

**State of California
Office of Administrative Law**

**In re:
California Horse Racing Board**

**DECISION OF DISAPPROVAL OF
REGULATORY ACTION**

**Regulatory Action: Title 4
California Code of Regulations**

Government Code Section 11349.3

**Adopt sections: 2086, 2086.1, 2086.5,
2086.6, 2086.7, 2086.8,
2086.9, 2087, 2087.5,
2087.6, 2088, 2088.6,
2089, 2089.5, 2089.6,
2090, 2090.5, 2090.6,
2091, 2091.5, 2091.6,
2092, 2092.5, 2092.6,
2093**

OAL File No. 2013-0131-04 S

SUMMARY OF REGULATORY ACTION

In this regulatory action, the California Horse Racing Board (Board) proposed to adopt a new article 27, which includes sections 2086, 2086.1, 2086.5, 2086.6, 2086.7, 2086.8, 2086.9, 2087, 2087.5, 2087.6, 2088, 2088.6, 2089, 2089.5, 2089.6, 2090, 2090.5, 2090.6, 2091, 2091.5, 2091.6, 2092, 2092.5, 2092.6 and 2093, in division 4, title 4, of the California Code of Regulations (CCR). The purpose of these proposed sections is to implement, interpret and make specific Business and Professions Code section 19604.5, which permits exchange wagering in California.

DECISION SUMMARY

On January 31, 2013, the Board submitted to the Office of Administrative Law (OAL) the proposed adoption of these sections in article 27. On March 15, 2013, OAL notified the Board that OAL disapproved the proposed regulations for failure to comply with specified standards and procedures of the California Administrative Procedure Act (APA). The reasons for the disapproval are summarized below:

- A. The agency failed to comply with the Necessity standard of Government Code section 11349.1(a)(1);

- B. The agency failed to comply with the Clarity standard of Government Code section 11349.1(a)(3);

C. The agency failed to comply with the Consistency standard of Government Code section 11349.1(a)(4);

D. The agency failed to comply with APA procedural requirements, including that the rulemaking file did not contain all required documents and required documents included in the file were defective.

E. The agency failed to adequately respond to all of the public comments made regarding the proposed action pursuant to Government Code section 11346.9(a)(3).

All issues must be resolved prior to OAL approval of any resubmission.

BACKGROUND

Sections 2086, 2086.1, 2086.5, 2086.6, 2086.7, 2086.8, 2086.9, 2087, 2087.5, 2087.6, 2088, 2088.6, 2089, 2089.5, 2089.6, 2090, 2090.5, 2090.6, 2091, 2091.5, 2091.6, 2092, 2092.5, 2092.6 and 2093 implement provisions of Business and Professions Code section 19604.5, which permits exchange wagering in California. This section was enacted as part of SB 1072 (Statutes of 2010, Chapter 283). Specifically, section 2086 provides definitions of terms used in proposed new article 27; section 2086.1 describes the authorization for exchange wagering; section 2086.5 establishes the requirements for application for licensure to operate exchange wagering; section 2086.6 describes the requirements of an operating plan for providing exchange wagering; section 2086.7 provides for the sharing of exchange wagering data; section 2086.8 describes requirements for monitoring and notifications to the Board; section 2086.9 requires financial and security integrity audits; section 2087 provides requirements for suspending a market; section 2087.5 describes requirements for an antepost market; sections 2087.6, 2088.6 and 2088, respectively, provide requirements for cancellation of matched wagers, cancellation of unmatched wagers, and the handling of non-starters and declared or scratched entries; section 2089 provides procedures for handling errors in payments of exchange wagers; section 2089.5 establishes requirements for exchange wagering accounts; section 2089.6 provides requirements for deposits to an exchange wagering account; section 2090 provides for posting of credits for winnings from exchange wagers; sections 2090.5 and 2090.6, respectively, provide requirements for debits to an exchange wagering account and withdrawals by the account holder; sections 2091 and 2091.5, respectively, provide requirements for closing an inactive account and suspending an account; section 2091.6 provides for Board review and audit of records; section 2092 provides for placement of exchange wagers after the state of a race; section 2092.5 provides prohibitions on wagers to lay a horse to lose; section 2092.6 provides for suspension of occupational license; and section 2093 provides some additional requirements on the provision of exchange wagering.

DISCUSSION

Any regulation amended or adopted by a state agency through its exercise of quasi-legislative power delegated to it by statute to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure, is subject to the APA unless a statute expressly

exempts the regulation from APA review. (Gov. Code, secs. 11340.5 and 11346.) OAL reviews regulatory actions for compliance with the standards for administrative regulations in Government Code section 11349.1. Generally, to satisfy the standards, a regulation must be legally valid, supported by an adequate record, and easy to understand. In its review, OAL may not substitute its judgment for that of the rulemaking agency with regard to the substantive content of the regulation. OAL review is an independent executive branch check on the exercise of rulemaking powers by executive branch agencies and is intended to improve the quality of rules and regulations that implement, interpret, and make specific statutory law, and to ensure that required procedures are followed in order to provide meaningful public opportunity to comment on rules and regulations before they become effective.

