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UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF CALIFORNIA

LARRY C. FLYNT; HAIG  
KELEGIAN, SR.; HAIG T.  
KELEGIAN, JR.,

Plaintiffs,

v.

STEPHANIE K. SHIMAZU, in her  
official capacity as the  
Director of the California  
Department of Justice, Bureau  
of Gambling Control, et al.,

Defendants.

No. 2:16-cv-02831-JAM-EFB

**ORDER GRANTING IN PART AND  
DENYING IN PART DEFENDANTS'  
MOTION TO DISMISS**

Larry Flynt, Haig Kelegian, Sr., and Haig Kelegian Jr. own card clubs in California. Flynt and the Kelegians want to substantially invest in out-of-state casinos, but California law prohibits them from owning more than a one-percent interest in facilities that host casino-style gambling. In 2016, Plaintiffs challenged the constitutionality of this prohibition, arguing it violates the Due Process Clause and the dormant commerce doctrine. Compl., ECF No. 1. Plaintiffs have since abandoned their due process claim. See Flynt v. Shimazu, 940 F.3d 457, 460 n.2 (9th Cir. 2019)

1 This Court previously dismissed Plaintiffs' suit with  
2 prejudice, finding the two-year statute of limitations barred  
3 their claims. Order Granting Defendants' Motion to Dismiss with  
4 Prejudice, ECF No. 40. The Ninth Circuit disagreed. See Flynt,  
5 940 F.3d at 462-63. Adopting the Sixth and Seventh Circuit's  
6 approach to the continuing violations doctrine, the Ninth Circuit  
7 found that "the continued enforcement of a statute inflicts a  
8 continuing or repeated harm" such that plaintiffs suffer a new  
9 injury each time they abstain from prohibited conduct. Id.  
10 Applying this doctrine, the Ninth Circuit found Plaintiffs'  
11 claims fell within the applicable limitations period. See id.  
12 462-63.

13 On remand, Defendants filed another motion to dismiss.<sup>1</sup>  
14 Mot. to Dismiss ("Mot."), ECF No. 50. Plaintiffs oppose the  
15 motion. Opp'n, ECF No. 51; see also Defs.' Reply, ECF No. 52.  
16 For the reasons discussed below, the Court grants in part and  
17 denies in part Defendants' motion to dismiss. To the extent  
18 that Plaintiffs' dormant commerce doctrine claims rest upon the  
19 theory that California Business and Professions Code Sections  
20 19858 and 19858.5 directly regulate or discriminate against  
21 interstate commerce, the Court dismisses them without prejudice.  
22 Plaintiffs lack standing to allege Sections 19858 and 19858.5  
23 improperly discriminate against out-of-state investors.  
24 Moreover, their allegations that these provisions directly  
25 regulate interstate commerce fail as a matter of law. Plaintiffs  
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27 <sup>1</sup> This motion was determined to be suitable for decision without  
28 oral argument. E.D. Cal. L.R. 230(g). The hearing was  
scheduled for May 5, 2020.

1 do, however, adequately allege that Sections 19858 and 19858.5  
2 indirectly regulate interstate commerce. To the extent that  
3 Plaintiffs' dormant commerce claims rests upon this theory of  
4 liability, the Court denies Defendants' motion to dismiss.

#### 5 I. BACKGROUND

6 Subject to some restrictions, California permits in-state  
7 gambling. Specifically, it allows both residents and non-  
8 residents to operate cardrooms. Prospective cardroom owners must  
9 obtain a California gambling license, and renew it every two  
10 years, to operate within the state. Cal. Bus. Prof. Code  
11 § 19876(a). To avoid monetary and licensing penalties,  
12 California cardroom licensees must comply with California  
13 gambling laws. This case arises at the intersection of three of  
14 these state laws.

15 First, California prohibits cardrooms from engaging in  
16 casino-like activities (e.g., blackjack, roulette, and other  
17 house-banked or percentage games). Cal. Penal Code § 330.  
18 Second, California prohibits a person from "hold[ing] a state  
19 gambling license to own a gambling establishment if," among other  
20 things, he "has any financial interest in any business or  
21 organization that is engaged in any form of gambling prohibited  
22 by Section 330 of the Penal Code." Cal. Bus. & Prof. Code  
23 § 19858(a). This restriction applies to business investments  
24 "within [and] without [the] state." Id. Finally, California  
25 carves out a limited exception to § 19858's prohibition. See  
26 Cal. Bus. & Prof. Code § 19858.5. Section 19858.5 allows  
27 California cardroom licensees to hold up to a 1% financial  
28 interest in entities that host gambling prohibited by California

1 law, so long as the gambling is legal in the state where it  
2 occurs.

