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COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

JAY GEROW AND ZDI GAMING, INC.,

Appellants,

v.

WASHINGTON STATE GAMBLING COMMISSION,

Respondent.

BRIEF OF RESPONDENT

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TABLE OF CONTENTS

I. INTRODUCTION 1

II. STATEMENT OF THE ISSUES 2

III. STATEMENT OF THE CASE 2

A. Washington Statutes And Rules Governing The Game Of Pull-Tabs And Electronic Video Pull-Tab Dispensers 2

B. ZDI's VIP Machine 5

C. The Commission's Rulemaking Relating To Electronic Video Pull-Tab Dispensers 8

1. Original proposed rule change to prohibit Electronic Video Pull-Tab Dispensers 8

2. Alternative rule proposals to permit electronic video pull-tab dispensers and the use of cash cards to purchase pull-tabs 9

D. Procedural History Following The Commission's Rule Adoption 11

IV. STANDARD OF REVIEW 13

V. ARGUMENT 14

A. The Superior Court Did Not Abuse Its Discretion When It Declined To Supplement The Commission's Rulemaking Record 14

B. The Commission Complied With The Rulemaking Process Prescribed By The Administrative Procedure Act 16

1. A majority vote of two Commissioners was sufficient to adopt the regulations 16

2. The Commission complied with the Regulatory Fairness Act 19

C. The Commission Acted Within The Scope Of Its Authority When It Regulated The Game Of Pull-Tabs 22

D. The Commission's Adoption Of The Administrative Rules Governing Electronic Video Pull-Tab Dispensers Was Not Arbitrary And Capricious 25

E. ZDI Is Not Entitled To Attorneys Fees And Costs Under The Equal Access To Justice Act 28

VI. CONCLUSION 29

TABLE OF AUTHORITIES

Cases

Armstrong v. State,
91 Wn. App. 530, 958 P.2d 1010 (1998) 13

Armstrong, 91 Wn. App. at 537 23

Brewster Pub. Schools v. PUD No. 1 of Douglas Cy.,
82 Wn.2d 839, 514 P.2d 913 (1973) 18

Costanich v. Dep't of Social and Health Serv., 164 Wn.2d 925, 929,
194 P.3d 988 (2008) 29

Mudarri v. State,
147 Wn. App. 590, 196 P.3d 153 (2008) 27

Okamoto v. Employ. Sec. Dep't,
107 Wn. App. 490, 27 P.3d 1203 (2001) 15

Rios v. Dep't of Labor & Indus.,
145 Wn.2d 483, 39 P.3d 961 (2002) 13, 26

State ex. rel. King County v. Tax Commission of the State of Washington,
174 Wash. 336, 24 P.2d 1094 (1933) 17

State ex. rel. Schillberg v. Safeway Stores, Inc.,
75 Wn.2d 339, 450 P.2d 949 (1969) 2

State v. Wright,
84 Wn.2d 645, 529 P.2d 453 (1974) 18

Tapper v. State Employ. Sec. Dep't,
122 Wn.2d 397, 858 P.2d 494 (1993) 13

WA Independent Tel. Ass'n v. State. Util. & Transp. Comm'n,
148 Wn.2d 887, 64 P.3d 606 (2003) 14, 15, 25

Wash. Pub. Ports Ass'n (WPPA) v. Dep't of Revenue,
148 Wn.2d 637, 62 P.3d 462 (2003) 23

