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November 19, 2007

The Honorable Martin O'Malley
Governor of Maryland
State House
Annapolis, Maryland 21401-1991

Dear Governor O'Malley:

We have reviewed Senate Bill 3, "Maryland Education Trust Fund - Video Lottery Terminals," for constitutionality and legal sufficiency. While we have identified a number of provisions with potential problems, it is our view that these provisions, if found invalid, would be severable, therefore, we approve the bill.

Senate Bill 3 has multiple provisions that rely on race or gender- based classifications. It is well-established that "when the government distributes burdens or benefits on the basis of individual racial classifications, that action is reviewed under strict scrutiny." *Parents Involved in Community Schools v. Seattle School Dist. No. 1*, 127 S.Ct. 2738 (2007). To satisfy this standard it is necessary to show that the racial classification is "narrowly tailored" to achieve a "compelling" governmental interest. *Id.* A lower standard applies when analyzing a gender classification under the United States

Constitution. *Thompson Building Wrecking Company, Inc. v. Augusta, Ga.*, 2007 WL 926153 (S.D.Ga. 2007); *Hershell Gill Consulting Engineers, Inc. v. Miami-Dade County, Fla.*, 333 F.Supp.2d 1305 (S.D.Fla. 2004); *Associated Utility Contractors v. Mayor*, 83 F.Supp.2d 613 (D.Md. 2000); 74 *Opinions of the Attorney General* 76, 90 n. 13 (1989). However, Article 46 of the Maryland Declaration of Rights most likely requires that sex based classifications in this context meet strict scrutiny as well. *Conaway v. Deane*, 401 Md. 219, __ n. 13 (2007).

It is also well-established that a State has a compelling interest in remedying the effects of past discrimination. *Parents Involved in Community Schools v. Seattle School Dist. No. 1*, 127 S.Ct. 2738 (2007); *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989). However, a State must also demonstrate a strong basis in evidence supporting its conclusion that race or gender-based remedial action is necessary to further that interest. Moreover, the remedy adopted must be narrowly tailored to the accomplishment of the State's compelling interest.

Senate Bill 3 requires that a licensee meet the minority business participation requirements for construction and procurement unless the county where the licensee is located has higher requirements, in which case the licensee shall meet those requirements. Section 9-1A-10(a)(1) and (2). The bill further requires the Lottery Commission to report annually on the attainment of minority participation goals by the licensees, and requires the State Auditor to focus on this issue in the annual audit of the licensees. Section 9-1A-34. Section 4 of the bill requires an agency designated by the Board of Public Works initiate two studies of the requirements of § 9-1A-10 that evaluate the continued compliance of the requirement with any federal or constitutional requirements. The studies are also to evaluate "race neutral programs or other methods that can be used to address the needs of minority investors and minority businesses." In order to facilitate the required study "the State Lottery Commission shall require video lottery license applicants and licensees to provide any information necessary to complete that study." The program sunsets July 1, 2011.

It is our view that there must be both a study of procurement practices in the video lottery business in Maryland, and a consideration of race neutral alternatives before a race- conscious remedy such as compliance with the State minority business participation requirements can be implemented. *Rothe Development Corp. v. U.S. Dept. of Defense*, 499 F.Supp.2d 775 (W.D.Tex. 2007); *Rothe Development Corp. v. U.S. Department of Defense*, 262 F.3d 1306, 1327-8 (Fed.Cir. 2001); *Builders Association of Chicago v. County of Cook*, 256 F.3d 642, 645 (7th Cir. 2001); *Florida A.G.C. Council, Inc. v.*

