revenue-sharing payments to the State based on free play credits played on the Pueblos' gaming machines. On April 13, 2017, the Defendants sent letters to each of the Pueblos titled "Notice of Noncompliance," in which Defendants claimed that the Pueblos "failed to comply with the requirements of Section 11 of the 2007 Compact related to the computation of 'Net Win' and the payment of revenue sharing." *See* Statement of Facts ("SOF"), *supra*, ¶ 14. The Defendants further asserted that "it has been and continues to be the position of the State that prizes awarded as a result of the use of 'free play' are not deductible unless the face value of the 'free play' is included in the calculation of the total amount wagered." *Id.* The Defendants thus demanded that the Pueblos make retroactive revenue-sharing payments based on free play credits. *Id.* On May 19, 2017, the Pueblos sent a joint letter objecting to the Defendants' demand and explaining why it was improper. SOF

¶ 15. In response, the Defendants sent each of the Pueblos a "Notice to Cease Conduct" on May 31, 2017, and then a "Notice to Invoke Arbitration" on June 30, 2017.[6] SOF ¶ 16.

The Defendants' demand for payments based upon free play credits is a violation of both federal law and the express terms of the 2007 Gaming Compact (which, as noted above, itself amounts to federal law). As described above, federal regulations require that "[e]ach gaming operation shall prepare general accounting records *according to Generally Accepted Accounting Principles*," including "records identifying revenues." 25 C.F.R. § 542.19(b) (emphasis added). Federal regulations also require an annual audit of the financial statements of each gaming operation, prepared in accordance with generally accepted accounting principles. *See* 25 C.F.R. § 571.12(b). Following these commands, the 2007 Compact, as is explained above in Section IV(C), requires an annual audit by an independent certified public accountant, in accordance with GAAP, that includes verification of the calculation of Net Win for purposes of determining revenue-sharing payments under Section 11.

As is also described above, the AICPA Gaming Guide, which is the authoritative source of GAAP for these purposes, prohibits the Tribes from treating free play credits in the manner demanded by the Defendants. Section 6.13 of the AICPA Gaming Guide specifically prohibits treating free play credits as revenue for purposes of determining Net Win. Likewise, Mr. Mintzer's expert opinion is that "GAAP does not permit the recognition of free play in the amount of 'net win' (gross gaming revenue) yet it does require that all monetary payouts, including those from free play, reduce 'net win.'" Mintzer Report ¶ 6.

[6] As explained in the Pueblos' Response in Opposition to the Defendants' Motion for Summary Judgment on the Issue of Arbitrability, the State's invocation of arbitration was invalid because it was untimely under the terms of the compact. ECF No. 58 at 18–20.

The Defendants' assertion that the Pueblos owe revenue-sharing payments based on free play credits, therefore, is a violation of GAAP, which is in turn a violation of federal regulations and of the 2007 Compact.

Moreover, because the payments demanded by the Defendants are impermissible under the regulations and compacts, they are also in violation of well established federal law prohibiting state taxation of Indian tribes. IGRA states that it does not "confer upon a State or any of its political subdivisions authority to impose any tax, fee, charge, or other assessment upon an Indian tribe or upon any other person or entity authorized by an Indian tribe to engage in a class III activity," except those assessments that may be agreed to under the provision that allows the state to insist on reimbursement of its costs of regulating Indian gaming. 25 U.S.C. § 2010(d)(4).[7] Because revenue-sharing payments on free play credits would violate GAAP, such payments are not an assessment permitted under Section 2710(d)(3)(C)(iii), and therefore constitute a "tax, fee, charge, or other assessment" on the Pueblos. It is undisputed that unless expressly authorized by Congress, states are prohibited from taxing tribes or tribal assets or activities on tribal land. *See, e.g., McClanahan v. Arizona State Tax Comm'n*, 411 U.S. 164, 173 (1973); *Moe v. Confederated Salish & Kootenai Tribes*, 425 U.S. 463, 480–81 (1976); *California v. Cabazon Band of Mission*