3 Flynt and the Kelegians are California residents who possess  
4 state-issued gambling licenses to operate card clubs in  
5 California. First Amended Compl. ("FAC") ¶¶ 8-10, ECF No. 32.  
6 Plaintiffs stand "ready, willing, and able to compete for the  
7 opportunity to invest in and/or operate out of-state-casinos,"  
8 but Sections 19858 and 19858.5 limit their ability to do so. At  
9 various points since 2014, Plaintiffs have declined otherwise  
10 attractive business opportunities because the investments would  
11 cost them their California gambling licenses. FAC ¶ 4.

## 12 II. OPINION

13 To state a section 1983 claim, "a plaintiff must allege the  
14 violation of a right secured by the Constitution and laws of the  
15 United States, and must show that the alleged deprivation was  
16 committed by a person acting under color of state law." West v.  
17 Atkins, 487 U.S. 42, 48 (1988). Plaintiffs allege Defendants  
18 violated their rights to be free from California's regulation of,  
19 and discrimination against, interstate commerce. FAC ¶ 5.  
20 Defendants, however, maintain Plaintiffs failed to allege a  
21 cognizable theory of liability under the dormant commerce  
22 doctrine. Mot. at 5-10. Moreover, Defendants contend Kelegian,  
23 Jr.'s failure to exhaust his state administrative remedies bars  
24 his claim. Mot. at 14-15.

### 25 A. Exhaustion Requirement

26 California law provides that "[a]ny person aggrieved by a  
27 final decision or order of the commission that limits,  
28 conditions, suspends, or revokes any previously granted license"

1 may petition the Sacramento County Superior Court for review.  
2 Cal. Bus. & Prof. § 19932(a). "Under California law, exhaustion  
3 of administrative remedies is a jurisdictional requirement and  
4 'absent a clear indication of legislative intent [a court]  
5 should refrain from inferring a statutory exemption from [the  
6 State's] settled rule requiring exhaustion of administrative  
7 remedies.'" City of Oakland, Cal. v. Hotels.com LP, 572 F.3d  
8 958, 961 (9th Cir. 2009).

9 In 2014, the California Bureau of Gambling Control found  
10 that Kelegian, Jr. violated California's 1% rule. FAC ¶¶ 69-70,  
11 ECF No. 32. As a result, Kelegian, Jr. had to pay \$210,000 in  
12 fines and assessments. FAC ¶ 71. Moreover, the state bureau  
13 required him to "refrain from any and all investment in out-of-  
14 state casino-style gambling facilities." FAC ¶ 71. Kelegian,  
15 Jr. did not petition for review of this decision.

16 Defendants argue this failure to exhaust administrative  
17 remedies precludes judicial review. Mot. at 14-15. Plaintiffs  
18 disagree, arguing Defendants waived their exhaustion argument by  
19 not raising it in their original motions to dismiss. Opp'n at 6  
20 n.5. Neither argument controls. Rather, it is well-established  
21 that plaintiffs need not exhaust state administrative remedies  
22 before initiating a section 1983 suit in federal court. Knick  
23 v. Township of Scott, Pennsylvania, 139 S. Ct. 2162, 2167-68  
24 (2019) (citing Patsy v. Bd. of Regents of State of Fla., 457  
25 U.S. 496, 501 (1982)). The Court therefore declines to dismiss  
26 Kelegian, Jr.'s claims on this ground.

27 B. Dormant Commerce Doctrine

28 "The Commerce Clause of the United States Constitution

1 assigns to Congress the authority '[t]o regulate Commerce with  
2 foreign Nations, and among the several States.'" Sam Francis  
3 Foundation v. Christies, Inc., 784 F.3d 1320, 1323 (quoting U.S.  
4 Const. art. I, § 8, cl. 3) (modifications in original). This  
5 affirmative grant of authority to federal lawmakers contains an  
6 implied restriction on states' powers to regulate. Id. Courts  
7 refer to this limitation as either the dormant Commerce Clause  
8 or, more precisely, the dormant commerce doctrine. See id.;  
9 United States v. Durham, 902 F.3d 1180, 1203 (10th Cir. 2018).  
10 Imposing the dormant commerce doctrine's limits on state  
11 regulation is necessary to "ensure that state autonomy over  
12 'local needs' does not inhibit 'the overriding requirement of  
13 freedom for the national commerce.'" Id. (quoting Great Atl. &  
14 Pac. Tea Co. v. Cottrell, 424 U.S. 366, 361 (1976)).