Florida, 303 F.Supp.2d 1307 (N.D.Fla. 2004). It is also our view that the goals for any program that is eventually implemented should be based on minority business availability in the markets used by video lottery licensee, which may be different than those for State or county contracting. *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989). We note that similar attempts to impose minority business participation requirements on gambling licensees have been found invalid. *Association for Fairness in Business v. New Jersey*, 82 F.Supp.2d 353 (D.N.J. 2000), *see also Schurr v. Resorts International Hotel*, 196 F.3d 486 (3rd Cir. 1999) (minority hiring requirements found invalid). Without the constitutionally required justification and tailoring, it is possible that the members of the Commission could be faced with personal liability if they attempt to implement this program. *Hershell Gill Consulting Engineers, Inc. v. Miami-Dade County, Fla.*, 333 F.Supp.2d 1305 (S.D.Fla. 2004). Therefore, we do not recommend that the program be implemented prior to the completion of a study that shows a need for the program, and the consideration or implementation of race neutral alternatives. *See* Letter to the Honorable Melanie G. Griffith dated March 4, 2003; Letter to the Honorable Gloria Lawlah, dated March 4, 1992. If the need for the program is established at some point in the future, the sunset date should be moved back accordingly.

Section 9-1A-35 establishes a Small, Minority and Woman-Owned Businesses Account to provide investment capital and loans to small, minority and woman-owned businesses. We have previously advised that this program meets constitutional standards, but recommend that it be given a sunset date, as programs that are unlimited can be found invalid on that basis if no evaluation is done of their continuing necessity. *Thompson Building Wrecking Company, Inc. v. Augusta, Ga.*, 2007 WL 926153 (S.D.Ga. 2007). *See* Letter to the Honorable Kumar P. Barve dated November 13, 2007.

Section 9-1A-36(k)(2)(vii) includes among the factors to be considered in awarding the video lottery facility licenses "the percent of ownership by entities meeting the definition of minority business enterprise under Title 14, Subtitle 3 of the State Finance and Procurement Article" and the contents of the licensee's plan to achieve minority business participation in accordance with the requirements described under §9-1A-10(A)(1) and (2). These factors are two of nine that, taken together, are to account for 70% of the decision, but no specific weight is assigned to them. Moreover, they do not guarantee favorable consideration based on race, and no goals or quotas are set. As a result, they are similar to the preference upheld in *Grutter v. Bollinger*, 539 U.S. 306 (2003). However, the program in *Grutter* was held justified as part of a program of student diversity intended to heighten the law school experience for all students, and the Court took into account the special niche occupied by universities in constitutional

tradition, in light of the "important purpose of public education and the expansive freedoms of speech and thought associated with the university environment." It is not clear that diversity in ownership of video lottery facilities plays a similar role. *Cf., Parents Involved in Community Schools v. Seattle School Dist. No. 1*, 127 S.Ct. 2738 (2007) (Plurality opinion holding that goal of diversity in elementary and high schools would not be compelling for strict scrutiny purposes). However, given the level of flexibility in the requirements, we cannot say that it is clearly unconstitutional.

Section 9-1A-10(a)(5) requires a licensee to provide health insurance coverage for its employees, and § 9-1A-10(a)(7) requires a licensee that is a racetrack location to provide health insurance coverage to all employees of the racetrack, including the employees of the racetrack on the backstretch of the racetrack. We have previously advised that similar provisions would be preempted by the federal Employees Retirement Insurance Security Act ("ERISA"). *See* Letter to the Honorable James Brochin, dated February 3, 2005. It continues to be our view that these provisions are unenforceable as a result of ERISA preemption. For similar reasons, it is our view that § 9-1A-10(a)(6), which requires licensees to provide retirement benefits for employees, would be preempted by ERISA and may not be enforced. However, it is our view that the health and retirement benefits to be provided by a licensee are appropriate considerations in the awarding of the license under § 9-1A-36(k)(3)(i).

Section 9-1A-10(a)(4) provides that an applicant for employment at a video lottery facility who believes that they have been discriminated against "may appeal the employment decision to the local human relations board in the county where the facility is located." It is our view that this provision is not intended to supplant the remedies already available under the law to persons who have been the victims of employment discrimination, including filing a complaint with the State Human Relations Commission or the Equal Employment Opportunity Commission. To conclude otherwise, would greatly limit the remedies available to applicants as three of the locations for video lottery facilities are in counties that have no human relations boards, Allegany, Cecil and Worcester, and one is in a county, Anne Arundel, where the human relations commission has only the power to attempt to mediate disputes.