A. FAILURE TO COMPLY WITH THE NECESSITY STANDARD OF GOVERNMENT CODE SECTION 11349.1(a)(1).

Government Code section 11349.1(a)(1) requires that OAL review all regulations for compliance with the “necessity” standard. Government Code section 11349(a) defines “necessity” to mean:

. . . the record of the rulemaking proceeding demonstrates by substantial evidence the need for a regulation to effectuate the purpose of the statute, court decision, or other provision of law that the regulation implements, interprets, or makes specific, taking into account the totality of the record. For purposes of this standard, evidence includes, but is not limited to, facts, studies, and expert opinion.

To further explain the meaning of substantial evidence in the context of the “necessity” standard, subdivision (b) of section 10, title 1, of the CCR provides:

In order to meet the ‘necessity’ standard of Government Code section 11349.1, the record of the rulemaking proceeding shall include:

- (1) A statement of the specific purpose of each adoption, amendment, or repeal; and
- (2) information explaining why *each provision* of the adopted regulations is required to carry out the described purpose of the provision. Such information shall include, but is not limited to, facts, studies, or expert opinion. When the explanation is based upon policies, conclusions, speculation, or conjecture, the rulemaking record must include, in addition, supporting facts, studies, expert opinion, or other information. An ‘expert’ within the meaning of this section is a person who possesses special skill or knowledge by reason of study or experience which is relevant to the regulation in question. [Emphasis added.]

In order to provide the public with an opportunity to review and comment upon an agency’s perceived need for a regulation, the APA requires that the agency describe the need for the regulation in the initial statement of reasons (ISR). (Gov. Code, sec. 11346.2(b).) The ISR must include a statement of the specific purpose for each adoption, amendment, or repeal, and the rationale for the determination by the agency that each regulation is reasonably necessary to carry out the purpose for which it is proposed or, simply restated, “why” a regulation is needed

and “how” this regulation fills that need. (Gov. Code, sec. 11346.2(b)(1).) The ISR must be submitted to OAL with the initial notice of the proposed action and made available to the public during the public comment period, along with all the information upon which the proposal is based. (Gov. Code, secs. 11346.2(b) and 11346.5(a)(16) and (b).) In this way the public is informed of the basis of the regulatory action and may comment knowledgeably.

The ISR submitted with this regulatory action for the adoption of section 2086.5 is inadequate. Subdivision 2086.5(b) requires an application for a license to operate exchange wagering and provides for the payment of a fee as follows:

A certified check in the amount of \$1,400,000 payable to the California Horse Racing Board, or an amount to be determined by the Board to fulfill Business and Professions Code section 19604.5(e)(6),... must accompany the application.

While the ISR describes the specific purpose of each new provision in the proposed regulations, the only rationale or necessity included in the ISR to explain the reasons for this provision is as follows:

Subsection 2086.5(b) requires the applicant to provide a certified check in the amount of \$1.4 million as a license fee to fulfill Business and Professions Code section 19604.5(e)(6), which provides that the Board may recover any costs associated with the licensing or regulation of exchange wagering from the exchange wagering licensee. The subsection states the Board may determine another amount is appropriate. This provides the Board with flexibility to adjust the license fee if it determines circumstances warrant such an action. This may occur if the Board determines it will adjust the term of license.

Business and Professions Code section 19604.5(e)(6) provides, in this regard:

The board may recover any costs associated with the licensing or regulation of exchange wagering from the exchange wagering licensee by imposing an assessment on the exchange wagering licensee in an amount that does not exceed the reasonable costs associated with the licensing or regulation of exchange wagering.

This license is ostensibly for two years (see Part B.(2) below regarding clarity). In the rulemaking record, an attachment to the Std. 399, “Economic and Fiscal Impact Statement,” shows the “total annual estimate” of program costs to regulate exchange wagering as \$510,000. The \$1.4 million fee per licensee appears to exceed the reasonable costs of the program. One commenter remarked on this lack of coincidence between program costs and the fee proposed to be assessed. The Board’s response to that comment in the final statement of reasons (FSR) is:

The fee breaks down to \$700,000 per license year, and is expected to cover costs of hardware, software, training, personnel—including real time wagering monitors, and enforcement. Other costs will include case management and deputy attorney general fees. The Board also anticipates the development and

management of an informant program that will involve confidential payments for information. When the Board staff consulted with the British Horse Racing Authority, which has extensive experience with exchange wagering, it was informed that the sum of approximately 1.4 million was a reasonable expectation of costs for regulation and enforcement.

