

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
 )  
W. GELPI, ) OTA NO. 21098630  
 )  
 ) APPELLANT.  
 )  
 )  
 )

## TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Thursday, August 17, 2023

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

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Transcript of Electronic Proceedings,  
taken in the State of California, commencing  
at 10:24 a.m. and concluding at 12:14 p.m.  
on Thursday, August 17, 2023, reported by  
Ernalyn M. Alonzo, Hearing Reporter, in and  
for the State of California.

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APPEARANCES:

Panel Lead: ALJ CHERYL AKIN

Panel Members: ALJ OVSEP AKOPCHIKYAN  
ALJ SHERIENE RIDENOUR

For the Appellant: MICHAEL SCHINNER

For the Respondent: STATE OF CALIFORNIA  
FRANCHISE TAX BOARD  
BRIAN MILLER  
PETER KWOK

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-19 were received at page 7.)

(Department's Exhibits A-K were received at page 7.)

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C R O S S

R E D I R E C T

R E C R O S S

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1 California; Thursday, August 17, 2023

2 10:24 a.m.

3  
4 JUDGE AKIN: We're opening the record in Appeal  
5 of William Gelpi, OTA Case Number 21098630. This matter  
6 is being held before the Office of Tax Appeals. Today's  
7 date is Thursday, August 17th, 2023, and the time is  
8 approximately 10:24 a.m.

9 Again, my name is Cheryl Akin, and I am the lead  
10 Administrative Law Judge for this appeal. With me on the  
11 panel today are Administrative Law Judges Ovsep  
12 Akopchikyan and Sheriene Ridenour. As a reminder Office  
13 of Tax Appeals is not a court. It is an independent  
14 appeals body. The office is staffed by tax experts and is  
15 independent of the state tax agencies. As an independent  
16 agency the only information we have are the arguments,  
17 evidence, and briefing that the parties have presented in  
18 this appeal.

19 With that, let me please have the parties  
20 introduce themselves for the record, starting with  
21 Appellant and Appellant's representative.

22 MR. SCHINNER: My name -- I'm Appellant's  
23 representative Michael Shimmer.

24 MR. GELPI: Good morning, everyone. I am the  
25 Appellant William Gelpi.

1 JUDGE AKIN: Okay. Thank you.

2 And Franchise Tax Board.

3 MR. MILLER: Brian Miller representing Franchise  
4 Tax Board.

5 MR. KWOK: Peter Kwok for the Franchise Tax  
6 Board.

7 JUDGE AKIN: Okay. Thank you.

8 As confirmed at the prior prehearing conference  
9 and my minutes and orders, the issue to be decided in this  
10 appeal is whether Appellant has shown that FTB erred in  
11 disallowing a portion of Appellant's charitable  
12 contribution deduction. I would note that this issue  
13 involves consideration of the fair market value of the  
14 charitable stock transfer.

15 Is this consistent with the parties'  
16 understanding of the issue to be decided here today in  
17 this appeal?

18 MR. SCHINNER: Yes, Your Honor.

19 MR. MILLER: Yes. Yes, it is. Thank you.

20 JUDGE AKIN: Okay. Thank you.

21 With that, I'd like to move onto the evidence in  
22 the appeal. I'll start with Appellant's exhibits. As  
23 noted at the prehearing conference, Appellant has  
24 submitted 19 exhibits, which have been labeled Appellant's  
25 Exhibits 1 through 19. Franchise Tax Board indicated at

1 the conference that it does not have any objections to  
2 Appellant's Exhibits 1 through 19.

3 Mr. Miller, is this still correct? Are there  
4 still no objections?

5 MR. MILLER: There are still no objections to the  
6 evidence. Thank you.

7 JUDGE AKIN: Okay. Thank you.

8 Appellant's Exhibits 1-19 are now admitted into  
9 the evidentiary record without objection.

10 (Appellant's Exhibits 1-19 were received  
11 in evidence by the Administrative Law Judge.)

12 JUDGE AKIN: And Franchise Tax Board, it looks  
13 like you have submitted 11 exhibits, which have been  
14 labeled Franchise Tax Board's Exhibits A through K.

15 Mr. Schinner indicated at the prehearing conference that  
16 Appellant does not have any objection to Franchise Tax  
17 Board's exhibits.

18 Mr. Schinner, is this still correct?

19 MR. SCHINNER: This is still correct, Your Honor.

20 JUDGE AKIN: Okay. Thank you.

21 Franchise Tax Board's Exhibits A through K are  
22 now admitted into the evidentiary record.

23 (Department's Exhibits A-K were received in  
24 evidence by the Administrative Law Judge.)

25 And I just wanted to quickly verify that both

1 parties have received the exhibit binder for use today.

2 MR. MILLER: Yes, Respondent received.

3 MR. SCHINNER: Yes.

4 JUDGE AKIN: Okay. Thank you. Perfect.

5 Next, I quickly wanted to go over the witnesses  
6 for today. It is my understanding that Mr. Gelpi will be  
7 testifying as a witness and will be the only witness here  
8 today.

9 Is that still correct, Mr. Schinner?

10 MR. SCHINNER: Correct, Your Honor.

11 JUDGE AKIN: Okay. And just so I know when to  
12 swear Mr. Gelpi in, will you be starting with his  
13 testimony or will you be providing some argument first?

14 MR. SCHINNER: Your Honor, I intend to provide a  
15 brief opening statement, and then we'll go into direct  
16 testimony.

17 JUDGE AKIN: Okay. Sounds good. I just ask that  
18 before you move on to Mr. Gelpi's testimony, please just  
19 let me know so that I can swear him in at that time.  
20 Okay.

21 And I just got a message. Mr. Schinner, can you  
22 speak a little louder or perhaps move a little closer to  
23 your microphone.

24 MR. SCHINNER: Yes.

25 JUDGE AKIN: Okay. So finally, before I move on



1 to the parties' presentations, I wanted to quickly go over  
2 the time estimates and the order for the proceedings here  
3 today. So as noted in my minutes and orders, Appellant  
4 will present first and will have one hour for the  
5 presentation, which includes Mr. Gelpi's testimony.  
6 Franchise Tax Board and the panel of Administrative Law  
7 Judges will be permitted to ask factual questions of  
8 Mr. Gelpi.

