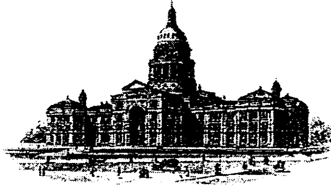
The Senate of The State of Texas

RQ-0417-JC



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OPINION COMMITTEE

Senator Eddie Lucio, Jr.

August 13, 2001

The Honorable John Cornyn
Attorney General, State of Texas
P. O. Box 12548
Austin, Texas 78711-2548
Attn: Opinions Committee

FILE # ML-42104-01
I.D. # 42104

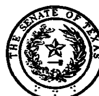
Dear General Cornyn:

This is a request for an Attorney General's Opinion regarding the proper interpretation and application of Tex. Occ. Code Ann. §2001.556, which prohibits price fixing in the sale of bingo supplies or equipment. The primary question is whether a revenue-share agreement between a manufacturer and its distributor could possibly be within the purview of that statute.

Background regarding manufacturer – distributor relationships in Texas

Several manufacturers of bingo cardminding equipment operate through "revenue share" leasing arrangements with their distributors. Under a typical revenue share arrangement, a manufacturer leases equipment to the distributor in exchange for a percentage of the revenues that the distributor earns by subleasing the equipment. The distributor leases the equipment to conducting organizations at a particular bingo hall, in exchange for a portion of the revenues that the conductors receive from their bingo customers. The conductor retains the ability to set the prices to the end customer, which results in fluctuation of the conductor's lease payment to the distributor, and in turn the distributor's lease payment to the manufacturer. This arrangement reduces the financial risk to the charity in a lease with the distributor.

Obviously, the amount of money the manufacturer receives is dependent on the amount of money the distributor receives from the conductors. Therefore, it is common in the industry for the manufacturer to have the right to approve the terms of the distributor's contract with the conductors. If the distributor proposed to lease the equipment to conductors at, for example, 5% of the conductors' revenue, the transaction likely would not make economic sense to the manufacturer and the manufacturer could refuse to lease equipment at that rate to its distributor.



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The revenue share arrangement differs significantly from an inventory lease. In an inventory lease, the distributor leases equipment from a manufacturer at an agreed upon dollar amount. The distributor then leases the equipment to bingo halls at whatever price the distributor can get for the equipment. Obviously, the distributor will charge at least the amount the distributor is paying the manufacturer. Anything less would constitute bad business practices and may constitute predatory pricing. A revenue share arrangement differs because the price paid to the manufacturer cannot be determined in advance – it is dependent on how much the conductor decides to charge its customers, which sets the dollar amount of the lease payment to the distributor, which in turn sets the dollar amount of the lease payment to the manufacturer. The revenue share concept has been in effect since electronic cardminding equipment became legal in the State of Texas.

Question No. 1

My first question is whether §2001.556 applies to vertical as well as horizontal agreements. I believe a proper reading of §2001.556 is that the statute only prohibits manufacturers from agreeing with other manufacturers, and distributors agreeing with other distributors, as to the price at which equipment may be sold. Obviously the statute is concerned with price *fixing*, that is, setting an artificially high price as a result of an agreement between parties at the same level in the distribution network. Conductors can only buy, or lease, from distributors. If one distributor is charging an artificially high price, the conductor is free to lease, or buy, equipment from another distributor. As long as the distributors don't agree among each other as to the price they will charge the conductors, there is no possibility that one distributor can set an artificially high price.

Similarly, it is not possible for a manufacturer to establish an artificially high price through an "agreement" with its own distributor. If a manufacturer and its own distributor "agree" on a price that is higher than the competition, the conductor will simply use a different distributor and a different manufacturer. If, however, the manufacturers agree with one another as to the price they will charge the distributors, then the distributors could be forced to pay an artificially high price, and in turn pass on an artificially high price to the end users. A vertical agreement has no impact on the prices established by the competitive marketplace (see §2001.556(b), price established by competitive marketplace).

Question No. 2

______My second question is whether §2001.556 applies at all to a lease arrangement. The statute specifically refers to sales and does not include leases. The law is very clear that every word omitted from a statute is presumed to be excluded for a reason. *Tex. Dept. of Human Services v. Green*, 855 S.W.2d 136, 142 (Tex. App.-Austin 1993, writ denied). It must be assumed that the Legislature made a deliberate decision to omit the term "lease" in section 2001.556. *Id.* In the case of *Maley v. 7111 Southwest Freeway, Inc.*, 843 S.W.2d 229, 231 (Tex. App.-Houston [14th Dist.] 1992, writ

denied), the court recognized the rule that express listing of certain classes in statute is equivalent to express exclusion of all others. Based on these principles, it seems apparent that §2001.556 should not apply to leases at all, but only to sales of equipment.

Question No. 3

______And even if the statute could conceivably apply to leases in general, does it apply to revenue share leases? In this context, please consider §2001.405 of the Occupations Code. That section prohibits bingo hall lessors and bingo conductors from setting the rent for bingo premises as a portion of the proceeds derived from bingo operation (much the same as a percentage lease). There is no similar prohibition against setting an equipment lease payment based on the amount of revenue derived from the use of the equipment. Had the Legislature or the Lottery Commission sought to prevent percentage leases for cardminding equipment, certainly they could have done so.

Additionally, the manufacturer and distributor in a pure revenue share contract have no input into the price paid by the customer for using the equipment. The bingo conductor sets the price to its customers. If market conditions change, the conductors have the flexibility to lower their prices charged for the equipment, and simultaneously lower their lease payments to the distributor. Compare this to the traditional lease for a set price, which obviously has no similar savings features to the benefit of the conducting organizations. The revenue share system permits bingo conductors to adjust their cost in the face of changing market conditions. Certainly the manufacturer and distributor cannot be said to have fixed prices if the price is subject to change at the discretion of the purchaser.

Finally, it should interest you to know that the percentage paid by bingo conductors under revenue share arrangements has dropped significantly, from an average of approximately 30% of revenues in 1996 to an average of 15% today. Competition is fierce between equipment manufacturers and between equipment distributors. Clearly the system is working, provided that horizontal agreements between manufacturers (or between distributors) do not occur. A manufacturer and its own distributor cannot cause any harm by agreeing on a percentage amount under the revenue share arrangement. Section 2001.556 seeks to prevent, and based on the evidence has prevented, horizontal agreements that seek to control prices. A revenue share agreement between a manufacturer and distributor does not bring about any of the potential harms that §2001.556 was designed to guard against.

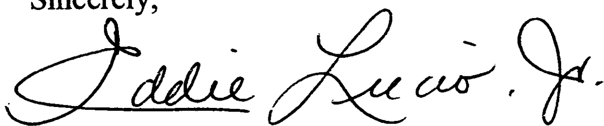
Conclusion

______These matters are important to manufacturers and distributors in the bingo industry, particularly those that manufacture and distribute electronic equipment. The revenue share lease has provided all parties, including the end user, the conductor, the distributor and the manufacturer, flexibility to deal with changing market conditions. As noted, the revenue share lease necessarily requires some sort of agreement or approval from the manufacturer regarding the distributor's

contract with the conductor. I believe that this agreement or approval does not implicate §200 1.556 of the Occupations Code. The alternative to a revenue share lease is simply a fixed price per unit, which provides no flexibility to the conductors and may well result in the conductors or end users paying a higher price.

Thank you for your consideration.

Sincerely,



Eddie Lucio, Jr.
State Senator

ELJ/bbw