The first part of this response describes anticipated expenses regarding program costs. However, the Board appears to have established the \$700,000 per license year based on the amount suggested by the British group and assumes there would be only one licensee, but the rulemaking record contains information that the Board anticipates more than one licensee. In addition, the fee amount required in the proposed regulation to cover program costs is much more than the amount calculated in the Std. 399 as program costs. Assuming only one licensee, the fee amount in the proposed regulation is \$380,000 more for a two year term than the cost established in the Std. 399. Any additional licensees would add \$1.4 million per licensee to Board revenue for a two year term and this is not supported by program costs.

The ISR is required to include an explanation of the need and the rationale for each proposed new provision and it must be made available to the public with the initial notice. The ISR does not provide the necessity for the amount of this \$1.4 million fee and the rulemaking record includes information regarding the costs of the program that does not support the \$1.4 million fee.

Pursuant to Government Code section 11347.1, any addition to the ISR to provide the necessity missing from the existing ISR must be made available to the public for at least 15 days prior to adoption of the regulations by the Board. Government Code section 11347.1 provides in part:

- (a) An agency that adds any technical, theoretical, or empirical study, report, or similar document to the rulemaking file after publication of the notice of proposed action and relies on the document in proposing the action shall make the document available as required by this section.
- (b) At least 15 calendar days before the proposed action is adopted by the agency, the agency shall mail to all of the following persons a notice identifying the added document and stating the place and business hours that the document is available for public inspection:
 - (1) Persons who testified at the public hearing.
 - (2) Persons who submitted written comments at the public hearing.
 - (3) Persons whose comments were received by the agency during the public comment period.
 - (4) Persons who requested notification from the agency of the availability of changes to the text of the proposed regulation.
- (c) The document shall be available for public inspection at the location described in the notice for at least 15 calendar days before the proposed action is adopted by the agency.

Prior to resubmission of the proposed regulations, the Board must provide notice of a 15-day public availability and comment period for a revised ISR that includes sufficient necessity for the

amount of whatever fee they set; summarize and respond to any comments on the revised ISR in an addendum to the FSR; and include all the related documents that are required in the rulemaking record.

B. FAILURE TO COMPLY WITH THE CLARITY STANDARD OF GOVERNMENT CODE SECTION 11349.1(a)(3).

OAL is mandated to review each regulation adopted pursuant to the APA to determine whether the regulation complies with the “clarity” standard. (Gov. Code, sec. 11349.1(a)(3).) “Clarity,” as defined by Government Code section 11349(c), means “written or displayed so that the meaning of regulations will be easily understood by those persons directly affected by them.”

The “clarity” standard is further defined in section 16, title 1, of the CCR, OAL's regulation on “clarity,” which provides:

In examining a regulation for compliance with the ‘clarity’ requirement of Government Code section 11349.1, OAL shall apply the following standards and presumptions:

(a) A regulation shall be presumed not to comply with the ‘clarity’ standard if any of the following conditions exists:

- (1) the regulation can, on its face, be reasonably and logically interpreted to have more than one meaning; or
- (2) the language of the regulation conflicts with the agency's description of the effect of the regulation; or
- (3) the regulation uses terms which do not have meanings generally familiar to those ‘directly affected’ by the regulation, and those terms are defined neither in the regulation nor in the governing statute;

(b) Persons shall be presumed to be ‘directly affected’ if they:

- (1) are legally required to comply with the regulation; or
- (2) are legally required to enforce the regulation; or
- (3) derive from the enforcement of the regulation a benefit that is not common to the public in general; or
- (4) incur from the enforcement of the regulation a detriment that is not common to the public in general.

(1) Proposed Adoption of Subdivision 2086.5(b).

The Board proposed to adopt subdivision 2086.5(b), which provides:

A certified check in the amount of \$1,400,000 payable to the California Horse Racing Board, *or* an amount to be determined by the Board to fulfill Business and Professions Code section 19604.5(e)(6),... must accompany the application.
[Emphasis added.]

The proposed adoption of subdivision 2085.5(b) lacks clarity in that it is unclear what factors would be examined in order for the Board to determine whether to require \$1.4 million in some

instances or “the amount to be determined by the Board to fulfill Business and Professions Code section 19604.5(e)(6)” in other instances. According to the ISR, the Board may reduce the fee if they reduce the length of term of the license (see Part B.(2) below). The Board must provide sufficient clarity as to the factors it will consider in making a determination for a lesser amount and what the amount of the fee will be based on those factors.

(2) Proposed Adoption of Subdivision 2086.5(c).

The Board proposed to adopt subdivision 2086.5(c), which provides:

The term of the exchange wagering License *shall not be more than 2 years* from the date the exchange wagering license is issued, *unless otherwise determined by the Board*. [Emphasis added.]