ZDI Gaming, Inc. v. WSGC,
151 Wn. App. 788, 214 P.3d 938 (2009) 7, 12

ZDI Gaming, Inc. v. WSGC,
173 Wn.2d 608, 268 P.3d 929 (2012) 7

Statutes

RCW 19.85 19

RCW 19.85.020(2) 19

RCW 19.85.030(1) 19

RCW 19.85.040(1) 20

RCW 34.05.010(2) 17

RCW 34.05.010(4) 17

RCW 34.05.010(9)(a) 16

RCW 34.05.010(9)(b) 16

RCW 34.05.310(1) 8

RCW 34.05.320(1)(j) 20

RCW 34.05.370(4) 14

RCW 34.05.558 14

RCW 34.05.562 12

RCW 34.05.562(1)(a) 15

RCW 34.05.562(1)(b) 15

RCW 34.05.562(1)(c) 15

RCW 34.05.570(1)(a) 13

RCW 34.05.570(1)(c) 13

RCW 34.05.570(2) 13

RCW 34.05.570(2)(c) 13

RCW 4.84 28

RCW 4.84.350 28

RCW 4.84.350(1) 28

RCW 9.46 1

RCW 9.46.010 ..... passim

RCW 9.46.0241 ..... 5, 8

RCW 9.46.0273 ..... 4, 24, 26

RCW 9.46.0325 ..... 3, 4

RCW 9.46.050(2) 16, 17

RCW 9.46.070 ..... 2, 3, 4, 23

RCW 9.46.070(11) 3, 24

RCW 9.46.070(14) 3, 17

RCW 9.46.070(4) 4

RCW 9.46.070(5) 5

RCW 9.46.215 ..... 5, 6

RCW 9.46.215(2) 5

RCW 9.46.231 5

RCW 9.46.310 ..... 4, 5, 24

RCW 9.46.360(6) 27

RCW19.85.011 19

Other Authorities

1999 Op. Att'y Gen. No.7 at n.11 5

25 U.S.C. § 2710(d)(3)(B) 27

RCW 9.46.0241(1) 6

The Indian Gaming Regulatory Act, 25 U.S.C. § 2701 27

Regulations

WAC 230-03-060 ..... 27, 28

WAC 230-03-185 4

WAC 230-03-190 4

WAC 230-06-003 ..... passim

WAC 230-06-005 5

WAC 230-06-050 5

WAC 230-06-071 5

WAC 230-06-074 5

WAC 230-12-050(2) 6

WAC 230-12-070(1) 6

WAC 230-14-010 4

WAC 230-14-045 ..... 8, 10

WAC 230-14-047 ..... passim

WAC 230-14-047(3) 22

WAC 230-14-060 4

WAC 230-14-070 4

WAC 230-14-100 4

WAC 230-15-553 21

WAC 230-16 5

WAC 260-16-160 5

WAC 260-16-180 5

Constitutional Provisions

Wash. Const. Art. II, Sect. 24 ..... 2, 23

I. INTRODUCTION

Petitioners Jay Gerow and ZDI Gaming, Inc. (collectively "ZDI"), licensed manufacturers of gambling equipment, ask this Court to declare two Washington State Gambling Commission ("Commission") rules – governing electronic video pull-tab dispensers, WAC 230-14-047, and defining cash, WAC 230-06-003 – invalid. ZDI erroneously contends that the Commission enacted the rules outside the scope of its authority under the State's Gambling Act, RCW 9.46, in violation of the Administrative Procedure Act ("APA"), and in retaliation for ZDI's prior litigation with the Commission. It also contends that the superior court erred in declining ZDI's request to supplement the Commission's rulemaking file. Each of these assertions lacks merit.

The Commission acted according to the procedures set forth in the APA and pursuant to its statutory mandate under the Gambling Act when it promulgated the administrative rules defining applicable standards for electronic video pull-tab dispensers ("EVPDs"). The Commission also did not act arbitrarily or capriciously when it declined ZDI's request to adopt an alternative version of the rules that conceivably expanded the scope of EVPDs in contravention of the Gambling Act's mandate to "limit the nature and scope of gambling activities" through "strict control and regulation." Because the Commission adopted the rules consistent with its

constitutional and statutory mandates and ZDI cannot meet its burden of proving that the adopted rules are invalid, ZDI's petition must be denied.

II. STATEMENT OF THE ISSUES

1. Did the superior court act within its discretion when it declined to supplement the Commission's rulemaking file with additional materials that were not related to the Commission's decision at the time it promulgated the rules and were not relevant to the issues in dispute?

2. Did the Commission properly comply with statutory rulemaking procedures under the APA when it promulgated WAC 230-06-003 and WAC 230-14-047?

3. RCW 9.46.070 authorizes the Commission to "regulate and establish the type and scope of and manner of" gambling activities authorized in the State of Washington. Did the Commission act within the scope of this authority when it promulgated the two rules regulating the gambling activity of pull-tabs?

4. Was the Commission's promulgation of the regulations related to electronic video pull-tab dispensers arbitrary and capricious?

III. STATEMENT OF THE CASE

A. Washington Statutes And Rules Governing The Game Of Pull-Tabs And Electronic Video Pull-Tab Dispensers

Gambling activities, involving consideration, chance and prize, are unlawful in Washington State unless specifically authorized by state law. Wash. Const. Art. II, Sect. 24; *State ex. rel. Schillberg v. Safeway Stores, Inc.*, 75 Wn.2d 339, 450 P.2d 949 (1969). Via the State's Gambling Act, the Legislature authorizes only certain specified gambling activities, including the game of "pull-tabs," provided that the games are conducted in

compliance with Washington's gambling laws and regulations. RCW 9.46.010, .0325. The Legislature also places the regulation and control of these authorized gambling activities under the Commission's authority. RCW 9.46.070. Specifically, the Legislature authorized the Commission "to regulate and establish the type and scope of and manner of conducting the gambling activities authorized by this chapter, including but not limited to, the extent of wager, money, or other thing of value which may be wagered or contributed or won by a player in any such activities." RCW 9.46.070(11). It also authorized the Commission to "adopt such rules and regulations as are deemed necessary to carry out the purposes and provisions of [the Gambling Act]." RCW 9.46.070(14).

In some instances, the Legislature gave the Commission specific authorization to regulate, in a certain manner, a particular gambling activity. For instance, when the Legislature authorized pull-tabs, it specified that the game be "conducted pursuant to the provisions of [the Gambling Act] and *any rules and regulations adopted pursuant thereto*." RCW 9.46.010 (emphasis added). It also specified that the game of pull-tabs be given its "usual and ordinary meaning as of July 16, 1973, *except that such definition may be revised by the Commission*" pursuant to duly promulgated

rules and regulations. RCW 9.46.0273 (emphasis added).[1] Moreover, the Legislature specified that pull-tabs could *only* be used as a commercial stimulant to businesses engaged in the selling of food or drink for consumption *and only* when operated pursuant to the Gambling Act and the rules and regulations of the Commission. RCW 9.46.0325.