9 At the conclusion of Appellant's presentation, I  
10 will also allow my panel to ask any questions they may  
11 have generally for Appellant. After that, Franchise Tax  
12 Board will have their turn to present, which is also  
13 estimated at one hour. Following Franchise Tax Board's  
14 presentation, I will turn to my panel of Administrative  
15 Law Judge for any questions they may have for Franchise  
16 Tax Board before allowing Appellant to do a brief final  
17 closing or rebuttal statement, estimated at ten minutes.

18 Any questions? Oh, before I move onto that, I  
19 will note that if needed, we will take a break for lunch  
20 and resume in the afternoon session. I'm hoping we'll be  
21 able to conclude before that. But if not, I will try to  
22 pick a time that's not interrupting anyone's presentation  
23 for that.

24 Okay. With that, are there any questions before  
25 I turn it over to Appellant for their presentation?

1           MR. MILLER: No questions. Thank you.

2           JUDGE AKIN: Okay. And I see no questions from  
3 Appellant.

4           So, Mr. Schinner, I believe we are ready for your  
5 presentation at this time. You have one hour total and  
6 may begin when you are ready.

7

8                           PRESENTATION

9           MR. SCHINNER: Good morning, Your Honor, Honors,  
10 Counsel to the Franchise Tax Board. My name is Michael  
11 Schinner, counsel for the taxpayer William Gelpi. I'll  
12 provide some background and identify the issues at hand,  
13 and then we'll present our testimony through direct  
14 examination.

15           In 2013 Mr. Gelpi and his partner Steven Jain  
16 left Zynga Games, creators of the wildly successful game  
17 played called FarmVille, to start their own gaming company  
18 called Rocket Games. Rapidly they achieved incredible  
19 success growing every quarter for 16 straight quarters.  
20 Crunchbase called them the fastest growing gaming company  
21 in the country. In 2016, they decided to engage a broker,  
22 Oakvale, to help them market and sell the company.

23           Rocket received multiple offers -- multiple  
24 letters of intent to purchase the company. All of these  
25 LOIs offered to purchase Rocket for between \$100 million

1 and \$170 million. They decided that Penn Interactive, a  
2 publicly traded company, presented the best offer and  
3 entered into negotiations. Penn offered to purchase  
4 Rocket for \$60 million in cash plus \$90 million in  
5 potential earn outs, including an incentive that the total  
6 purchase price could reach \$170 million.

7 Mr. Gelpi and his partner, Steven Jain, made a  
8 pack when they formed Rocket to give a large gift to  
9 charity if they ever, quote, "made it big." On July 21st,  
10 2016, Mr. Gelpi donated \$1.1 million of his \$6 million  
11 shares, so close to 20 percent of his shares of Rocket  
12 Games to Dechomai, a 500 -- a 501(c)(3) order -- tax  
13 exempt organization. Seven days later on July 28th, 2016,  
14 Rocket and its shareholders sold all of its stocks to  
15 Penn.

16 Penn is a public company reported to the  
17 Securities and Commission on its form --

18 JUDGE AKIN: Mr. Schinner.

19 MR. SCHINNER: Yes.

20 JUDGE AKIN: I'm terribly sorry for the  
21 interruption. I think we're having a little difficulty  
22 hearing you. You know, we're having to focus. It's  
23 really hard to hear your voice. I don't know if you are  
24 able to turn your microphone up or even move a little  
25 closer to your computer. And I apologize for the

1 interruption.

2 MR. SCHINNER: Okay. Is this any better?

3 JUDGE AKIN: Is that better? Can people nod if  
4 that sounds better.

5 JUDGE RIDENOUR: Can you speak up some more,  
6 please. I'm the one who is having trouble, and I feel  
7 like also my stenographer -- our stenographer is.

8 MR. SCHINNER: Sure. Is this any better?

9 JUDGE RIDENOUR: A little bit but not --

10 Ms. Alonzo, do you have trouble or is it just me?

11 THE STENOGRAPHER: He's a little quiet on my  
12 part, and I have my volume turned up.

13 MR. GELPI: In the audio settings, there's a way  
14 to increase the microphone volume if you click the down  
15 carrot next to the microphone and click audio settings.  
16 There's a volume slider.

17 Is my volume sufficient? Thank you.

18 MR. SCHINNER: Volume.

19 JUDGE AKIN: I'm going to take us off the record  
20 for just a moment while we're figuring this out, and I'll  
21 let everybody know when we're back on the record.

22 (There is a pause in the proceedings.)

23 JUDGE AKIN: We're going back on the record.

24 And Mr. Schinner, if you could maybe just back up  
25 to your previous sentence and start from there.

1           MR. SCHINNER: Sure. I was saying that Mr. Gelpi  
2           and his partner made a pact to donate a large percentage  
3           of their shares, roughly 20 percent, to a charity. And  
4           they then entered into negotiations and stock purchase  
5           agreement with Penn for the amount of -- which amounted to  
6           a potential \$170 million purchase price. Penn, as a  
7           publicly traded company, reported to the SEC on its 10  
8           form -- 10-Q form that the value of the purchase, the  
9           value of Rocket was \$116 million. That included 60  
10          million in cash and they had to put an estimate on the  
11          earn out of \$56 million, which worked out to \$116 million.

12                 As a public company it has a legal obligation to  
13          present accurate information to the regulators and to the  
14          public. This evaluation as supported by its independent  
15          appraisers, Ernst & Young who conducted their own  
16          appraisal. Allied Business Group was also retained by the  
17          taxpayer to value Rocket and the value of the donated  
18          stock. They valued Rocket at about \$111 million, and the  
19          value of the donated stock at \$7.7 million.

20                 Based on the value of Rocket as evidenced by the  
21          letters of intent, the stock purchase agreement, Penn's  
22          independent valuation, Allied's appraisal, Rocket's value  
23          exceeded \$100 million and supported Mr. Gelpi's claimed  
24          deduction of \$7.7 million on his tax return in 2016. In  
25          fact, he took a fairly conservative -- of the value, which

1 put an intrinsic value of the company of less than \$100  
2 million, but he wanted to that, take the most conservative  
3 route in choosing the valuation.