Subdivision 2086.5(c) does not meet the clarity standard of Government Code section 11349.1 since it cannot be easily understood by those persons who are directly affected and can, on its face, be reasonably and logically interpreted to have more than one meaning. It is unclear what factors would be considered as the basis upon which the Board would determine to shorten or lengthen the term of the license. As written, this would allow the Board to make the license term for any period of time. The Board must clarify the term of the license and/or provide the factors upon which it would shorten or lengthen the term.

(3) Proposed Adoption of Subdivision 2086.5(d).

The Board proposed to adopt subdivision 2086.5(d). Section 2086.5 describes the application process, the term of an application, and the timelines regarding the Board’s determination of approval or denial. The pertinent part of subdivision 2086.5(d) is:

... The Board *may approve* the application if, after reasonable investigation and inspection, as it deems appropriate, it determines that the applicant has demonstrated that exchange wagers placed through the exchange will be accurately processed and that there will be sufficient safeguards to protect the public and to maintain the integrity of the horse racing industry in this state. [Emphasis added.]

This sentence in subdivision (d) does not meet the clarity standard of Government Code section 11349.1 since it cannot be easily understood by those persons who are directly affected. If, after reviewing the application, the Board has determined that the applicant has made the demonstration described in subdivision (d), the Board “may” approve the application. No factors are provided as to why the Board might not approve an application after the Board has determined that the applicant has made the demonstration described in subdivision (d). The Board must either change “may” to “shall,” or clearly provide such factors as to when the Board may or may not approve the application.

(4) Proposed Adoption of Subdivision 2086.6(a).

The Board proposed to adopt subdivision 2086.6(a), which provides:

As part of the exchange wagering license application, and any renewal application, the applicant shall submit a detailed operating plan in ***a format and containing such information as required by the Board***. ***At a minimum***, the operating plan shall address the following: ... [Emphasis added.]

Subdivision 2086.6(a) does not meet the clarity standard of Government Code section 11349.1 since it cannot be easily understood by those persons who are directly affected and can, on its face, be reasonably and logically interpreted to have more than one meaning. This provision is followed by a list of eight different types of information that must be provided. There is no guidance provided in the regulations as to the format required by the Board so an applicant will not know what format to use to present the operating plan. Also, it is unclear what additional information, beyond the “minimum” that is listed, might be required or in what instance the Board might require any additional information. If an applicant somehow was able to determine the required format and present its operating plan in that format providing the “minimum” information, the Board would not be obligated to accept it under this proposed subdivision as written since they can always ask for more. The Board must clearly describe the required format and the factors it would consider in making a determination to require more information than the “minimum” and what additional information would be required in that instance.

(5) Proposed Adoption of Subdivision 2086.7(a).

The Board proposed to adopt subdivision 2086.7(a), which provides:

For the purposes of pari-mutuel accounting and settlement of exchange revenues according to contract, as well as reporting and analysis of data related to exchange wagering, the exchange provider shall furnish the nonprofit horse racing data base ***as designated by the Board*** with the following ***data interface*** in a format agreed upon by the exchange provider and the nonprofit horse racing data base:

(1) A daily reconciliation of the amounts settled by the exchange provider and its account holders, including but not limited to: ... [Emphasis added.]

Subdivision 2086.7(a) does not meet the clarity standard of Government Code section 11349.1 since it cannot be easily understood by those persons who are directly affected and it conflicts with the Board’s description of the effect of the regulation. There are two problems with clarity in this provision.

First, the proposed regulation does not indicate which data base has been “designated by the Board” as the one to which the exchange provider must furnish anything. The ISR refers to a nonprofit horse racing database called CHRIMS so this may be the one the Board intends each exchange provider to interact with, but the regulation does not make any such designation. The Board must either make a clear designation or describe the factors upon which such designation will be made in each instance.

Second, the proposed regulation does not require the exchange provider to provide data, but only a data interface. (A data system interface is “a common aspect of two or more data systems involving the capability of intersystem communications” (www.answers.com)). However, this

provision is followed by a list of nine data elements that must be included in this interface. There is an inference in the introductory phrase of this provision, “For the purposes of pari-mutuel accounting and settlement of exchange revenues according to contract, as well as reporting and analysis of data related to exchange wagering...” that the intention of this provision is to require the exchange provider to not only provide a data interface with the database, but to provide the listed data as well. This inference is also reflected in the ISR:

The purpose of the interface is pari-mutuel accounting, as well as reporting and analysis of data related to exchange wagering. ... Using software tools that have been developed specifically for the task CHRIMS loads and balances California pari-mutuel data daily.

In addition to providing the data interface agreed upon by the exchange provider and the nonprofit horse racing database, if it is the Board’s intention in subdivision 2086.7(a) that the exchange provider also provide the data listed within that data interface, then the Board must revise subdivision 2086.7(a) to make this clear.