The Legislature also authorized the Commission to license manufacturers and distributors of gambling equipment, including pull-tab dispensers. RCW 9.46.070(4), .310. While the Commission licenses persons and entities to conduct these gambling activities, it does not license gambling equipment. *See* RCW 9.46.070, .310; WAC 230-03-185, -190. However, the Commission is prohibited from issuing licenses to persons or entities wishing to manufacture and distribute gambling equipment except "respecting devices which are designed and permitted for use in connection with the activities authorized under [the Gambling Act]: PROVIDED, that this requirement for licensure shall apply only insofar as the *Commission has adopted, or may adopt, rules implementing it as to particular categories of gambling devices and related equipment.*" RCW 9.46.310 (emphasis

[1] As currently defined by the Commission, a pull-tab is a paper ticket that contains a "window," or a series of windows, that conceals numbers or symbols from view. *See* WAC 230-14-010. When revealed, certain combinations of numbers or symbols signify that they are pre-determined winners and entitle the player to collect a prize. *Id.* Pull-tab prizes in excess of $20 are designated on a "flare," which is displayed near the pull-tab game. *See* WAC 230-14-060, -070 and -100. When a prize with a value over $20 is won, the licensed operator of the game must cross the prize off the flare, thereby informing players what prizes are still available to be won in that particular pull-tab series. WAC 230-14-100.

added). Because certain gambling devices – including slot machines and video pull-tabs – are illegal in the State of Washington, the Commission requires that licensees submit certain gambling equipment for review to verify compliance with the Gambling Act and the Commission's rules. *See* RCW 9.46.0241, .070(5), .215, .231, and .310; WAC 230-06-050; WAC 230-14-047. The Commission then furnishes the *licensees* with identification stamps to affix to their gambling equipment to show that the equipment is in compliance with the law upon inspection.[2] *See* RCW 9.46.070(5); RCW 9.46.215(2); WAC 230-06-005, -071 to -074; WAC 230-16-160 to -180. As with most other gambling equipment, EVPDs are subject to regulation by the Commission. *See* RCW 9.46.310; WAC 230-16; *see also* 1999 Op. Att'y Gen. No.7 at n.11 (Gambling Commission can "use its regulatory discretion in deciding whether to authorize [EVPDs] ...and with what limitations").

B. ZDI's VIP Machine

Since 1997, the Commission has approved and regulated EVPDs that dispense paper pull-tabs and feature video displays with lights, spinning reels, and audio sounds. Administrative Record ("AR") 10, 119, 329-38.[3] While the approved machines' video displays loosely mimic that

[2] Unauthorized gambling devices are subject to seizure. RCW 9.46.231.

[3] As indicated in the Index to Clerk's Papers, the administrative record in this matter, which contains the Commission's rule-making file and meeting transcripts,

of electronic slot machines,[4] nothing in the display or function of the approved machines affects the chance and prize element of gambling. *Id.* Instead, the approved EVPDs merely accept consideration and dispense a paper pull-tab upon purchase. *Id.* The Commission-approved version of ZDI's EVPD is commonly referred to as the "VIP." AR 35.

In 2005, ZDI petitioned the Commission for an administrative declaratory order allowing it to upgrade its VIP with the ability to read pull-tabs and automatically credit any winnings under $20 to an electronic cash card that the player inserts into the machine. AR 10. The Commission issued a Final Declaratory Order denying the petition and upholding an earlier ruling by an administrative law judge that the VIP upgrade violated (former) WAC 230-12-050(2) and 230-12-070(1) because the equipment allowed the purchase of pull-tabs with cash cards, not cash, as that term was used in various Commission regulations.

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was submitted to this Court under separate cover. *See* CP 75-76. Citations to the administrative record will be referred to as "AR." Citations to the verbatim transcripts of the Commission's meetings will be referred to as "TR [Date]." Citations to the Clerk's Papers will be referred to as "CP."

[4] Although certain EVPDs are allowed in Washington, the Legislature has expressly outlawed slot machines and video pull-tabs. RCW 9.46.0241(1) defines "gambling device" to mean "[a]ny device or mechanism the operation of which a right to money, credits, deposits or other things of value may be created, in return for consideration, as the result of the operation of an element of chance including, but not limited to, slot machines, video pull-tabs, video poker, and other electronic games of chance." The Gambling Act expressly criminalizes the knowing ownership, possession or manufacture of those same "gambling devices." RCW 9.46.215.

AR 10, 302-14, 346. Thereafter, ZDI sought judicial review of the Commission's Final Declaratory Order. *Id.*

The Thurston County Superior Court reversed the Commission's Final Declaratory Order finding that the VIP equipment upgrade complied with then-existing Commission rules governing pull-tabs.[5] AR 302-14. The Gambling Commission appealed the superior court's decision.[6] *ZDI Gaming, Inc. v. WSGC*, 151 Wn. App. 788, 214 P.3d 938 (2009). Both the Washington State Court of Appeals and the Washington Supreme Court affirmed. *ZDI Gaming, Inc. v. WSGC*, 173 Wn.2d 608, 268 P.3d 929 (2012). The Washington Supreme Court ultimately held that ZDI met its burden of showing that the Commission erred in concluding the VIP upgrade violated the then-in force regulations. *ZDI Gaming, Inc.*, 173 Wn.2d at 621-23. The court noted, however, that "the Commission has the inherent authority to revise the rules to better comport with the modern realities of the industry if it elects to do so....Since then many of [the Commission's] rules have been revised." *Id.* at 614, n. 1 (internal quotations and citations removed).

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[5] The Commission's then-existing rules for pull-tabs did not explicitly authorize EVPDs or provide any standards for their operation. *See* WAC 230-14-045; former WAC 230-12-050(2) and 230-12-070(1) (repealed as of 1/1/08).

[6] The Gambling Commission also appealed the superior courts' transfer of venue from Pierce County to Thurston. That issue, which was affirmed by the Washington Supreme Court, is not relevant to the present matter.