4 During the audit, the FTB partially disallowed  
5 the deduction and chose to use a value derivative from an  
6 amended stock purchase agreement that was entered into  
7 more than 14 months later. And we'll get into the reasons  
8 why the parties entered into an amended stock purchase  
9 agreement, one of which was to settle a dispute that had  
10 been growing relating to the capitalization versus  
11 expensing of certain development cost, as well as other  
12 unforeseen circumstances, such as Apple removing the  
13 product from its Apple store, which was a significant  
14 driver of the company's business. This dealt a  
15 devastating blow to its projected earnings and obviously  
16 effects the earn out.

17 Today you will hear from Mr. Gelpi who will  
18 describe the events that occurred over the preceding  
19 14 months after the stock purchase was entered into and  
20 after he had donated the stock. He will explain that none  
21 of these events were foreseeable. They were not foreseen  
22 anymore than the circumstances we see today. For example,  
23 during Covid businesses suddenly dropped, had a dramatic  
24 collapse in their values.

25 None of that was foreseen three years ago a month

1 before those events occurred. If you had donated stock  
2 prior to Covid and then in two months later the value  
3 precipitously dropped, would the FTB be able to go in and  
4 reevaluate the value of those donations. Likewise, just a  
5 few months ago we saw the values of billion -- companies  
6 that have billion-dollar market caps, such as Silicon  
7 Valley Bank, First Republic Bank, Facebook or Apple's  
8 change in policies. These companies lost billions in  
9 value overnight and became -- Silicon Valley and First  
10 Republic basically became penniless.

11 Had you made gifts prior to the collapse, would  
12 you have been denied a deduction because of changed  
13 circumstances? No, that's not how the world works.  
14 That's not how the tax law works. It's supposed to look  
15 at the situation as the date occurred on the donation  
16 date, not subsequent events, not things that are  
17 unforeseeable. I looked at -- we live in a changing  
18 world. I saw on the news today that there might be a  
19 hurricane off the coast of Los Angeles. That hasn't  
20 occurred in over 100 years.

21 We can't predict things. All we can do is at the  
22 time there has to be predictability. In the tax system  
23 there has to be consistency. Mr. Gelpi made a donation  
24 based on evaluation at the time, based on the information  
25 he had, based on the appraisal he had, based on the

1 information that Penn reported to the public. So what  
2 we're going to show today is Mr. Gelpi did, in fact, meet  
3 the standards to make a -- to claim his charitable  
4 deduction. He met the standard of what the IRS proffers  
5 as well as the FTB adopts, which is the willing  
6 standard -- willing buyer, willing selling standard.

7 That is, what would a willing buyer under no  
8 compulsion and a willing seller under no compulsion to  
9 buy, what would they have paid? Well, that price was  
10 reflected in the stock purchase agreement in 2016. They  
11 reported it to the Securities & Exchange Commission and  
12 only based on subsequent events, which no party could have  
13 foreseen, did they amend the stock purchase agreement. We  
14 presented -- we have and will today present evidence of  
15 the appraisals, evaluations, the stock purchase agreement.

16 The FTB hasn't presented any evidence and they  
17 will not be able to do so today. They haven't produced  
18 any expert testimony, any appraisals that contradict the  
19 testimony that Mr. Gelpi has provided and, thereof, we  
20 believe that Mr. Gelpi has met his burden proof and should  
21 be able to sustain the deduction.

22 Thank you.

23 JUDGE AKIN: Okay. Thank you, Mr. Schinner. Are  
24 you ready for Mr. Gelpi's testimony?

25 MR. SCHINNER: I am, Your Honor.



1 JUDGE AKIN: Okay. Mr. Gelpi can you please  
2 raise your right hand.

3  
4 W. GELPI,  
5 produced as a witness, and having been first duly sworn by  
6 the Administrative Law Judge, was examined and testified  
7 as follows:

8  
9 JUDGE AKIN: Okay. As a reminder you will be  
10 under oath for the entirety of this hearing. Okay.

11 You may proceed with Mr. Gelpi's testimony.

12  
13 DIRECT EXAMINATION

14 BY MR. SCHINNER:

15 Q Mr. Gelpi, can you provide us some background  
16 about where you went to school and what you did after  
17 graduation?

18 A Yes, I can. Good morning, Your Honors, and  
19 representatives of the California FTB.

20 My name is William Gelpi. I'm 38 years old. My  
21 background, growing up I was a huge lover of video games.  
22 I used to play them with my -- my friends and my father as  
23 a way to connect with them. When I got to college, I  
24 studied biology because I had childhood epilepsy, and I  
25 thought I wanted to become a neurologist to help others

1       like me.

2               After I graduated, I worked as an EMT while  
3       studying for the MCATs, but I decided that eight years --  
4       eight more years of school was not my path and decided to  
5       pursue my passion in video games. So I taught myself game  
6       development and game design and started a small game  
7       company when I was 24 with my later co-founder Steven  
8       Jain, who I met playing World of Warcraft, believe it or  
9       not.

10              And we spent two years making games. We didn't  
11       make a penny, but we learned a lot and that was enough to  
12       get us hired at Zynga, which was an up-and-coming game  
13       company in San Francisco. I joined Zynga in 2010 as the  
14       low man on the totem pole as an associate game designer  
15       and over three-and-a-half years there grew tremendously.  
16       They were rapidly expanding and giving a lot of  
17       responsibility to -- to people there and towards the end I  
18       was a director of product of some of their larger  
19       franchises. I worked on FrontierVille, and I worked on  
20       Zynga Poker at the end of my tenure there.

21              In 2013 shortly after they IPO'd, I felt the  
22       company culture had changed quite a bit and gotten a  
23       little bit slow and disconnected from customers. And my  
24       cofounder and I, Steve, we both worked there together,  
25       decided it was time to go back into business together,

1 start our gaming studio again.