(6) Proposed Adoption of Subdivision 2087.6(c).

The Board proposed to adopt subdivision 2087.6(c), which provides:

An account holder who believes a payout was *inappropriately disrupted* due to the cancellation of a matched wager may submit a claim to the exchange provider in accordance with Rule 2089 of this article. [Emphasis added.]

Subdivision 2087.6(c) does not meet the clarity standard of Government Code section 11349.1 since it cannot be easily understood by those persons who are directly affected. There is no guidance in the proposed regulations as to when a payout might be considered to be “inappropriately disrupted” which could likely leave the account holder guessing as to whether any disruption was inappropriate. The Board must state clearly what is meant by “inappropriately disrupted” so that account holders will know when they can submit such a claim.

(7) Proposed Adoption of Subdivision 2089(a).

Section 2089 contains requirements regarding errors in payments of exchange wagers. The pertinent part of subdivision (a) provides:

... The exchange provider shall *immediately* notify the account holder of the overpayment and shall be entitled to recover from such account holder the amount of the overpayment. [Emphasis added.]

Subdivision 2089(a) does not meet the clarity standard of Government Code section 11349.1 since it cannot be easily understood by those persons who are directly affected. The exchange provider and the account holder would not be able to determine whether this notification must be made within a certain number of minutes, hours, days or weeks. The Board must amend this to

clarify what is meant by immediate so that those directly affected will understand the timeframe within which this notification must be made.

(8) Proposed Adoption of Subdivision 2089.5(j).

The Board proposed to adopt subdivision 2089.5(j), which provides:

All wagering conversations, transactions or other wagering communications through the exchange wagering system, verbal or electronic, shall be recorded by means of electronic media, and the tapes or other records of such communications shall be kept by the entity [meaning the exchange provider] *for at least 180 days, unless otherwise directed by the Board.* [Emphasis added.]

Subdivision 2089.5(j) does not meet the clarity standard of Government Code section 11349.1 since it cannot be easily understood by those persons who are directly affected and can, on its face, be reasonably and logically interpreted to have more than one meaning. The Board does not provide the factors that might necessitate the Board to direct the entity to keep these recordings for a longer or shorter period of time. The Board must amend this subdivision to clearly specify the timeframe and any factors that would cause the Board to shorten or lengthen the time and, specifically, by how much time, when those factors are present.

C. FAILURE TO COMPLY WITH THE CONSISTENCY STANDARD OF GOVERNMENT CODE SECTION 11349.1(a)(4).

OAL is mandated to review each regulation adopted pursuant to the APA to determine whether the regulation complies with the “Consistency” standard. (Gov. Code, sec. 11349.1(a)(4)). “Consistency” as defined by Government Code section 11349(d) means “...being in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or other provisions of law.”

(1) Proposed Adoption of Subdivisions 2086(h), (m), (p), and (s), 2087.6(a)(2) and 2089(b)(4).

Business and Professions Code section 19604.5(a)(17) specifically defines “person” for purposes of that section:

(a)(17) ‘Person’ means any individual, partnership, corporation, limited liability company, or other association or organization.

Business and Professions Code section 19604.5 does not define “natural person,” but the Board’s proposed regulations, in addition to duplicating the statutory definition of “person,” also define “natural person” in section 2086(r):

(r) ‘Natural person’ means a living, breathing human being, as opposed to a legal entity.

Business and Professions Code section 19604.5 uses “natural person(s)” in two instances, in subdivisions (a)(8) and (c):

(a)(8) ‘Exchange wagering account’ means the account established with an exchange wagering licensee by a *person* participating in exchange wagering. An exchange wagering account may *only* be established or maintained with an exchange wagering licensee by a *natural person*. [Emphasis added.]

(c) A *person* shall not be permitted to open an exchange wagering account, or place an exchange wager, except in accordance with federal law, this section, and rules and regulations promulgated by the board. *Only natural persons* with valid exchange wagering accounts may place wagers through an exchange. [Emphasis added.]

As is evident in both of these subdivisions, the statute, unfortunately, uses the terms “person” and “natural person” interchangeably in both of these examples and in a few other instances (e.g., subdivisions (a)(4), (a)(7), (b)(7) and (e)(3)(C) and (D)). However, the intent of the Legislature, judging from the several bill analyses for SB 1072, appears to be that only “natural persons” may hold accounts and place wagers through an exchange. For example, the Senate Floor Analyses, dated 8/31/10, states that this bill:

Provides that only persons 18 years of age or older could establish exchange wagering accounts and requires the CHRB to approve security policies and safeguards to ensure player protections, age verification and location.