C. The Commission's Rulemaking Relating To Electronic Video Pull-Tab Dispensers

1. Original proposed rule change to prohibit Electronic Video Pull-Tab Dispensers

While the judicial proceedings regarding the Commission's Final Declaratory Order were pending,[7] the Commission initiated rulemaking about EVPDs because of a new concern that the machines could possibly be illegal "gambling devices" under RCW 9.46.0241. *See* AR 10; TR 9/14/07 at 5. On July 23, 2007, pursuant to RCW 34.05.310(1), the Commission filed a rulemaking pre-proposal statement of inquiry (CR-101) with the Office of the Code Reviser. AR 21. The CR-101 gave notice that the Commission was considering repealing certain rules thereby effectively banning EVPDs. *Id.* It also invited interested parties to participate in the discussion of the proposed change. *Id.*

A few months later, at the Commission's September meeting, Commission staff submitted a draft rule amendment to WAC 230-14-045 that would ban EVPDs entirely. TR 9/14/07 at 5; AR 15. After discussing the proposed amendment and listening to significant public comment on the issue, the Commission chose to table the proposal until its next regularly scheduled meeting. TR 9/14/07 at 5-22.

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[7] The appeals concerned the Commission's Final Declaratory Order denying the VIP upgrade and did not involve the subsequent rulemaking proceedings at issue in this case.

After again receiving public testimony at the Commission's October monthly meeting, the Commission voted to file – for future discussion – staff's initial rule proposal banning EVPDs. TR 10/12/07 at 12-30; AR 10-15 (CR-102 "Proposed Rulemaking"). However, the Commission also asked staff to work with the gambling industry on an alternative proposal that would set out specific standards for EVPDs. TR 10/12/07 at 25. On October 16, 2007, the Commission filed a second CR-101 for a rule change to "set out requirements for operating electronic video pull-tabs dispensers." AR 20.

2. Alternative rule proposals to permit electronic video pull-tab dispensers and the use of cash cards to purchase pull-tabs

In November 2007, Commission staff sent a letter to stakeholders updating them on the proposed rule changes and encouraging the public to attend that month's scheduled Commission meeting. AR 25. On November 27, 2007, Commission staff filed two additional CR-102 proposed rulemaking notices. AR 6-9, 16-19. The first alternative rule proposal, designated as "Alternative #1," was submitted by Commission staff. AR 6-9. Alternative #1 proposed two new rules that would "explicitly authorize . . . electronic video pull-tab dispensers by incorporating prior Commission decisions and more recent rule changes into a new rule." AR 6. The new rules were designed to memorialize the

agency's definition of "cash" and maintain the industry's status quo allowing EVPDs, but explicitly set forth the machines' allowed features. *Id.* Staff indicated that a small business economic impact statement would not be required because the rule preserved the status quo and did not increase regulatory compliance costs. AR 7.

ZDI submitted the second alternative rule proposal, designated as "Alternative #2." AR 16-19. Alternative #2 "explicitly authorize[d] the use of . . . electronic video pull-tab dispensers" and "would allow pull-tab dispensers to add prizes of twenty dollars or less to a cash card upon insertion of the winning pull-tab." AR 16. Again, staff indicated that a small business economic impact statement would not be required because ZDI's proposed rule "provides clarification without changing current requirements." AR 17. Unlike the original proposed amendment banning EVPDs, both Alternatives #1 and #2 not only permitted their use as per current practice, they also expressly permitted the use of cash cards to purchase pull-tabs. AR 6-9, 16-19. However, only ZDI's Alternative #2 allowed EVPDs to credit pull-tab winnings and add them back to a cash card. *Id.*

During its January 2008 Commission meeting,[8] the Commission considered the original proposed amendment to WAC 230-14-045 banning

[8] Per its usual schedule, the Commission did not meet in December 2007. *See* http://www.wsgc.wa.gov/comm_mtgs/2007.asp (last accessed 05/06/2013).

EVPDs, Alternative #1, and Alternative #2. TR 1/11/08 at 6-21; AR 114. After considering the purpose of the Gambling Act and the risks associated with adopting the alternative proposals,[9] the Commission voted two to one to adopt Alternative #1. *See* TR 1/11/08 at 16-19; AR 2-5. On January 11, 2008, the Commission filed its rulemaking order (CR-103) giving notice of the adopted EVPD rules. AR 2-5. Those rules, which took effect February 11, 2008, are codified at WAC 230-06-003 (defining "cash") and WAC 230-14-047 (governing EVPDs). *See* AR 2.

D. Procedural History Following The Commission's Rule Adoption

On February 12, 2008, ZDI commenced this action challenging WAC 230-06-003 and WAC 230-14-047 under the APA, as well as making Open Public Meetings Act claims. CP 11-24. A few months later, ZDI amended its petition to drop the Open Public Meetings Act claims. CP 42-62.

During the course of the judicial review proceedings, ZDI sought to supplement the Commission's rulemaking file with: (1) excerpts of depositions and exhibits thereto taken after the rules were adopted; (2) a declaration from a former Commission member regarding past

[9] Commissioner Ellis was specifically concerned with the speed of play under the EVPDs and the social impacts of the machines on gambling. TR 1/11/08 at 16. Commissioner Rojecki was concerned with the legal impacts of adopting the alternative proposals. TR 1/11/08 at 17.

Commission practices; (3) a November 6, 2007 memorandum to the Commission summarizing changes to the Regulatory Fairness Act; and (4) excerpts of past Commission meeting minutes from 1995, 1999, and 2000. *See* CP 553-56. The Commission objected on the grounds that the supplemental materials did not satisfy the APA's requirements under RCW 34.05.562 for supplementing an agency's administrative record. CP 668-82. After considering the parties' briefs, the certified administrative record, and the case file, the superior court denied ZDI's request to supplement the record. CP 719-20.