[7] Revenue-sharing payments generally have been viewed as a use of gaming revenues "to promote tribal economic development," as allowed by IGRA, specifically at 25 U.S.C. §§ 2710(b)(2)(B)(iii), (d)(1)(A)(ii), provided that they are made in exchange for a valuable economic benefit, such as the exclusive right to conduct certain forms of class III gaming, and the inclusion in the compacts of provisions regarding such revenue sharing is allowed by 25 U.S.C. § 2710(d)(3)(C)(vii). Section 11 of the 2007 Compact (and of the 2015 Compact) details the exclusive rights to engage in gaming to which the signatory tribes are entitled in exchange for their revenue-sharing payments. *See Wisconsin v. Ho-Chunk Nation*, 512 F.3d 921, 932 (7th Cir. 2008) (noting, however, that "the legitimacy of these revenue-sharing provisions is far from a settled issue"). The Pueblos do not challenge the legitimacy of revenue-sharing generally in this action, but rather only the Defendants' unlawful demand that the Pueblos calculate Net Win for purposes of determining revenue-sharing payments in a manner that violates federal law and the express terms of the 2007 Compact.

Indians, 480 U.S. 202, 215 n.17 (1987) ("In the special area of state taxation of Indian tribes and tribal members we have adopted a *per se* rule."). As is noted above, IGRA expressly does *not* provide any such authorization.

F. The Department of the Interior Agrees with the Pueblos' View That Revenue-Sharing on Free Play Credits Violates IGRA.

The Pueblos' interpretation of the applicable law in this area is further supported by the Department of the Interior. The Assistant Secretary has repeatedly informed the Defendants that their efforts to collect revenue-sharing payments on free play credits violates IGRA. When the Pueblos and the State submitted the 2015 Compact for approval, the Assistant Secretary sent materially similar letters to each Pueblo stating:

> We wish to commend the Tribe and the State for the successful resolution of the free play and point play issue. Free play and point play will now be treated according to industry standards and Generally Accepted Accounting Principles (GAAP) by excluding both from the definition of "net win," which forms the basis for revenue sharing calculations. We note, however, that Section 7 of the 2015 Compact reserves a two-year period from its effective date for the State to pursue its assertion that the Tribe's net win—and thus their revenue sharing payments—should include wins and losses arising from free play or point play. In light of its conflict with industry standards and GAAP, *it is our view that such an assertion by the State to include such sums in revenue sharing calculations would constitute an impermissible tax on tribal gaming revenues in violation of IGRA.*

See SOF ¶ 12 (emphasis added).

The Department reaffirmed this position as recently as October 23, 2017, in a letter to the Pueblo of Pojoaque, in which the acting official explained that the Department's position on GAAP and free play "remains the same. Free play and point play must be treated according to industry standards and Generally Accepted Accounting Principles (GAAP) by excluding both from the definition of 'net win,' which forms the basis of revenue-sharing calculations." SOF ¶ 13.

G. The Defendants' Contention that GAAP is Inapplicable to the Calculation of Net Win is Meritless.

In Defendants' April 13, 2017 letter to the Pueblos, they contended that GAAP and the AICPA Gaming Guide were inapplicable to the calculation of Net Win under the 2007 Compacts, stating:

> the State has considered the position of the various gaming tribes that the calculation of "Net Win" should take into consideration Generally Accepted Accounting Principles ("GAAP") and the AICPA Gaming Guide's provision that identify a method for handling "free play" for purposes of financial statement preparation and reporting. However, the 2007 Compact contains no provision that states or infers that the parties are to utilize GAAP for the calculation of "Net Win."

SOF ¶ 14. The Defendants' assertion that GAAP is inapplicable to the calculation of Net Win is utterly incorrect.

First, as described above, federal regulations specifically require that the Pueblos' internal accounting and outside auditing of its gaming operations be conducted in accordance with GAAP. The Pueblos' revenue-sharing payments to the State, including the calculation of those payments, must therefore comply with GAAP. The Defendants do not identify any exception to these regulations which would permit the Pueblos not to comply with GAAP for purposes of their revenue-sharing payments to the State.