The more specific statements in statute limit account holders to being “natural persons” (e.g., the second sentence in both subdivisions (a)(8) and (c)). The Board reiterates the statute in the limitation that an account holder must be a natural person. However, the Board’s usage of the term “person” in sections 2086(h), (m), (p), and (s), 2087.6(a)(2) and 2089(b)(4) is inconsistent with the more specific statements in statute that only “natural persons” may hold an exchange wagering account and place wagers through an exchange. This violates the consistency standard in Government Code section 11349.1. In each instance in which the term “person” is used in the Board’s proposed regulations, but “natural person(s)” is intended pursuant to Business and Professions Code section 19604.5, subdivisions (a)(8) and (c), the Board must make amendments to be consistent with the specific limitation in the statute.

(2) Proposed Adoption of Subdivision 2086.6(i).

The Board proposed to adopt subdivision 2086.6, which requires the exchange provider, as part of application for licensure, to provide an operating plan to the Board. Subdivision (i) provides:

The operating plan submitted pursuant to this regulation, and any subsequent updates or changes to such operating plan, shall be exempt from disclosure pursuant to Government Code section 6254(k) and non-disclosable to the public.

Subdivision 6254(k) of the Government Code is part of a list of items that are exempt from disclosure under the California Public Records Act. It provides:

Records, the disclosure of which is exempted or prohibited pursuant to federal or state law, including, but not limited to, provisions of the Evidence Code relating to privilege.

Subdivision 2086.6(i) does not meet the consistency standard since it is not in harmony with Government Code subdivision 6254(k). This writer was unable to locate any federal or state law that exempts or prohibits disclosure of this operating plan as a record that would fall within this exemption from disclosure. The Board must either cite to another legal basis for non-disclosure or allow disclosure.

Prior to resubmission of the proposed regulations, the Board must amend these subdivisions discussed in Part C (1) and (2) above to eliminate the consistency problems; provide notice for a 15-day public availability and comment period on the modified text; include a summary and response to any comments on the modified text and a demonstration of sufficient necessity for the changes in an addendum to the FSR; and include all the related documents that are required in the rulemaking record. The 15-day public availability and comment period provided for this purpose may be concurrent with the same 15-day period for the revised ISR as discussed in Part A above.

D. FAILURE TO COMPLY WITH APA PROCEDURAL REQUIREMENTS

(1) Failure to include all relied upon documents in the rulemaking file and defective economic impact assessment.

Government Code section 11346.2(b)(3) requires identification in the ISR of each technical, theoretical, and empirical study, report, or similar document, if any, upon which the agency relies in proposing the adoption, amendment, or repeal of a regulation. Government Code section 11347.3(b)(7) requires the following to be included in the rulemaking record:

All data and other factual information, technical, theoretical, and empirical studies or reports, if any, on which the agency is relying in the adoption, amendment, or repeal of a regulation, including any economic impact assessment or standardized regulatory impact analysis as required by Section 11346.3.

The ISR for the proposed rulemaking states that “the Board relied on the results of its economic impact analysis prepared pursuant to section 11346.3(b).” However, the Board did not include the economic impact analysis (EIA) in the rulemaking record. Upon alerting the contact person to this omission, the Board emailed the EIA to OAL. Upon review of the EIA, OAL determined that some of the required elements were missing.

Pursuant to Government Code section 11346.3(b)(1), the EIA must assess whether and to what extent the proposed regulations will affect the following:

- (A) The creation or elimination of jobs within the State of California.
- (B) The creation or new businesses or the elimination of existing businesses within the State of California.
- (C) The expansion of businesses currently doing business within the State of California.
- (D) The benefits of the regulation to the health and welfare of California residents, worker safety, and the state's environment.

The Board's EIA includes some assessment regarding subdivision (b)(1)(A) just above, but does not include any discussion of subdivisions (b)(1)(B), (C) and (D). The Board must revise the EIA to include an assessment regarding these elements, provide 15-day notice of public availability and comment pursuant to Government Code section 11347.1, summarize and respond to any comments on the revised EIA in an addendum to the final statement of reasons and include all the related documents that are required in the rulemaking record.

(2) Failure to attach the incorporated by reference document to the regulatory text

Government Code section 11343 requires that a certified copy and six duplicate copies of the proposed regulation be submitted to OAL for review. Pursuant to section 20(b), title 1, of the CCR, OAL must review materials proposed for incorporation by reference in accordance with the procedures and standards for a regulation to be published in the CCR.

The Board proposed to incorporate by reference a form to be used for the licensure application. This form was not attached to the regulatory text. Upon resubmission, the Board must submit a copy of the form attached to each copy of the regulatory text (original and six copies).

(3) Failure to include the required information in the updated informative digest in the rulemaking record.

Government Code section 11346.9(b) requires that an agency prepare an updated information digest that includes:

... a clear and concise summary of the immediately preceding laws and regulations, if any, relating directly to the adopted, amended, or repealed regulation and the effect of the adopted, amended, or repealed regulation.