Approximately five months later, on April 3, 2009, the superior court stayed the rule review proceedings pending the outcome of the court case, *ZDI Gaming, Inc. v. WSGC, supra.* CP 804-05. Three years later, the stay was lifted. CP 811-13. After considering the parties' briefs and hearing oral argument, the superior court denied ZDI's petition to declare WAC 230-06-003, defining "cash," and WAC 230-14-047, governing EVPDs, invalid. CP 907-09, 954-56. The superior court found that the Commission acted within its authority under the Gambling Act and the APA, and that the rules were not arbitrary and capricious. *Id.* ZDI timely filed a notice of appeal after the superior court denied its motion for reconsideration. CP 940-41, 957-68.

IV. STANDARD OF REVIEW

ZDI challenges the Commission's rules pursuant to RCW 34.05.570(2) of the APA. As such, ZDI bears the burden of proving the rules' invalidity and is entitled to relief only if it is substantially prejudiced by the agency's adoption of the rules. *See* RCW 34.05.570(1)(a), (c); *Rios v. Dep't of Labor & Indus.*, 145 Wn.2d 483, 491, 39 P.3d 961 (2002). The scope of an agency's rulemaking authority is an issue of law that is reviewed *de novo*. *Armstrong v. State*, 91 Wn. App. 530, 536, 958 P.2d 1010 (1998). In reviewing the Commission's rules, this Court sits in the same position as the superior court, applying the standards of the APA directly to the agency record. *Tapper v. State Employ. Sec. Dep't*, 122 Wn.2d 397, 402, 858 P.2d 494 (1993). Per the APA, a court shall declare a rule invalid only if: "[t]he rule violates constitutional provisions; the rule exceeds the statutory authority of the agency; the rule was adopted without compliance with statutory rulemaking procedures; or the rule is arbitrary and capricious." RCW 34.05.570(2)(c). Here, ZDI has not satisfied its burden under the APA of showing that the Commission's rules, WAC 230-06-003, defining "cash," and WAC 230-14-047, governing EVPDs, are invalid under any of these categories.

V. ARGUMENT

A. The Superior Court Did Not Abuse Its Discretion When It Declined To Supplement The Commission's Rulemaking Record

ZDI argues that the superior court erred in denying its motion to supplement the Commission's rulemaking file with "helpful information regarding agency practice and procedure." Br. of App. at 18-19. Relying on non-APA related cases, ZDI asserts that the supplemental material represented the Commission's past practices, and thus should have been considered to determine the propriety of the Commission's adoption of the rules. *Id.* at 19. ZDI's assertions are incorrect as a matter of law and fact.

In a rule challenge under the APA, the agency's rulemaking file serves as the basis for the court's review. *WA Independent Tel. Ass'n v. State. Util. & Transp. Comm'n,* 148 Wn.2d 887, 906, 64 P.3d 606 (2003); RCW 34.05.370(4) (rulemaking file required by APA constitutes the agency record for judicial review); *see also* RCW 34.05.558 (judicial review of disputed issues of fact must be confined to the agency record).[10] A court can supplement the agency's file *only* under highly limited circumstances: (1) if the material relates to the validity of the rule as of the time the agency took the action adopting the rule, *and* (2) the

[10] Although the agency's rulemaking file becomes the agency record for judicial review, RCW 34.05.370(4) also provides that the official agency rule-making file "need not be the exclusive basis for agency action on that rule."

additional material is needed to decide disputed issues regarding improper agency action, unlawfulness of procedure, or material facts in rulemaking not required to be determined on the agency record. *See* RCW 34.05.562(1)(a)-(c); *WA Independent Tel. Ass'n*, 148 Wn.2d at 906. Moreover, "the admission or refusal of evidence is largely within the discretion of the trial court and will not be reversed on appeal absent a showing of a manifest abuse of discretion." *Okamoto v. Employ. Sec. Dep't,* 107 Wn. App. 490, 494-95, 27 P.3d 1203 (2001), *review denied,* 145 Wn.2d 1022, 41 P.3d 482 (2002).

In this case, the superior court did not abuse its discretion when it denied ZDI's request to supplement the Commission's rulemaking file with additional materials. The proposed materials were not contemporaneous with the Commission's rulemaking at issue in this matter. Rather, they pre-dated and post-dated the Commission's consideration of the rule proposals. *See, e.g.*, CP 654-66 (Commission meeting minutes from 1995, 1999, 2000). Furthermore, none of the materials were considered or relied upon by the Commission during its rulemaking deliberations. *See, e.g.*, AR 112-231 (Jan. 2008 Commission Rulemaking Packet). Finally, contrary to ZDI's assertions, the proposed materials were not direct evidence of the Commission's historical construction and implementation of the APA's requirements for

rulemaking. *See* Br. of App. at 18-19. Instead, they reflected third-party personal interpretations and recollection of past-Commission practice and proceedings. *See, e.g.*, CP 531-52 (Decl. of Bob Tull).

Because ZDI's proposed supplemental materials did not satisfy the APA's criteria for supplementing the Commission's rulemaking file, the superior court appropriately denied ZDI's motion. Such a decision was not an abuse of discretion and should be upheld on appeal.

B. The Commission Complied With The Rulemaking Process Prescribed By The Administrative Procedure Act

1. A majority vote of two Commissioners was sufficient to adopt the regulations

ZDI argues that the Commission's adoption of the EVPD rules via a vote of two to one was invalid under a proviso to RCW 9.46.050(2) that requires three affirmative votes for all Commission actions "relating to the regulation of licensing." Br. of App. at 21. Relying on the APA's definition of license,[11] ZDI contends the rules require Commission approval for EVPDs, therefore they must be "related to the regulation of licensing." Br. of App. at 19-23. These assertions are incorrect as ZDI has conflated the legal requirements for promulgation of administrative rules with the legal requirements for the regulation of licensing.