2 So we left in the middle of 2013 to found Rocket  
3 Games with the dream of -- well, with the dream of  
4 building games that we loved. So we founded Rocket in the  
5 summer of 2013, and would love to tell you the story about  
6 Rocket as well. Shall I move on to continue?

7 Q Maybe you can give us a short background about  
8 what kind of games and where it was positioning itself in  
9 the market?

10 A Sure. So early on we decided to go into the  
11 mobile social casino genre to make games like Zynga Poker,  
12 which we were familiar with and also slot machine style  
13 games and blackjack style games. We started that in the  
14 Q4 of 2013. And believe it or not, within six months we  
15 already had some amount of profitability.

16 We only invested our personal savings into the  
17 company. Never took any outside investors and slowly grew  
18 it over the next three-and-a-half years to one of the  
19 biggest mobile casino companies in the world. Yeah.

20 Q So at the time -- about what time did you start  
21 to market the company for sale?

22 A Originally, we had no intention of selling the  
23 company but after about two-and-a-half years of growing  
24 and starting to become recognized in the industry, we had  
25 other larger gaming companies start to come to us and ask

1 us if we we're interested in selling the company to them.  
2 That was -- I think it was sometime in 2015 that we had --  
3 we we're approached by the first potential buyer, and we  
4 decided that was a good time to take it seriously.

5 And we decided to engage with a banker who  
6 understood more about selling companies. We didn't know  
7 anything about that at the time, and so that's when we  
8 chose to engage Oakvale Capital who helped us through the  
9 process, helped us meet additional potential buyers and  
10 helped us negotiate in the best interest of the company.

11 MR. SCHINNER: I'd like to show you Exhibit 3,  
12 Your Honors. Should I share a screen, or should I just  
13 refer to it?

14 JUDGE AKIN: I think the Panel as well as  
15 Franchise Tax Board, we all have the electronic exhibits.  
16 So I think if you just refer us to the exhibit number and  
17 the page of that exhibit, that would work for us.

18 MR. SCHINNER: Okay. I'd like you -- I'd like  
19 everyone to go to Exhibit 3 of Appellant's exhibits. It's  
20 only one page.

21 BY MR. SCHINNER:

22 Q And Mr. Gelpi, can you let me know when you see  
23 it?

24 A Yes, I see Exhibit B -- oh, sorry -- Exhibit 3.

25 Q Exhibit 3. Can you describe what Exhibit 3

1 consist of?

2 A Yes.

3 Q It may be hard to read.

4 A Exhibit 3 is a table outlining some of the terms  
5 that we received from different potential buyers outlining  
6 some of the different purchase prices and structures of  
7 deals. On the page there are four offers listed,  
8 although, there were additional that are not included in  
9 here. But there are four offers ranging from \$135 million  
10 total purchase price to \$165 million purchase price on  
11 this page.

12 Q Okay. And did you end up choosing Penn out of  
13 these different potential suitors?

14 A Yes. We -- we ended up choosing to sell to Penn  
15 Interactive Ventures. We felt that we had the greatest  
16 synergy with that company and that together we could  
17 continue to grow and even accelerate our growth. They had  
18 a long history in the land-based casino business, and they  
19 were just starting to move into the digital space. We had  
20 tremendous experience in software development, which they  
21 didn't have. And so we thought together we could have  
22 very good synergy.

23 Q And can you tell us the proposed transaction with  
24 Penn?

25 A Yes. The proposed transaction was \$60 million up

1 front, plus an earn out that was based on our EBITDA  
2 earnings in the two years after the transaction closed.  
3 And then an additional employee incentive program that was  
4 a stretch goal to try to further incentivize retention and  
5 motivate employee engagement.

6 Q Okay. I'd like you to go to Respondent's  
7 Exhibit C, page 3. It's titled United States Security &  
8 Exchange Commission Form 10-Q. That's page 1. Do you see  
9 that?

10 A I'm sorry. Which exhibit is that? I'm  
11 looking --

12 Q There are two binders of exhibits. There are two  
13 separate exhibits. There's Appellant's, and the second is  
14 Respondent's. That would be the Franchise Tax Board?

15 A Okay. Yes.

16 Q And Exhibit C, 1 of 3?

17 A I'm moving there right now. Yes. Exhibit C.

18 Q And can you read what this exhibit says and  
19 generally, if you know, what this exhibit is about?

20 A Yes. This exhibit is from Penn National Gaming.  
21 It is a public disclosure of their financial statements,  
22 which they have to disclose every quarter. And in it  
23 there is a description of the acquisition that they made  
24 of Rocket Games speaking to the initial purchase price and  
25 estimated contingent liability of the earn out payment.

1           Q    Sorry to interrupt.  I'll take you -- since you  
2   started to touch on, let's go to page 3 of that exhibit.  
3   If you go down to paragraph 4, acquisition, if you can  
4   read the first couple sentences of page 3, paragraph 4,  
5   acquisitions?

6           A    Sure.  It says on August 1st, 2016, the company,  
7   Penn National Gaming, acquired 100 percent of the  
8   outstanding equity shares of social casino game developer,  
9   Rocket Games, for the initial cash consideration of  
10  \$59.1 million, subject to customary working capital  
11  working adjustments.  The stock purchase agreement  
12  includes a contingent consideration of payments over the  
13  next two years that will be based on a multiple of 6.25  
14  times Rocket Game, then trailing 12 months of earnings  
15  before taxes -- before interest, taxes, depreciation, and  
16  amortization subject to a cap of \$110 million.

17          Q    Okay.

18          A    Would you like me to continue?

19          Q    And then skip two sentences.  "The preliminary  
20  fair value," can you read that sentence?

21          A    Yes.  The preliminary fair value of the  
22  contingent purchase price was estimated to be \$56 million  
23  at the acquisition date, based on an income approach by  
24  applying an option pricing method to the company's  
25  internal earning projections using a Monte Carlo

1 simulation.

2 Q Okay. That's sufficient. So I'll represent that  
3 the cash consideration of approximately \$60 million, plus  
4 the estimated fair market value of the earn out  
5 consideration totals \$116 million. Is that an accurate  
6 statement as to the perceived value of this transaction in  
7 terms of how they reported it to the public?