Second, the 2007 Compact expressly requires compliance with GAAP. Section 4(C) of the 2007 Compact "require[s] *all books and records relating to Class III Gaming* to be maintained in accordance with generally accepted accounting principles." 2007 Compact, § 4(c) (emphasis added). This provision makes clear that *all* of the Pueblos' accounting records must comply with GAAP. In order to calculate Net Win in the manner demanded by the Defendants, the Pueblos would need to create accounting records that treat free play credits in a manner that violates GAAP, which would be a clear violation of Section 4(C).

Third, and with definitive clarity, the 2007 Compact also requires each Pueblo to require an audit and a certified financial statement covering all financial activities of the

Gaming Enterprise, "*including written verification of the accuracy of the quarterly Net Win calculation*," by an independent certified public accountant licensed by the State. 2007 Compact, § 4(C) (emphasis added). The financial statement "shall be prepared *in accordance with generally accepted accounting principles* and shall specify *the total amount wagered in Class III Gaming on all Gaming Machines at the Tribe's Gaming Facility for purposes of calculating 'Net Win' under Section 11 . . .*" *Id.* (emphasis added). This provision, thus, expressly provides that the Pueblos' financial statements verifying the accuracy of the Pueblos' "Net Win" under Section 11 must also be prepared in accordance with GAAP.

For all of these reasons, the Defendants' claim that "the 2007 Compact contains no provision that states or infers that the parties are to utilize GAAP for the calculation of 'Net Win'" is thoroughly wrong, and should be disregarded.

H. The Defendants' Contention that the 2007 Compact Does Not Allow Wins from Free Play Credits to be Deducted from Net Win is Also Meritless.

The Pueblos also anticipate that the Defendants will argue that their demand for payments is supported by Section 11(C)(1) of the 2007 Compact, which states:

> 1. As used in this Compact, "Net Win" means the total amount wagered in Class III Gaming at a Gaming Facility, on all Gaming Machines less:
>
> (a) the amount paid out in prizes to winning patrons, including the cost to the Tribe of noncash prizes, won on Gaming Machines. *The phrase "won on Gaming Machines" means the patron has made a monetary wager, and as a result of that wager, has won a prize of any value.* Any rewards, awards or prizes, in any form, received by or awarded to a patron under any form of a players' club program (however denominated) or as a result of patron-related activities, are not deductible. The value of any complimentaries given to patrons, in any form, are not deductible; . . .

2007 Compact, § 11(C)(1) (emphasis added). As they claimed in the complaint that was filed by the State and subsequently dismissed, *see New Mexico v. Pueblo of Isleta*, No. 17-cv-0995 (D.N.M., filed Sept. 29, 2017), ECF No. 1 (Complaint), the Defendants will probably assert here that under Section 11(C)(1), prizes that were won on gaming machines by customers playing free play credits should not have been deducted when calculating Net Win, because

those prizes were not won "as a result of [a monetary] wager." Disallowing deductions of such prizes would result in higher revenue-sharing payments to the State. But this interpretation of Section 11(C)(1) is contrary to the express and unambiguous terms of the 2007 Compact.

As explained in the Mintzer Report, calculating Net Win in the manner insisted upon by the Defendants would be a violation of GAAP. It is Mr. Mintzer's opinion that "GAAP does not permit the recognition of free play in the amount of 'net win' (gross gaming revenue) yet *it does require that all cash or cash equivalent payouts, including those from free play, reduce 'net win.'*" Mintzer Report ¶ 6 (emphasis added). This interpretation of GAAP is further confirmed by Section 6.13 of the AICPA Gaming Guide, which states: "If a customer bets $5 of his or her own cash, uses $5 of credits from his or her club card, and wins $1, the gaming entity reports revenue of $4. In each transaction, the net win is $4." *Id.* at ¶ 35. In this example, the $1 that was won by the customer is deducted in the calculation of revenue *without regard* to whether it was won based on a cash bet or a free play credit. Regarding this example, Mr. Mintzer states:

> As clearly demonstrated by this example GAAP requires that the gross gaming revenue or net win is calculated using the cash value of what remains "in" the machine – such as cash, coins, electronic money transfers, tickets with cash redemption values. *Thus in complying with GAAP all cash/cash equivalent payouts must be considered without regard as to whether the value was paid as the result of a paid bet or a free play bet.*

Id. at ¶ 38 (emphasis added).