The Board included the name "Updated Informative Digest" (UID) in the index for the rulemaking record and in the title as part of the FSR; however, there was no update to the information provided in the informative digest of the notice of proposed action. Since the Board substantively modified the proposed regulations after the 45-day comment period, the Board must discuss the effect of the changes to the regulations in the UID. Any additional modifications to the text made as a result of this decision must also be appropriately addressed in the UID upon resubmittal.

(4) Failure to include the necessary finding when the regulations include a business reporting requirement.

Government Code section 11346.3(d) requires:

Any administrative regulation adopted on or after January 1, 1993, that requires a report shall not apply to businesses, unless the state agency adopting the regulation makes a finding that it is necessary for the health, safety, or welfare of the people of the state that the regulation apply to businesses.

Pursuant to Government Code section 11346.5(a)(11), this finding must be included in the notice of proposed action. The Board proposes to adopt section 2086.9, which requires that exchange providers submit an annual audited financial statement, including the Service Organization Controls I (SOC I) and Service Organization Controls II (SOC II) reports of the Statement on Standards for Attestation Engagements 16 (SSAE 16) audit.

The Board did not make the required finding for the reporting requirement to apply to businesses. If the Board intends that this apply to exchange provider businesses, it must include this finding in a 15-day notice of public availability and comment.

5) Failure to prepare adequate statement confirming compliance with section 44, title 1, of the CCR and Government Code section 11347.1.

Section 44(b), title 1, of the CCR describes requirements when an agency makes modifications to the regulatory text, including who must be provided with notice of the modifications. It also requires:

The rulemaking record shall contain a statement confirming that the agency complied with the requirements of this section and stating the date upon which the notice and text were mailed and the beginning and ending dates for this public availability period.

Government Code section 11347.1(e) describes requirements when an agency adds a document to the rulemaking record after publication of the notice of proposed action. It requires:

The rulemaking file shall contain a statement confirming that the agency complied with the requirements of this section and stating the date on which the notice was mailed.

The “Statement of Mailing” in the record for “Notification of Modification of Texts and Supplement to the Initial Statement of Reasons” (the ISR supplement was solely for the purpose of adding additional relied on documents to the record) states compliance with Government Code sections 11346.8, subdivisions (c) and (d), but does not make the compliance statements required by section 44, title 1, of the CCR and Government Code section 11347.1. In addition, it does not state that the text was mailed nor does it provide the beginning and ending dates for the 15-day public availability and comment period. The Board must revise this confirming mailing statement to include all of the required elements.

(6) Failure to include the affidavit/declaration of closure as part of the rulemaking record index/table of contents.

Government Code section 11347.3(b)(12) requires that the affidavit/declaration of closure be included as part of the index/table of contents. The Board included the affidavit/declaration in the rulemaking record, but it was not part of the index/table of contents. The Board must include these together in the rulemaking record.

(7) Failure to include a discussion of all proposed alternatives in the initial statement of reasons.

Government Code section 11346.2(b)(5)(A) requires that the ISR include:

A description of reasonable alternatives to the regulation and the agency's reasons for rejecting those alternatives. Reasonable alternatives to be considered include, but are not limited to, alternatives that are proposed as less burdensome and equally effective in achieving the purposes of the regulation in a manner that ensures full compliance with the authorizing statute or other law being implemented or made specific by the proposed regulation. ...

The rulemaking record includes two proposed alternatives: one from Betfair and one from Global Betting Exchange (GBE), both dated October 2, 2011. The Board included in the ISR a brief discussion of the GBE proposed alternative and the Board's reasons for rejecting that alternative, but the Board did not include a discussion of the Betfair alternative and reasons for rejecting it. In the revised ISR prepared pursuant to Part A above, the Board must include a discussion of this alternative and reasons for rejecting it.

(8) Failure to include several required elements in the final statement of reasons.

Government Code section 11346.9 requires the inclusion of an FSR in the rulemaking record and describes the elements that must be included in this document. Subdivision (a)(1) of this section, in pertinent part, requires:

An update of the information contained in the initial statement of reasons. ...

Also, subdivision (a)(4) requires:

A determination with supporting information that no alternative considered by the agency would be more effective in carrying out the purpose for which the regulation is proposed, would be as effective and less burdensome to affected private persons than the adopted regulation, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law. ...

Additionally, subdivision 20(c), title 1, of the CCR, in pertinent part, requires:

(c) An agency may “incorporate by reference” only if the following conditions are met:

(1) The agency demonstrates in the final statement of reasons that it would be cumbersome, unduly expensive, or otherwise impractical to publish the document in the California Code of Regulations.

(2) The agency demonstrates in the final statement of reasons that the document was made available upon request directly from the agency, or was reasonably available to the affected public from a commonly known or specified source. In cases where the document was not available from a commonly known source and could not be obtained from the agency, the regulation shall specify how a copy of the document may be obtained. ...