8 A Yes, that's correct. I believe because of the  
9 working capital adjustments, we had additional cash on our  
10 balance sheet at the time of the acquisition, and that was  
11 calculated afterwards. So there was a -- several extra  
12 million dollars that were in addition to that.

13 Q Okay. Can you describe what was -- what would  
14 have triggered the additional earn outs?

15 A Yes. On the 12-month anniversary, after the  
16 sales agreement, we were to calculate the then trailing  
17 EBITDA of the company and apply a 6.25 multiple on top of  
18 that. So this would be basically around September 2017.  
19 We'd look at the trailing 12 months EBITDA, multiply that  
20 by 6.25, and there would be earn out payment of the delta  
21 between that number and the upfront consideration. And  
22 each year there was a capped amount that could be earned  
23 in that year. In total, the consideration had an  
24 additional \$110 million of earn out payments after the  
25 closing of the transaction.



1           Q   And the parties -- can you describe what happened  
2   in September 2017 when the parties entered into an amended  
3   stock purchase agreement? Can you describe the  
4   circumstances surrounding that amendment?

5           A   Yes. Unfortunately, it was a very rocky time  
6   after we got acquired. Initially, things were looking  
7   good. We're trying to partner with each other, and they  
8   had some need for us to help -- help them build a digital  
9   platform for some of their other products. This was not  
10   part of our original agreement when we acquired -- when  
11   they acquired the company.

12               But they verbally told us that we would be able  
13   to capitalize that expense so that it didn't affect our  
14   EBITDA calculations for the earn out. And so we agreed to  
15   work with them wanting to be good partners with them.  
16   Unfortunately --

17           Q   Sorry, Mr. Gelpi, just for some of us that do not  
18   have a financial background, can you explain briefly the  
19   impact of a capital expenditure versus an expenditure and  
20   how that might have impacted your earn out milestone or  
21   your EBITDA?

22           A   Yes.

23           Q   So normal expenses you -- each month they are  
24   expensed on your profit and loss of the company on that  
25   month, and so it lowers profitability that the company has

1       in this month.

2               Capital expenses are investments that are  
3       expected to be delivered -- returned to the company over a  
4       longer period of time. And so as a result you don't incur  
5       those expenses when you invest in them. So because this  
6       platform was not going to be something that was going to  
7       be delivered and actually recognized, any revenue for our  
8       company or for Penn National in the first year, we were  
9       going to defer some of those expenses into the future to  
10      when the platform would be finished and would actually  
11      recognize revenue.

12              In that way the -- I believe it was around  
13      \$2 million that we invested in that platform would not  
14      affect our profitability in 2017. If we were to expense  
15      that, then that would reduce our EBITDA by \$2 million for  
16      that year.

17              Q     So did a dispute arise among the parties as to  
18      the treatment of those expenditures?

19              A     Yes, it did. Because we didn't have this all  
20      documented in writing, I was naive and just believing the  
21      verbal agreement would be enough, when it came to actually  
22      calculating the earn out payment, there was a difference  
23      of opinion within Penn National as to whether that should  
24      be honored or not or whether the original terms of the  
25      contract should be held to, which stipulated that we were

1 to calculate EBITDA payments based on how we had  
2 calculated our finances before the acquisition happened.

3 And so as a result, we had a dispute as to  
4 whether or not we had actually met our earn out threshold  
5 in that first year and were considering going to court  
6 over it because our view was that we upheld our end of the  
7 bargain, and that we had exceeded the earn out threshold,  
8 and their view was perhaps we hadn't.

9 Q And was it anticipated, foreseen at the time you  
10 entered into the purchase of sale of contract in 2016?

11 A No. This was not something we had foreseen or  
12 talked about building a digital platform for them at the  
13 time of the acquisition, nor had this been something we  
14 thought about investing in, you know, capital investments  
15 for the future of our shared businesses.

16 Q So these events arose after the donation of the  
17 stock?

18 A Yes. Yes. We were told throughout the whole  
19 period of the acquisition and our understanding was that  
20 we would be left to be completely independent for the  
21 first two years. And that was actually very important to  
22 us because we had a very strong corporate culture at our  
23 company that we thought was very important to our success.  
24 And so we're under the impression that it was going to be  
25 very hands off for the first two years. So we had not

1 contemplated any type of investment like this.

2 Q Let's transition to the donation of the stock.  
3 When did you decide to donate the stock, and how much  
4 stock did you donate?

5 A You know, I don't recall the exact time when we  
6 originally decided to donate the stock. I do recall that  
7 we completed the transaction in July of 2016, but we were  
8 looking for a partner to work with for many months before  
9 that. And because this was shares in a privately held  
10 company and we're liquid assets, and so we needed to work  
11 with a certain partner that could receive those assets and  
12 hold them until a transaction had been completed or until  
13 they were converted into cash.

14 I apologize. What was the other part of the  
15 question?

16 Q Who did you ultimately select as the donee and  
17 why?

18 A Well, in the short term we -- we chose to work  
19 with the Dechomai Foundation which was the largest  
20 foundation in the United States that works with illiquid  
21 assets. Our intended recipient of that in my case was the  
22 Buck Institute in Novato, California. As somebody who  
23 loves biology and medicine, I really wanted to make sure  
24 that my donation was going to go to institutions that were  
25 funding scientific research that could, you know, benefit,

1 and particularly the disease of aging which afflict all of  
2 us.

3 Q At the time you made this donation, did you  
4 obtain an appraisal?

5 A We engaged a firm after we made the donation and  
6 worked with them for a period of, I believe, eight months  
7 while they conducted the investigations on the company,  
8 interviews of all the C-staff, investigations on the  
9 comparable transactions. So yes, we did work with a  
10 third-party company to conduct an independent appraisal.

11 Q And you said you engaged them after the donation,  
12 but do you know when the effective date of the appraisal  
13 was? Was it before the transaction closed?