15 The dormant commerce doctrine prohibits two types of state  
16 lawmaking: (1) direct regulation of interstate commerce and  
17 (2) discrimination against interstate commerce. Daniels  
18 Sharpsmart, Inc. v. Smith ("Daniels"), 889 F.3d 608, 614 (9th  
19 Cir. 2018). "If a state statute 'directly regulates or  
20 discriminates against interstate commerce, or . . . its effect  
21 is to favor in-state economic interests over out-of-state  
22 interests,' it is 'struck down . . . without further inquiry.'" Chinatown Neighborhood Ass'n v. Harris, 794 F.3d 1136, 1145 (9th  
23 Cir. 2015) (quoting Brown-Forman Distillers Corp. v. N.Y. State  
24 Liquor Auth., 476 U.S. 573, 579 (1986)).

26 If, however, a state statute "regulates evenhandedly" and  
27 "has only indirect effects on interstate commerce," courts  
28 proceed to ask whether those indirect effects "impose[] a

1 'significant burden on interstate commerce.'" Id. at 1146. If  
2 not, Ninth Circuit precedent "preclude[s] any judicial  
3 'assessment of the benefits of [a state] law[] and the . . .  
4 wisdom in adopting' it." Id. (quoting Nat'l Ass'n of  
5 Optometrists & Opticians v. Harris, 682 F.3d 1144, 1156 (9th  
6 Cir. 2012)) (modifications in original). But if the statute  
7 imposes a "significant burden" on interstate commerce, courts  
8 must weigh that burden against the law's intrastate benefits.  
9 See Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).  
10 Chinatown Neighborhood Ass'n, 794 F.3d at 1145-46. A state law  
11 will survive "Pike balancing" so long as the burden it imposes  
12 on interstate commerce is not "clearly excessive in relation to  
13 the putative local businesses." Pike, 397 U.S. at 142.

14 1. Discrimination Against Interstate Commerce

15 Within the context of the dormant commerce doctrine,  
16 "discrimination simply means differential treatment of in-state  
17 and out-of-state economic interests that benefits the former and  
18 burdens the latter." United Haulers Assoc., Inc. v. Oneida-  
19 Herkimer Solid Waste Mgt. Auth., 550 U.S. 330, 338 (2007)  
20 (internal quotations omitted). A statutory scheme can  
21 discriminate against out-of-state interests in three ways:  
22 facially, purposefully, or in effect. Nat'l Ass'n of  
23 Optometrists & Opticians LensCrafters, Inc. v. Brown, 567 F.3d  
24 521, 525 (9th Cir. 2009). Although Plaintiffs contend an  
25 earlier iteration of Section 19858 was discriminatory on its  
26 face, they do not allege that the law in its current form is  
27 facially discriminatory. Correctly so. California law  
28 prohibits both residents and non-residents with California

1 cardroom licenses from owning more than a 1% interest in casino-  
2 style gambling entities. Cal. Penal Code § 330; Cal. Bus &  
3 Prof. Code §§ 19858, 19858.5 The text of these provisions does  
4 not discriminate.

5 Plaintiffs do, however, argue that the purpose and effect  
6 of these laws are discriminatory. See Opp'n at 9-11; FAC ¶¶ 3,  
7 5.a, 6, 26, 29, 41, 44-45. The complaint alleges that state  
8 officials, including former-Governor Gray Davis have said that  
9 Section 19858 was "primarily [] intended to prohibit out-of-  
10 state gambling interests from owning cardrooms in California."  
11 FAC ¶ 45. Plaintiffs argue discovery will show that "the only  
12 businesses that would be interested in obtaining [California]  
13 cardroom licenses are indeed casinos." Opp'n at 11. If true,  
14 the laws serve as a barrier to all out-of-state competition with  
15 in-state cardrooms. Id. But this injury does not align with  
16 the injury Plaintiffs claim.

17 The standing doctrine's "'injury in fact' test requires  
18 more than an injury to a cognizable interest. It requires that  
19 the party seeking review be himself among the injured.'" Lujan  
20 v. Defenders of Wildlife, 504 U.S. 555, 563 (1992) (quoting  
21 Sierra Club v. Morton, 405 U.S. 727, 734-735 (1972)).

22 Plaintiffs are California residents with California gambling  
23 licenses. Their alleged injury is that California law prevents  
24 them from substantially investing in out-of-state casinos while  
25 retaining their licenses. See FAC ¶¶ 72, 75. Plaintiffs are  
26 not out-of-state casinos barred from procuring a California  
27 gambling license and competing with local cardrooms. They  
28 therefore lack standing to allege discrimination on an out-of-



1 state investor's behalf. See Lujan, 504 U.S. at 563; see also  
2 RK Ventures, Inc. v. City, 307 F.3d 1045, 1056 (9th Cir. 2002)  
3 (addressing the issue of standing sua sponte). To the extent  
4 that Plaintiffs' dormant-commerce claim rests on this theory of  
5 liability, the Court grants Defendants' motion to dismiss.