[11] RCW 34.05.010(9)(a) defines "license" in relevant part as "a franchise, permit, certification, approval, registration, charter, or similar form of authorization required by law." RCW 34.05.010(9)(b) defines "licensing" as the "agency process respecting the issuance, denial, revocation, suspension, or modification of a license."

As described previously, the Commission is authorized "to adopt such rules and regulations as are deemed necessary to carry out the purposes and provisions of [the Gambling Act]." RCW 9.46.070(14). Moreover, the Commission's rules and regulations must be adopted pursuant to the APA. *Id.* Under the APA, agency action, such as rulemaking, is accomplished by a majority vote. *See* RCW 34.05.010(2), (4). The Gambling Act provides that a majority of the five Commission members constitutes a quorum. RCW 9.46.050(2). In this case, three members of the Commission were present to make the quorum and they voted two to one to adopt Alternative #1. TR 1/11/08 at 15-19. Therefore, the Commission's vote in favor of adoption was sufficient to enact Alternative #1, as it was a majority vote of the quorum.[12]

Although RCW 9.46.050(2) provides that "all actions of the Commission relating to the regulation of licensing under this chapter shall require an affirmative vote by three or more members of the Commission," this requirement does not relate to the promulgation of all rules. ZDI's expansive reading of the proviso and the definition of "license" under the APA overshadows the majority rule requirement, as

[12] ZDI relies on a 1933 case, *State ex. rel. King County v. Tax Commission of the State of Washington*, 174 Wash. 336, 24 P.2d 1094 (1933), for the proposition that unanimity is required for a government body to act. *See* Br. of App. at. 22-23. In that case, the Tax Commission was composed of only two members due to the resignation of its third member. 174 Wash. at 344. Unanimity was thus required to constitute affirmative action by the majority. *Id.*

one could argue that virtually every action by the Commission "relates" in some way to licensing. However, provisos should be "strictly construed with any doubt to be resolved in favor of the general provision." *State v. Wright*, 84 Wn.2d 645, 652, 529 P.2d 453 (1974); *see also Brewster Pub. Schools v. PUD No. 1 of Douglas Cy.*, 82 Wn.2d 839, 845-46, 514 P.2d 913 (1973) (laws should be interpreted so as to give all provisions meaning and effect). ZDI's argument to the contrary would reduce the general provision that a simple majority of a quorum of Commission members is sufficient to enact rules to mere surplusage.

Moreover, the rules at issue relate to allowable standards for EVPDs, and are not related to the Commission's process for issuing, denying, revoking, etc. the license of persons, associations, or organizations carrying on specific gambling activities. *See* WAC 230-06-003 and 230-14-047. Indeed, ZDI continues to possess valid licenses to manufacture and distribute gambling equipment in Washington. The Commission's rulemaking process regarding the EVPDs did not impact the validity of those licenses. Simply because ZDI cannot market a version of an EVPD that it wants does not invalidate its license to manufacture and distribute other approved gambling equipment, including the approved version of its VIP, in this State. ZDI's argument to the contrary fails.

2. The Commission complied with the Regulatory Fairness Act

ZDI also contends that the Commission violated the APA and Regulatory Fairness Act, RCW 19.85, by failing to prepare a small business economic impact statement. *See* Br. of App. at 23-25. However, the Commission's rulemaking action memorialized the existing regulatory structure for authorized EVPDs; therefore, the Commission properly concluded that a small business economic impact statement was not necessary because small businesses would not incur any additional costs to comply with the new rules.[13]

The Regulatory Fairness Act reduces "the disproportionate impact of state administrative rules on small business." RCW19.85.011. Under RCW 19.85.030(1), an agency must prepare a small business economic impact statement if a proposed rule "will impose more than minor costs on businesses in an industry."[14] If required, the statement "must include a brief description of the reporting, recordkeeping, and other compliance requirements of the proposed rule, and the kinds of professional services that a small business is likely to need in order to comply with such

[13] In fact, the Commission determined that neither Staff's Alternative #1 nor ZDI's Alternative #2 required a small business impact statement because they "provided clarification without changing current requirements." *See* AR 7, 17.

[14] The term "minor cost" is defined as "a cost per business that is less than three-tenths of one percent of annual revenue or income, or one hundred dollars, whichever is greater, or one percent of annual payroll." RCW 19.85.020(2).

requirements" and "analyze the costs of compliance for businesses required to comply with the proposed rule." RCW 19.85.040(1). These "costs" include "costs of equipment, supplies, labor, and increased administrative costs." *Id.* A notice for a proposed rulemaking hearing must either contain a small business impact statement, or an explanation as to why preparation of an impact statement is unnecessary. RCW 34.05.320(1)(j).

ZDI erroneously contends that a small business economic impact statement was necessary because WAC 230-14-047 created additional requirements for EVPD manufacturers and prohibited "new innovation." Br. of App. at 24-25. However, the rule did not change the regulatory environment. Instead, it memorialized existing requirements authorized by the Commission, including that the gambling equipment be submitted to the Commission to ensure compliance with state laws and regulations. *See, e.g.,* AR 35 (2002 letter to ZDI authorizing its original VIP).

Moreover, the purpose of a small business economic impact statement is to capture and analyze costs that a business must incur in order to comply with a proposed regulation, such as equipment costs, supplies, labor, and increased administrative costs. *See* RCW 19.85.040(1). Accordingly, any costs that an EVDP manufacturer, like ZDI, voluntarily incurs for purposes of potential technological innovation

or development are not "costs" that trigger preparation of an impact statement. Significantly, the type of innovation and technological development that ZDI wanted – the ability to credit pull-tab winnings to a cash card – had never been regulated or authorized by the Commission.