14 A Yes. The effective date was before the  
15 transaction closed. The appraisal was done on the date of  
16 the donation. This was something I recall in working with  
17 them that they were very clear that they were only to use  
18 information that was available up until the point of the  
19 donation and not any additional information after that.

20 Q Okay. I'd like you to go to Appellant's  
21 Exhibit C. It's the Allied Rocket Games appraisal --  
22 excuse me, Exhibit 6.

23 A Exhibit 6.

24 Q Exhibit 6 of Appellant's exhibits, can you  
25 describe what you see there?

1           A    Yes.  On Exhibit 6 I see a letter describing the  
2           conclusion of their independent evaluation which states  
3           that the 1.1 million shares that were donated had a fair  
4           market value of \$7.715 million.

5           Q    Okay.  And just to be clear for the judges,  
6           you're on what page of Exhibit C -- 6, excuse me,  
7           Exhibit 6?

8           A    I apologize.  That was on page 2.  This page 1  
9           says Rocket Games equity evaluation of multiple shares of  
10          common stock.

11          Q    And what's the date on page 1?

12          A    The date is September 29th, 2017.

13          Q    But what's the effective date of the appraisal?

14          A    I apologize.  The effective date of the appraisal  
15          is as of June 30th, 2016.

16          Q    And when did the transaction close approximately?

17          A    The transaction for the donation?

18          Q    Yeah, for the Penn -- the sale from Rocket to  
19          Penn Interactive?

20          A    I believe it was August.  I don't recall the  
21          exact date, but I believe it was as of August 1st.

22          Q    Okay.  So is it fair to say the donation and the  
23          effective date of the appraisal proceeded the closing of  
24          the transaction by approximately a month?

25          A    Yes, that's correct.

1           Q    Okay.  And then going back to page 2 you'll see  
2           in the first bold print, can you read that again?  We're  
3           in the middle of the page.

4           A    Yes.  Exhibit 6, page 2, it says, "1 -- 1,100,000  
5           shares was appraised at \$7.715 million."

6           Q    And what do those 1.1 million shares -- because  
7           there's a number of different blocks, but whose shares are  
8           reflected by this 1.1 million shares?

9           A    Yes.  There were several donations made.  Myself,  
10          my cofounder, and a couple of other employees all donated  
11          shares.  Also, I donated some shares to family members  
12          around that time as well.  So this is an appraisal of the  
13          all the charitable donations and donations to family  
14          members that I did around that time.

15          Q    Okay.  I'd like you to go to Respondent's  
16          Exhibit E, page 3.  It should be your tax return?

17          A    Could you repeat that please, Michael?

18          Q    Yes.  Respondent's Exhibit E, as in echo, page 3.

19          A    Yes.

20          Q    If you're looking at a PDF, it would be -- it  
21          would be page 99 of 162.  Do you see that?

22          A    I --

23          Q    Exhibit E is your -- Mr. Gelpi's tax return for  
24          2016.  Do you see that Exhibit E?

25          A    I see Exhibit E, yes.  I see 23 pages here.  Is

1       that correct?

2           Q     That's correct. And I'm going to page 3 of that  
3       exhibit.

4           A     Okay.

5           Q     Itemized deductions. And if you go down to  
6       "Guest to Charity", do you see that in the middle of the  
7       page?

8           A     Yes, I do.

9           Q     Okay. Line 17. What is the amount on line 17 on  
10      your exhibit?

11          A     On that line it's \$7,715,740.

12          Q     Same amount that you just read on Exhibit 6,  
13      which is the Allied appraisal?

14          A     Very close. There's 770 additional dollars, yes.

15          Q     Okay. And so why did you claim a deduction of  
16      approximately \$7.7 million on your tax return in 2016?

17          A     I claimed that deduction because that was the  
18      fair market value of the shares at the time, as reported  
19      to me by the independent appraisal that I had done.

20          Q     Okay. I'd like to go into the events that  
21      occurred post closing now.

22          A     Yes.

23          Q     So the timeline, we've established you donated  
24      the shares around June 30, 2016. You closed the  
25      transaction approximately a month later. Then we started



1 to talk about -- well, we talked about the amended stock  
2 purchase agreement. There are other intervening events  
3 after the close that impacted the EBITDA and the earn out  
4 considerations. A significant one was the change in  
5 Apple's policy regarding the listing of your products on  
6 the Apple store app.

7 Can you go to Exhibit 5 of Appellant's exhibits?

8 A Yes, I can.

9 Q Okay.

10 A I am on Exhibit 5.

11 Q Okay. And give everyone a second to get there.  
12 It's an only five of -- it's only six pages. Can you  
13 describe to the panel what Exhibit 5 represents? It's  
14 called Exhibit D, Communication with Apple Regarding  
15 Removal of Games. Can you describe the circumstances and  
16 what kind of communications that transpired at this time  
17 and when it occurred -- when this occurred?

18 A Yes. So about seven months after our  
19 acquisition, March 15th, we received an automated email  
20 notice from Apple for many of our applications that we had  
21 on their store that we were distributing through them.  
22 For context as a mobile game developer, we build our  
23 games, and we try to distribute them to everyone on Apple,  
24 on Google, on Kindle. And Apple was one of our most  
25 important distribution partners.

1           We received this automated email, which you will  
2       see. It says, "Your app IOS status is remove from sale,"  
3       about 20 times there, indicating that many of our  
4       applications that we had on their store were unilaterally  
5       just removed. And I remember actually being on a plane  
6       flying back home and landing and just having my whole team  
7       and my email blowing up with them say, "What's happening?  
8       All our games just got removed."

9           And what's not included here as well is even for  
10      people who had the game on their phone, for a period of  
11      about a week, they couldn't even make purchases in the  
12      game. That did change after a week where people --  
13      existing customers who already had the download were able  
14      to make some purchases. But we weren't able to update the  
15      game for them, and we weren't able to distribute the game  
16      to anyone else from that point on.

17           Q     What was the financial impact to Rocket Games as  
18      a result of Apple's removal of these games from the Apple  
19      Store?