## 6 2. Direct Regulation of Interstate Commerce

7 "Direct regulation [of interstate commerce] occurs when  
8 state law directly affects transactions that take place across  
9 state lines or entirely outside of the state's borders."  
10 Daniels, 889 F.3d at 614. States cannot enact laws that  
11 "directly control[]" commerce occurring "wholly outside" the  
12 state's boundaries. Id. (quoting Healy v. Beer Inst., 491 U.S.  
13 324, 336 (1989)). State laws that regulate extraterritorially  
14 are per se invalid under the dormant commerce doctrine,  
15 "regardless of whether the statute's extraterritorial reach was  
16 intended by the legislature." Id.

17 In determining whether a state statute directly regulates  
18 out-of-state business, "[t]he critical inquiry is whether the  
19 practical effect of the regulation is to control conduct beyond  
20 the boundaries of the state." Healy, 491 U.S. at 336.  
21 Plaintiffs contend their extraterritorial-regulation argument  
22 directly mirrors the one recognized in Daniels, 889 F.3d at 615-  
23 616. Daniels addressed a medical waste handler's dormant  
24 commerce challenge to the California Medical Waste Management  
25 Act (MWMA). Id. at 612. Plaintiff sought and obtained a  
26 preliminary injunction against the Department's MWMA  
27 enforcement. Id. at 613. The Ninth Circuit upheld the  
28 injunction. In doing so, it found Plaintiff was likely to

1 succeed on his claim that the Department's extraterritorial  
2 application of the MWMA violated the dormant commerce doctrine.  
3 Id. at 615-616.

4 But Daniels is not a perfect match for this case. In  
5 Daniels, the Ninth Circuit found itself "faced with an attempt  
6 to reach beyond the borders of California and control  
7 transactions that occur wholly outside of the state after the  
8 material in question . . . ha[d] been removed from the state."  
9 Id. at 615. Put simply: the state was regulating activity it  
10 had no business regulating. Sections 19858 and 19858.5 do not,  
11 however, regulate conduct that is wholly unrelated to, or occurs  
12 wholly outside of, the state. These provisions regulate the  
13 ownership of cardrooms within California's borders and prevent  
14 illegal gambling interests from becoming too intertwined with  
15 legal gambling operations. These provisions have  
16 extraterritorial effects, such as requiring Plaintiffs to  
17 restructure out-of-state business deals or forego them entirely.  
18 See FAC ¶¶ 49-77. But extraterritorial effects do not render a  
19 law per se invalid if those effects "result from a regulation of  
20 in-state conduct." Chinatown Neighborhood Ass'n, 794 F.3d at  
21 1145-46 (collecting cases). Sections 19858 and 19858.5's out-  
22 of-state consequences flow from California's valid regulation of  
23 its in-state cardrooms.

24 Plaintiffs argue this case differs from cases like  
25 Chinatown Neighborhood Ass'n and Nat'l Ass'n of Optometrists &  
26 Opticians LensCrafters, Inc. v. Brown where the Ninth Circuit  
27 upheld state statutes with extraterritorial effects. Opp'n at  
28 8-9. Specifically, they argue the laws upheld in those cases

1 did not bar California residents from going to another state and  
2 engaging in business that was lawful outside California. This  
3 argument misgauges the scope of Sections 19858 and 19858.5.  
4 Plaintiffs do not allege these provisions restrict all  
5 California residents from investing in out-of-state casinos.  
6 Nor do Plaintiffs allege these laws prevent all California  
7 residents from owning casinos in states where casino-style  
8 gambling is lawful. California law only restricts these business  
9 practices when they intersect with the ownership or operation of  
10 a card club located in California.

11 Finally, Plaintiffs argue Sections 19858 and 19858.5  
12 impermissibly regulate wholly out-of-state conduct because "the  
13 Statutes' effect is not only on the cardroom licensees, but  
14 instead, applies to all of the licensee's partners, officers,  
15 directors, and shareholders, regardless of their location."  
16 Opp'n at 8 (citing FAC ¶¶ 26, 57-63) (emphasis in original).  
17 The Court declines to address the merits of this argument. To  
18 sufficiently allege a facial challenge, a plaintiff "must  
19 establish that no set of circumstances exist under which the Act  
20 would be valid." United States v. Salerno, 481 U.S. 739, 745  
21 (1987). Plaintiffs therefore had to allege Sections 19858 and  
22 19858.5 directly regulated interstate commerce with respect to  
23 licensees and non-licensees. As previously discussed,  
24 Plaintiffs fail to allege Sections 19858 and 19858.5 directly  
25 regulate interstate commerce with respect to California cardroom  
26 licensees. The laws' application to non-licensees cannot, in  
27 itself, revive Plaintiffs' facial challenge. Nor can it serve  
28 as the basis for an as-applied challenge. Plaintiffs, as

1 licensees, lack standing to challenge Sections 19858 and 19858.5  
2 on non-licensees' behalf. Lujan, 504 U.S. at 563.