ZDI also fails to show how WAC 230-06-003 imposed additional regulatory compliance costs on small businesses. ZDI erroneously asserts that WAC 230-06-003's definition of "cash" creates inconsistent policies amongst gambling rules, and thus somehow increases costs for small businesses. Br. of App. at 24-25. Specifically, ZDI contends that the definition of "cash" conflicts with WAC 230-15-553's definition of "cash equivalent." Br. of App. at 24-25. However, WAC 230-06-003 defined "cash" as it is used in the Gambling Act and other Commission regulations. The provision puts the public on notice that cash is "currency in the form of coins or bills issued by the government of the United States or Canada only and does not include electronic, digital or other representations of money or other methods of payment." WAC 230-15-553, on the other hand, lists nine specific "cash equivalents" that are acceptable substitutes for cash in house-banked card rooms. WAC 230-06-003 clarifies WAC 230-15-553 by providing a clear definition for the word "cash" as used in that rule and in other areas of the Gambling Act. It does not, as ZDI contends, impose regulatory costs on small businesses.

ZDI's procedural challenges to the Commission's rulemaking under the APA and the Regulatory Fairness Act fail.

C. The Commission Acted Within The Scope Of Its Authority When It Regulated The Game Of Pull-Tabs

ZDI asserts throughout its brief that the Commission lacked authority to adopt WAC 230-06-003 and WAC 230-14-047 because the rules impermissibly restrict the game of pull-tabs in contravention of public policy and the Commission's statutory authority. Br. of App. at 17-18, 27-30. Specifically, ZDI argues that the adoption of Alternative #1, which authorized certain functions for EVPDs including utilizing cash cards to purchase the pull-tabs, exceeded the Commission's authority because the Legislature did not specifically direct the Commission to regulate or "ban the use of gift cards." *Id.* at 27, 30.[15] ZDI's arguments are without merit and should be rejected.

An agency has those powers expressly granted by statute, as well as those necessarily implied by its statutory grant of authority. *Wash. Pub. Ports Ass'n (WPPA) v. Dep't of Revenue*, 148 Wn.2d 637, 646, 62 P.3d

[15] Contrary to ZDI's repeated contentions, the Commission has not "ban[ned] the use of cash cards." *See, e.g.*, Br. of App. at 30. The Commission specifically authorized cash cards in EVPDs so long as they are used only to purchase pull-tabs, not to accumulate pull-tab winnings. *See* WAC 230-14-047(3). That the Commission did not authorize the full panoply of ZDI's proposed use of cash cards for accumulating pull-tab winnings does not equate their action to a ban.

462 (2003). When determining the extent of an agency's implied powers, courts will consider a statute's declaration of legislative purpose. *Armstrong*, 91 Wn. App. at 537. An agency's ability to adopt regulations is determined by analyzing whether the regulation is "reasonably consistent with the statute that it implements." *WPPA,* 148 Wn.2d at 646. While rules cannot amend legislation, they may be created to fill "gaps" when necessary to effectuate the general legislative purpose. *Id.* A duly enacted rule is presumptively valid and will be upheld if it is reasonably consistent with the implementing statute. *Id.* In this case, the Commission's adoption of the EVPD rules was entirely consistent with the State's constitutional and statutory mandate to strictly regulate and control gaming activities.

As initially adopted in 1889, article II, § 24 of the Washington Constitution banned all gambling. It was not until 1972 that the people of Washington amended the provision to permit only those gambling activities specifically approved by supermajority vote of either the Legislature or the electorate. Const. art. II, § 24. Shortly thereafter, the Legislature adopted the Gambling Act, which authorized certain specific forms of gaming and placed the regulations of those games under the control of the Commission. *See, e.g.*, RCW 9.46.010, .070. In adopting the Gambling Act, the Legislature directed that the public policy was "to

keep the criminal element out of gambling and to promote the social welfare of the people by limiting the nature and scope of gambling activities and by strict regulation and control." RCW 9.46.010. Reinforcing the importance of controlling and limiting state-sanctioned gambling, the Legislature also specified that "[a]ll factors incident to the activities authorized in [the Gambling Act] shall be closely controlled, and the provision of this chapter shall be liberally construed to achieve such end." *Id.*

Not only does RCW 9.46.010 provide guidance for the Commission in implementing the State's public policy on gaming, but the Legislature provided the Commission with specific authority to regulate pull-tabs and EVPDs. *See* RCW 9.46.0273, .070(11), .310. These provisions grant the Commission authority to define the game of pull-tabs, to specify how gambling winnings are awarded, and to regulate gambling equipment associated with pull-tabs. *Id.* Therefore, while the Legislature did not specifically direct the Commission to regulate "cash cards," the constitutional and statutory provisions cited above leave no reasonable doubt that the Legislature empowered the Commission to regulate all aspects of pull-tab gaming, including designating by rule the permissible features of EVPDs.

As shown, the Commission's adoption of the EVPD rules is

entirely consistent with provisions of the Washington Constitution and the Gambling Act. ZDI, therefore, has not met its burden of showing that the Commission acted outside its statutory authority. Its challenge to the Commission's rulemaking authority for EVPDs must fail.

D. The Commission's Adoption Of The Administrative Rules Governing Electronic Video Pull-Tab Dispensers Was Not Arbitrary And Capricious

Finally, ZDI contends that the Commission's adoption of the Alternative #1 was arbitrary and capricious because the rules lack "regulatory rationale." Br. of App. at 32. It also contends that the rulemaking was arbitrary and capricious because the Commission approved automated cashier features for tribal gaming and did not approve the cash card technology in the present matter. Br. of App. at 32-33.