SB 3 also requires a licensed video lottery operator to "give a preference to hiring qualified employees from the communities within 10 miles of the video lottery facility." §9-1A-10(A)(5)(II). This residency requirement may run afoul of the Privileges and Immunities Clause of Article IV, §1 of the U.S. Constitution. *See United Building and Construction Trades Council v. Mayor and Council of Camden,* 465 U.S. 208 (1984). If

the State is unable to justify that discrimination against out-of-state residents is necessary because they constitute a "peculiar source of evil", such a preference could be found unconstitutional. *See W.C.M. Window Co. v. Bernardi,* 730 F. 2d 486, 497 (7th Cir., 1984).[1]

The bill provides that proceeds from the operation of VLTs are to be transferred to the State Lottery Fund. SG § 9-1A-26. The bill also specifies how the proceeds are to be distributed. SG §§ 9-1A-27 through 9-1A-35. Of course, the bill should be implemented consistent with the constitutional provisions governing the appropriation process.

Section 9-1A-31(c) provides for the establishment of local development councils to advise concerning the distribution of local impact grants. Each council includes senators and delegates from the area where the grants are to be spent. The local governments are to consult with the local development council in developing a multi-year plan for the expenditure of the local impact grant funds for services and improvement, and provide the plan to the local development councils for review and comment. In addition, the local governments are to "make best efforts" to accommodate the recommendations of the local development council. It is our view that the role of the local development councils is strictly advisory, and thus the presence of legislators on the councils does not violate separation of powers or cause a violation of Maryland Constitution Article III, § 11, which provides that a person holding a civil office of profit or trust is not eligible to be a senator or a delegate. This is also true with respect to the addition of senators and delegates to the Pimlico Community Development Authority to the extent that it acts as a local development council with respect to the grant made under § 9-1A-31(a)(1) which provides funds to the area around Pimlico.[2] However, the addition of legislators to the Pimlico Community Development Authority does raise separation of

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[1] It is often difficult to bring a Privileges and Immunities Clause challenge because the provision only protects individuals, not corporations. *See Smith, Setzer & Sons, Inc. v. S.C. Procurement Review Panel,* 20 F. 3d 1311 (4th Cir. 1994); and *Chance Management, Inc. v. State of South Dakota,* 97 F. 3d 1107 (8th Cir. 1996).

[2] We note that the amendment to Business Regulation Article § 11-1203, which adds the new members, contains an incorrect cross-reference. The reference should be to § 9-1A-31(a)(1)(ii), which relates to the grant to the area around Pimlico, and not to § 9-1A-31(a)(2), which relates to the grant to Prince George's County for the area around Rosecroft Raceway.

powers and Article III, § 11 problems with respect to the existing duties of the Authority, which include the receipt and expenditure of State funds. Business Regulations Article, § 11-1205. These duties clearly make the members of the Authority civil officers. For this reason, it is our view that the legislative members should participate as members of the Authority only for purposes of its advisory function under § 9-1A-31, and not for other purposes. We also recommend that the provisions of the law be amended to reflect this.

Section 9-1A-07(c)(7)(v) requires an applicant or license to show that they have "entered into a labor peace agreement with each labor organization that is actively engaged in representing of attempting to represent video lottery and hospitality industry workers in the State." Our understanding is that a labor peace agreement is one in which an employer and a union lay out ground rules conduct of the employer and union during efforts to organize the workforce. Because a labor peace agreement could impact on employer and union actions that would arguably be protected by the National Labor Relations Act ("NLRA"), that provision would appear that it would be preempted by that Act. *Building & Construction Trades Council v. Associated Builders & Contractors of Massachusetts/Rhode Island, Inc*., 507 U.S. 218, 226-27,(1993); *Wisconsin Dept. of Industry, Labor & Human Relations v. Gould, Inc.*, 475 U.S. 282 (1986); *Machinists v. Wisconsin Employment Relations Comm'n*, 427 U.S. 132 (1976). The only case that we have found that addresses this issue agrees with this conclusion. *Metropolitan Milwaukee Ass'n of Commerce v. Milwaukee County*, 431 F.3d 277, 278 (7th Cir. 2005). Therefore, it is our view that it may not be given effect.[3]

Section 9-1A-04(f) provides that the Lottery Commission and its employees have the authority, without notice or warrant: to inspect all premises in which video lottery operations are conducted or any authorized video lottery terminals, central monitor and control system, or associated equipment and software are designed, built, constructed, assembled, manufactured, sold, distributed, or serviced, or in which records of those activities are prepared or maintained; to inspect the video lottery machines and related equipment; to seize and remove from the premises video lottery machines and related equipment and software; to inspect, examine and audit books and records; and to seize or assume physical control of books, records, ledgers, cash boxes and their contents, a counting room or its equipment, or other physical objects relating to video lottery operations.