3 The Court finds Plaintiffs lack a cognizable legal theory  
4 for their claim that Sections 19858 and 19858.5 directly  
5 regulate interstate commerce. To the extent that Plaintiffs'  
6 dormant commerce claims rest upon a direct-regulation theory,  
7 the Court grants Defendants' motion to dismiss.

8 3. Indirect Regulation of Interstate Commerce

9 A state's evenhanded regulation of intrastate activity will  
10 nonetheless violate the dormant commerce doctrine if its indirect  
11 effects on interstate commerce impose a "significant burden" that  
12 is "clearly excessive in relation to the putative local  
13 benefits." Pike, 397 U.S. at 142; Nat'l Ass'n of Optometrists &  
14 Opticians v. Harris, 682 F.3d at 1156-57.

15 Plaintiffs allege Sections 19858 and 19858.5 impose a  
16 significant burden on interstate commerce in two respects.  
17 First, the State's 1% rule not only prevents Plaintiffs from  
18 substantially investing in casino-style gambling; it also  
19 prevents Plaintiffs from doing business with anyone who has  
20 substantial investments in casino-style gambling. FAC ¶ 83. As  
21 enforced, this restriction all but completely bars California  
22 cardroom licensees from investing in out-of-state gambling  
23 ventures. Opp'n at 12-13. Second, the laws restrict Plaintiffs'  
24 ability to invest in businesses unrelated to gambling. Flynt,  
25 for example, owns an out-of-state "exotic dance establishment."  
26 FAC ¶ 83. If Flynt's business partner independently invests in a  
27 Nevada casino, Flynt will have to divest his interest in the  
28 dance club—even though the dance club itself does not host

1 gambling that is illegal under California law. Id. Plaintiffs  
2 argue Sections 19858 and 19858.5's ability to regulate industries  
3 unrelated to gambling adds to the significance of their burden on  
4 interstate commerce. Opp'n at 3.

5 Plaintiffs contend these burdens are "clearly excessive" in  
6 relation to California's claimed interest in crime prevention—  
7 namely because this interest no longer exists. FAC ¶ 85. They  
8 allege state officials on both sides of the political spectrum  
9 have repudiated the notion that Sections 19858 and 19858.5 are  
10 still necessary to prevent crime. FAC ¶¶ 39, 44-46. That the  
11 State has exempted various cardrooms from complying with the 1%  
12 rule only further undermines this putative benefit. See FAC  
13 ¶¶ 28, 36, 40-41. Defendants fail to illustrate how these  
14 allegations are insufficient as a matter of law. To the extent  
15 that Plaintiffs' dormant commerce doctrine claims rest upon an  
16 indirect-regulation theory of liability, the Court denies  
17 Defendants' motion to dismiss.

### 18 III. ORDER

19 For the reasons set forth above, the Court GRANTS IN PART  
20 and DENIES IN PART Defendants' motion to dismiss. To the extent  
21 that Plaintiffs' dormant commerce doctrine claims rest upon the  
22 theory that Sections 19858 and 19858.5 directly regulate or  
23 discriminate against interstate commerce, the Court DISMISSES  
24 them WITHOUT PREJUDICE. Plaintiffs lack standing to allege  
25 Sections 19858 and 19858.5 improperly discriminate against out-  
26 of-state investors. Moreover, their allegations that these  
27 provisions directly regulate interstate commerce fail as a matter  
28 of law. Plaintiffs do, however, adequately allege that Sections

1 19858 and 19858.5 indirectly regulate interstate commerce. To  
2 the extent that Plaintiffs' dormant commerce claims rests upon  
3 this theory of liability, the Court DENIES Defendants' motion to  
4 dismiss.

5 If Plaintiffs amend their complaint, they shall file an  
6 Amended Complaint within twenty (20) days of this Order.  
7 Defendants' responsive pleading is due twenty days thereafter.

8 IT IS SO ORDERED.

9 Dated: June 12, 2020

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11 JOHN A. MENDEZ,  
12 UNITED STATES DISTRICT JUDGE  
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