It is blackletter law that a contract "is interpreted as a whole, and all writings that are part of the same transaction are interpreted together." *Resolution Tr. Corp. v. Fed. Sav. & Loan Ins. Corp.*, 25 F.3d 1493, 1499 (10th Cir. 1994) (quoting Restatement (Second) of Contracts § 202); *see also Dona Ana Mut. Domestic Water Consumers Ass'n v. City of Las Cruces*, 516 F.3d 900, 907 (10th Cir. 2008) ("a contract should be interpreted as a

harmonious whole to effectuate the intentions of the parties, and every word, phrase or part of a contract should be given meaning and significance according to its importance in context of the contract."). Here, Section 11(C)(1) must be interpreted in conjunction with Section 4(C), discussed above, which expressly requires that "all books and records" relating to Class III gaming be maintained in accordance with GAAP, and more specifically that financial statements prepared "for purposes of calculating 'Net Win' under Section 11," must comply with GAAP. 2007 Compact, § 4(C).

When the 2007 Compact is read as a whole, it is clear that the Defendants' proposed interpretation of Section 11(C)(1) cannot be correct because it would require calculation of Net Win in a manner that violates GAAP, and therefore is directly contrary to the requirements of Section 4(C). Rather, the express and unambiguous terms of the 2007 Compact demonstrate that the parties' intention was that *all* accounting would be in compliance with GAAP, including specifically the calculation of Net Win under Section 11. The Defendants' proposed interpretation of Section 11(C)(1) must therefore be rejected.

There are other factors that show the Defendants' interpretation of Section 11(C)(1) to be incorrect. First, as a practical matter, it is not possible for the Pueblos to calculate Net Win in the manner that the Defendants insist, a fact that necessarily demonstrates that it could not have been the parties' intention for Net Win to be calculated that way. The Pueblos' accounting systems cannot distinguish wins from free play credits from those won on the basis of cash wagers, and to the Pueblos' knowledge no existing slot machine accounting system can make such a distinction. *See* Declaration of John Cirrincione (Cirrincione Decl.") ¶ 3. The Pueblos, thus, have no way to identify wins from free play credits so as to exclude them from the calculation of Net Win. Furthermore, some wins could be based upon both types of credits, if, for example, a customer used $1 in free play credits and $1 in cash to make a $2 bet on a slot machine, and won a prize.

Second, in the gaming context, the term "monetary" wager is not limited to cash wagers but also applies to electronic credits, such as free play credits. The AICPA Gaming Guide, for example, states that "monetary credits" for slot machines "may be played by using bills, coins, tickets, *electronic wagering credits recorded on cards, or by other means*." *See* Mintzer Decl. Ex. B at 255 n.3 (emphasis added). Free play credits are electronic wagering credits that are recorded on a customer's card, and thus would qualify as "monetary credits" under the AICPA Guide. The Defendants' interpretation of Section 11(C)(1) is based entirely upon the view that "monetary" wager does not include free play credits, but that interpretation is not supported by the AICPA Guide.

Finally, the Defendants' argument also fails because even if their interpretation of Section 11(C)(1) were correct (which, as shown, it cannot be), this provision would be invalid and unenforceable because it is contrary to federal law. It is a well-established principle of contract law that "express contractual provisions may be rendered *unenforceable* based on public policy." *Christy v. Travelers Indem. Co. of Am.*, 810 F.3d 1220, 1228 n.6 (10th Cir. 2016) (citing 5 Williston on Contracts § 12:1 (4th ed.); Restatement (Second) of Contracts § 178). As explained above, the Defendants' interpretation of Section 11(C)(1) would require calculation of Net Win in a manner that violates GAAP. Federal regulations require all accounting for the Pueblos' casinos to be conducted in accordance with GAAP, and thus the Defendants' interpretation of this provision fails.

V. CONCLUSION

For the reasons stated above, the Pueblos' Motion for Summary Judgment should be granted.

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Respectfully submitted,

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