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[3] The NLRA may also preempt licensing requirements under §9-1A-10(a)(5), which are imposed "notwithstanding any collective bargaining agreement."

It is our view that video lottery operations are clearly among the businesses that are so pervasively regulated that they may be subjected to warrantless administrative search. *United States v. Biswell*, 406 U.S. 311 (1972) (firearms dealers); *Colonade Catering Corp. v. United States*, 397 U.S. 72 (1970) (alcoholic beverages licensees). Moreover, it is arguable that the manufacturers of the video lottery equipment also fall within this class given the State's longstanding regulation of the distributors of slot machines. Criminal Law Article § 12-305.[4] However, even in a pervasively regulated area, a warrantless inspection will be deemed reasonable only so long as three criteria are met. *New York v. Burger*, 482 U.S. 691, 702 (1987). There must be a substantial government interest that informs the regulatory scheme of which the inspections are a part. The warrantless inspections must be necessary to further the regulatory scheme, and "the statute's inspection program, in terms of certainty and regularity of its application, must provide a constitutionally adequate substitute for a warrant." *Id.* at 702-703. This means that the regulatory scheme must perform two basic functions of a warrant: " it must advise the owner of the commercial premises that the search is being made pursuant to the law and has a properly defined scope, and it must limit the discretion of the inspecting officers. To perform this first function, the statute must be sufficiently comprehensive and defined that the owner of commercial property cannot help but be aware that his property will be subject to periodic inspections undertaken for specific purposes. In addition, in defining how a statute limits the discretion of the inspectors, we have observed that it must be carefully limited in time, place and scope." *Id.* at 703.

Here, the substantiality of the State interest is clear. Moreover, it seems clear that the purpose of the statute is furthered by unannounced inspections, as warning would allow the licensee or vendor to alter or dispose of incriminating evidence with respect to its operations. It would also appear that the law in this area is sufficiently comprehensive and defined as to make the owner aware that his property will be subject to periodic inspection. The law clearly designated what places, objects and records are subject to search and limits search to those that are related to video lottery operations. In addition, paragraph (f)(1) and the structure of the remainder of the section indicate that the purpose of the search would be to enforce the subtitle and the regulations adopted thereunder. The only parameter not limited is the time of the search. Such searches are frequently

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[4] It may, however, be desirable to include an agreement to inspection in any contract that the State enters into with respect to the purchase, lease or repair of these machines, especially with respect to any vendors that are not located in the State.

limited to business hours. And it may be appropriate that this limitation be imposed by regulation. Letter to the Honorable Anthony C. Brown dated February 7, 2000. However, in the time we have had for review, we have not had the time to determine whether this is an absolute constitutional requirement.

Section 10 amends provisions of the State Election Law. First, the provision requires that ballot issue committees formed to support or defeat the constitutional amendment of House Bill 4 file additional campaign finance reports under Election Law Art. § 13-309. We see no reason that additional reports could not be required of ballot issue committees. Section 10 also imposes disclosure and reporting requirements on corporations who make independent expenditures supporting or opposing the constitutional amendment passed in House Bill 4. In our view the provision is narrowly drawn and supported by a compelling State interest so that it could survive constitutional muster. *See attached* Letter to Delegate Jon S. Cardin, dated November 15, 2007.

In conclusion, because the potential defects identified in this letter would all be severable if found invalid, we approve the bill for signing.

Very truly yours,

/s/

Douglas F. Gansler
Attorney General

DFG/KMR/RAZ/as
cc: Joseph Bryce
Secretary of State
Karl Aro