The Board included an FSR in the rulemaking record, but it does not update information contained in the ISR; nor does it include the determination with supporting evidence regarding alternatives that were proposed or considered (alternatives proposed by Betfair and by GBE are included in the record); nor does it include the demonstrations required by subdivision 20(c)(1) and (2), title 1, of the CCR. The Board must include all of this information in an FSR addendum.

E. FAILURE TO ADEQUATELY RESPOND TO ALL OF THE PUBLIC COMMENTS MADE REGARDING THE PROPOSED ACTION PURSUANT TO GOVERNMENT CODE SECTION 11346.9(a)(3).

Government Code section 11346.9(a) provides that an agency proposing regulations shall prepare and submit to OAL a “final statement of reasons.” One of the required contents of the FSR is a summary and response to public comments. Specifically, Government Code section 11346.9(a)(3) requires that the FSR include:

(3) A summary of each objection or recommendation made regarding the specific adoption, amendment, or repeal proposed, together with an explanation of how the proposed action has been changed to accommodate each objection or recommendation, or the reasons for making no change. This requirement applies only to objections or recommendations specifically directed at the agency’s proposed action or to the procedures followed by the agency in proposing or adopting the action....

Furthermore, where an agency makes substantial, but sufficiently related changes to its originally proposed regulatory text and provides notice of the changes pursuant to Government Code section 11346.8(c), that statutory provision specifically includes the following requirement:

(c) ... Any written comments received regarding the change must be responded to in the final statement of reasons required by [Government Code] Section 11346.9.

In this rulemaking action, the Board provided a 45 day public comment period for its originally proposed text, a public hearing which was continued three times, and a 15 day public availability period for adding some relied upon documents to the rulemaking record and for modifications to

the text. During these periods, the Board received written and oral comments from over 25 commenters. The Board adequately summarized and responded to most of these comments. However, a detailed review of the FSR indicates that for some of the public comments the response contained errors, was incomplete, or was otherwise not fully responsive to the comments received. Some revision of responses will be required before resubmitting the rulemaking action to OAL for review. The following are responses that require revision:

1) Response to Drew J. Couto, Couto & Associates on page 17 of the FSR and to Carlo Fisco, Law Office of Carlo Fisco on page 43 of the FSR: Regarding proposed section 2086.6(i), Mr. Couto requests that the Board clarify what privilege it is seeking to preserve pursuant to Government Code section 6254(k). Mr. Fisco expresses objection to the applicability of Government Code section 6254 (subdivision 6254(k) as referenced in section 2086.6(i)) to exempt the entire operating plan from disclosure. He acknowledges that any “trade secret” component should remain confidential. The Board’s response to both of these comments only states the purpose of the operating plan, that it is required by the Board, that “a candid assessment has to be confidential,” and that information on exchange wagering transactions “may be obtained from the CHRIMS database.”

This response does not address the objections/concerns expressed by Mr. Couto and Mr. Fisco. Upon resubmittal, the Board must revise these responses and provide a legal analysis for the Board’s authority regarding the applicability of Government Code section 6254(k) to non-disclosure of an operating plan. (See Part C (2) above.)

2) Response to Carlo Fisco, Law Office of Carlo Fisco on page 45 of the FSR: Mr. Fisco raises some objections to proposed language regarding notification of cancellation of matched wagers. He also states that 2087.6(c), which regards “inappropriately disrupted” payouts due to cancellation of a matched wager, is not clear or consistent with the heading for section 2087.6, which regards cancellation of unmatched wagers. The Board’s response is that it modified this section in regards to notifications, but the Board did not respond to the comments about lack of clarity or consistency. The Board must revise this response to address each issue raised.

ADDITIONAL CONCERNS

OAL notes the following additional concerns with the regulations and rulemaking file:

1. When conducting any 15 day comment period or public availability period, please ensure that the days are counted correctly. The correct manner of counting days is found in Government Code section 6800. The public availability period that was conducted for this rulemaking from October 8 through October 22, 2012 consisted of only 14 days.
2. In the final regulation text attached to the Form 400, please ensure that it is only single underlined with no strikeouts to indicate that these are all new sections that are being proposed for adoption. The current version of the text has some double-underlines and some strikeouts that are apparently left over from the modified text that was sent out to the public.

3. In the final regulation text, since there is currently not an article 27 in division 4 of title 4, please ensure that, on the first page of the proposed regulatory text, the article heading is underlined and the phrase "Proposed Addition of" is inserted above that heading.

CONCLUSION

For the reasons set forth above, OAL has disapproved this regulatory action.

Date: March 20, 2013



George C. Shaw
Senior Counsel

FOR: DEBRA M. CORNEZ
Director

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