20           A     It was tremendous. Apple made up about  
21      50 percent of our revenue. While almost overnight our  
22      revenue went down about 50 percent. Fortunately, a couple  
23      of our largest games on Apple we were able to get up and  
24      running again on the store, but the majority we couldn't.  
25      And so from then on forward, it was about a 30 percent

1 reduction of revenue to the best of my knowledge.

2 Q And did that reduction in revenue impact your  
3 earn out with -- by the acquire of Penn?

4 A Yes, dramatically. Up until this point we were  
5 on target to exceed our earn out. But after this month  
6 our revenue took a dramatic change, and we started to get  
7 a lot closer to our earn out minimums, which ultimately  
8 led to the dispute on the first anniversary of the sale.

9 Q So you said -- you just testified that you were  
10 caught somewhat blindsided by this development with Apple  
11 seven months after the transaction closed. Had they --  
12 were there any warning signs, anything that existed at the  
13 time you closed the transaction with Penn that Apple was  
14 going to take these steps?

15 A No. None at all. We had never had any -- any  
16 conflict with Apple. They had never given us any warnings  
17 for any of our applications. We hadn't heard. We had  
18 many other developer friends that were also publishing  
19 games on Apple and Google and none of them had heard any  
20 issues or seen any of their games be removed.

21 Q So in terms of some of these significant events  
22 that developed after the closing, namely Apple removing  
23 your product from the Apple Store, the situation you  
24 testified to earlier as to Penn's treatment of the  
25 capitalization versus expensing of the development cost,

1       were any of these items foreseen or foreseeable at this  
2       time when you closed the transaction in August 2016?

3           A     In no way were these foreseen or foreseeable.

4           Q     So when these events occurred seven months later,  
5       a year later, did you believe you had any legal obligation  
6       to amend your tax return because of the reduction in the  
7       value of the transaction?

8           A     No.  My -- my understanding was that the donation  
9       should be valued at the date when it was donated and based  
10      on a fair market appraisal.  And so my understanding was  
11      that the valuation report that I had done by Allied  
12      represented the value of the shares at the time when I  
13      donated them, and also to the best, you know, my  
14      understanding of, you know, what the value was at that  
15      time.  I was party to the transactions around that time,  
16      and we wouldn't have sold the company for under  
17      \$100 million at the time.  We were growing for four years  
18      straight almost and saw tremendous potential in the  
19      business.

20               MR. SCHINNER:  No further questions, Your Honor.

21               JUDGE AKIN:  Okay.  Thank you.

22               I'm going to turn to Franchise Tax Board to see  
23      if they have any questions for you, Mr. Gelpi.

24               Mr. Miller, did you have any questions?

25               MR. MILLER:  Please allow me to consult with my

1 colleague, Peter, for a moment, please.

2 JUDGE AKIN: Okay. Just make sure you're muted.

3 MR. MILLER: Okay, Judge. Yes, Franchise Tax  
4 Board does not have questions for the witness -- thank  
5 you -- at this time. Thank you.

6 JUDGE AKIN: Okay. Thank you.

7 Let me turn to my panel to see if any of them may  
8 have questions for you, Mr. Gelpi.

9 Let me start with Judge Akopchikyan. Do you have  
10 any questions for Mr. Gelpi?

11 JUDGE AKOPCHIKYAN: I just have a quick question.

12 Mr. Gelpi, I'm looking at the exhibit that  
13 indicate the games were not in compliance with the Apple  
14 review guidelines. Can you -- can you tell me a little  
15 bit more how these games violated Apple guideline?

16 MR. GELPI: Yes, Your Honor.

17 So in our business we produce many different  
18 casino games all targeted to different customers. This  
19 was very common for game developers to offer multiple  
20 different product SKUs to different customer types. If  
21 you know Candy Crush, for example, they have Candy Crush  
22 and then they have Pet Saga, which is a slightly different  
23 version of a Match 3 game.

24 We had many different casino titles targeting  
25 women, targeting men, younger players, and older players.

1       They told us after talking to them -- because we didn't  
2       hear about this when they sent these automated messages to  
3       us -- that they wanted us to combine all of our  
4       applications together into one application and offer only  
5       one application on their store.

6               This was not -- they -- to my knowledge, they  
7       didn't have actually a guideline of this. So it was an  
8       interpretation, I think, of their content curation  
9       policies to not have so many applications on the store.  
10       So I'm still not 100 percent clear why they chose to  
11       target us and ask us to combine all of our applications  
12       here. We tried to, you know, point out that many other  
13       developers offer multiple SKUs to different customers and  
14       that technically it was infeasible for us to actually  
15       combine all these different applications together.

16              And that also, experientially, it wouldn't be the  
17       best experience for customers to have all these combined  
18       into one. That's, you know, to the best of my ability to  
19       explain it is they just seem to not want so many  
20       applications on their store, and were trying to reduce the  
21       amount of applications storewide.

22              JUDGE AKOPCHIKYAN: Thank you. So, for example,  
23       the Tiger King Casino Slots is a game that was removed.

24              MR. GELPI: Correct.

25              JUDGE AKOPCHIKYAN: I did see other slot games

1       were also removed. So what did they use to interface each  
2       of these games were different, like, different  
3       backgrounds, different color schemes?

4               MR. GELPI: Yes. Yes.

5               JUDGE AKIN: How related or not related were  
6       they?

7               MR. GELPI: They -- it depended. They -- all of  
8       them had different themes. All of them had different slot  
9       machines in them. Some of them did share some slot  
10      machines that were popular that we would put into  
11      multiples of them. But all of them had their own unique  
12      slot machines in them, and many of them had different game  
13      mechanics, different progression systems, different  
14      features set in them, which is why it was infeasible for  
15      us to actually combine them together.

16              JUDGE AKOPCHIKYAN: And just to confirm, to date  
17      you're not aware of any actual guideline in Apple's review  
18      process that advises you that these games should be  
19      different to a certain degree?

20              MR. GELPI: No. That's not my understanding. I  
21      believe they do have some policies that are against just  
22      spamming the same application out multiple times. But  
23      that wasn't the case with what we were doing.