As described previously, the validity of a rule is determined as of the time the agency took the action. *Wash. Indep. Tel. Ass'n*, 148 Wn.2d at 906.

> When a rule is challenged as arbitrary and capricious, the reviewing court must consider the relevant portions of the rulemaking file and the agency's explanations for adopting the rule as part of its review in order to determine whether the agency's action was willful and unreasoning and taken without regard to the attending facts or circumstances.

Id. This standard gives deference to agency decision-making and requires courts to uphold a rule even if the court deems it erroneous as long as the

rule was enacted with due consideration. *Id.* at 905. Thus, the arbitrary and capricious standard allows for differences of opinion. A rule will not be invalidated as arbitrary and capricious simply because different decision-makers could reach different conclusions based on the evidence. *Rios v. Dep't of Labor & Indus.*, 145 Wn.2d 483, 504, 39 P.3d 961 (2002). Here, the Commission's adoption of Alternative #1 was not arbitrary or capricious.

As shown above, the Commission is not only charged with effectively regulating gambling, it is also responsible for strictly controlling and limiting state-sanctioned gambling in Washington. RCW 9.46.010. This responsibility includes insuring that the game of pull-tabs is not transformed into a prohibited form of electronic slot machine gambling. *See* RCW 9.46.0273. The Commission's adoption of Alternative #1 was a legitimate and reasonable exercise of its authority. In adopting Alternative #1, the Commissioners considered the purpose of and limitations set in the Gambling Act (TR 1/11/08 at 15-16) and the risks involved with adopting alternative proposals (TR 1/11/08 at 16-17). Alternative #1 neither banned EVPDs outright as per the original rule proposal, nor potentially expanded their function into an illegal gambling device as per ZDI's alternative rule proposal. *See, e.g.*, AR 117-21 (Commission Rule Packet); TR 1/11/08 at 15-18 (discussion of voting

Commissioners). Instead, Alternative #1 assisted the industry by explicitly setting - by rule - existing standards for EVPDs and continuing to sanction their use in the State. *See* AR 2 (CR-103); WAC 230-14-047; WAC 230-03-060. That ZDI disagrees does not alter the fact that the Commission adopted the rules with due consideration for the State's mandate to "limit the nature and scope of gambling activities" through "strict control and regulation." RCW 9.46.010.

ZDI's assertion that the Commission treats tribes differently with regard to EVPDs is also misplaced. The Indian Gaming Regulatory Act, 25 U.S.C. § 2701 *et seq.*, provides the statutory basis for the operation and regulation of gaming by Indian tribes in this State. Under this federal authority, tribes must conduct gaming activities pursuant to a negotiated Tribal-State compact that is executed by the Governor and approved by the federal Secretary of the Interior. *See* 25 U.S.C. § 2710(d)(3)(B); RCW 9.46.360(6). As such, the tribes' operation of any form of gaming machines in this State is governed by an entirely separate statutory scheme and issues of tribal sovereignty. *See Mudarri v. State*, 147 Wn. App. 590, 196 P.3d 153 (2008). Furthermore, the State's dealings with the tribes have no bearing on the Commission's authority to regulate non-tribal gaming in the State, including adopting rules governing EVPDs thereto. ZDI's assertions to the contrary are simply incorrect.

The Commission's adoption of Alternative #1 was reasonable, cogent, and consistent with the Gambling Act, the APA, and the attendant facts and circumstances. ZDI did not meet its burden of proving that either the rules or their adoption was arbitrary and capricious, therefore, its claim must be rejected.

E. ZDI Is Not Entitled To Attorneys Fees And Costs Under The Equal Access To Justice Act

Finally, ZDI and Mr. Gerow's request for fees and costs under RCW 4.84.350 should be rejected. Br. of App. 33-34. The Equal Access to Justice Act ("EAJA"), RCW 4.84, provides that a qualified "party that prevails in a judicial review of agency action" may be entitled to recover attorney fees and costs, not to exceed $25,000, incurred during a Judicial Review proceeding. RCW 4.84.350. A prevailing party in a judicial review is defined as when a "party obtained relief on a significant issue that achieves some benefit that the qualified party sought." RCW 4.84.350(1). Here, both ZDI and its owner, Mr. Gerow, seek attorney fees and costs of up $100,000 for its original petition and for this appellate review. Br. of App. at 34. As shown above, ZDI and Mr. Gerow will not prevail in this matter as the Commission's adoption of WAC 230-14-047 and WAC 230-03-060 was valid. Moreover, they seek duplicative attorney fees and costs in excess of the limit established by the EAJA - up

to $25,000 in total for each level of review. *See* RCW 4.84.350(2) ("If two or more qualified parties join in an action, the award in total shall not exceed twenty-five thousand dollars."); *Costanich v. Dep't of Social and Health Serv.*, 164 Wn.2d 925, 929, 194 P.3d 988 (2008) (EAJA cap applies to each level of judicial review). Their request must be denied.

VI. CONCLUSION

ZDI failed to satisfy its burden of proving that the Commission's rulemaking action in this matter was invalid. Accordingly, the Commission respectfully requests this Court dismiss ZDI's Petition.

RESPECTFULLY SUBMITTED this 10th day of June, 2013.

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COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

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I, hereby certify that on June 10, 2013, I caused the Brief of Respondent and this Certificate of Service to be served, via U.S. mail, upon the parties herein, as indicated below:

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I certify under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

DATED this 10th day of June, 2013.

HANG NGUYEN-LE
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