24              JUDGE AKOPCHIKYAN: Okay. Thank you, Mr. Gelpi.  
25      I don't have any other questions at this time.

1 JUDGE AKIN: Okay. Thank you.

2 And Judge Ridenour, did you have any questions  
3 for Mr. Gelpi?

4 JUDGE RIDENOUR: Yes, I did. Just one real quick  
5 question.

6 Mr. Gelpi, is it your testimony that Apple didn't  
7 give you any notice to like improve the apps or make them  
8 different before they took them off the store?

9 MR. GELPI: That's correct. They just took them  
10 all down. And it actually took us many weeks to get in  
11 contact with anyone that would tell us what was going on,  
12 what was happening, and the only guidance that we received  
13 was, you need to combine all your applications together.

14 And, you know, it's -- several of our  
15 applications we were able to get back onto the store but  
16 not all of them. And I know that -- that they continued,  
17 after I left, you know, to produce additional slot games,  
18 casino games and release them as independent applications.  
19 So I'm not sure why this was decided at this time to take  
20 all these down. And we had other developers at the time  
21 that were friends of ours that also had multiple SKUs on  
22 the store that were not affected.

23 JUDGE RIDENOUR: Okay. Thank you very much. No  
24 questions.

25 JUDGE AKIN: Okay. Judge Akin speaking. I also



1 have one question very much, I think, related to what my  
2 Panel members asked. I guess I'm just seeking a little  
3 clarification on, you said a couple of games you were able  
4 to get restored on the app store, so some of your largest  
5 ones. Whatever happened to the remaining games in terms  
6 of the app store. I understand these still might have  
7 been available on other platforms.

8 MR. GELPI: Yes, that's correct. So they were  
9 available on other platforms. On the app store people who  
10 had already downloaded the game were able to continue to  
11 play the game as of that version that we had, but we were  
12 no longer able to provide any updates for those users  
13 anymore. And they were no longer available to discover or  
14 download or for us to market to customers on the store  
15 anymore. So in the eyes of future customers, they were  
16 just -- they didn't exist.

17 JUDGE AKIN: Okay. Thank you. I don't have any  
18 other questions for you at the time. So thank you for  
19 testimony, Mr. Gelpi.

20 Mr. Schinner --

21 MR. GELPI: Thank you, Your Honor.

22 JUDGE AKIN: Yes. You're welcome.

23 I calculated before we started our questioning  
24 that you have used approximately 47 minutes of the  
25 60 minutes you had for your presentation. Did you have

1 any final closing statements you wanted to make at this  
2 time before I turn it over to Franchise Tax Board for  
3 their presentation?

4 MR. SCHINNER: I was going to make a closing  
5 statement. I can do that now or after the FTB has  
6 presented.

7 JUDGE AKIN: So just clarify the process, you  
8 have some time now if you want to use it after which we'll  
9 turn to the Franchise Tax Board for their presentation.  
10 And then following Franchise Tax Board's presentation, you  
11 will have an additional 10 minutes for a final closing  
12 statement. So whatever your preference is at this time.  
13 Did you want to speak now, or did you want me to go ahead  
14 and hand it off to Franchise Tax Board?

15 MR. SCHINNER: Let's hand it off at this time.  
16 Thank you, Your Honor.

17 JUDGE AKIN: And before I do, let me just check  
18 with my Panel to see if they have any general questions  
19 for you, Mr. Schinner.

20 Judge Akopchikyan, did you have any general  
21 questions for Mr. Schinner?

22 JUDGE AKOPCHIKYAN: No questions at this time.  
23 Thank you.

24 JUDGE AKIN: Thank you.

25 And Judge Ridenour?

1 JUDGE RIDENOUR: Also, no questions at this time.  
2 Thank you.

3 JUDGE AKIN: Okay. Thank you.

4 And I don't have any questions either. So I  
5 think we are ready for Franchise Tax Board's presentation.

6 Mr. Miller, you had 60 minutes, and you may begin  
7 when you are ready.

8 MR. MILLER: Very good. Thank you.

9

10 PRESENTATION

11 MR. MILLER: Good morning. I'm Brian Miller,  
12 Attorney IV, representing Respondent Franchise Tax Board.  
13 With me this morning as second chair is Peter Kwok also  
14 Attorney IV.

15 This case is about Respondent's partial  
16 disallowance of Appellant's charitable contribution  
17 deduction. Respondent determined that the strongest  
18 evidence of the fair market value of Appellant's non-cash  
19 charitable contribution at the time of contribution was  
20 the charity's portion of the aggregate purchase price that  
21 Penn paid to all Rocket Games shareholders. Appellant  
22 claimed that the fair market value of his contributed  
23 shares was more than the charity's portion of the  
24 aggregate purchase price based on an appraisal. Appellant  
25 claimed a larger charitable contribution deduction than

1 Respondent allowed.

2 We'll begin the presentation with the important  
3 facts of this case followed by a short restatement of  
4 applicable income tax law. Next, I'll explain the facts  
5 and laws supporting FTB's determination that the aggregate  
6 purchase price paid for Rocket Games is the strongest and  
7 best evidence of the fair market value of Appellant's  
8 charitable contribution. Finally, I will explain why  
9 Appellant's evidence does not prove that FTB's  
10 determination is in error.

11 This case began in 2016 when Appellant  
12 contributed some of his Rocket Games shares to charity.  
13 About one week after Appellant's contribution, Penn agreed  
14 to purchase all of Rocket shares. In exchange for all of  
15 Rocket shares, Penn and Rocket agreed to an initial  
16 purchase price of \$60 million with potential earn outs and  
17 other payments ranging from zero to \$90 million depending  
18 on Rocket's earning performance over the following two  
19 years. Whether there would be earn out payments and, if  
20 so, what amount, meant that the actual purchase price for  
21 Rocket shares was uncertain at the time of the sale.

22 About one year later, Penn and Rocket amended the  
23 purchase agreement. Penn agreed to buy out the contingent  
24 earn out payments and the parties agreed that the  
25 aggregate purchase price for Rocket shares was the initial

1 purchase price of \$60 million plus Penn's earn out payment  
2 of \$17.5 million. The amended stock purchase agreement  
3 stated that the aggregate purchase price of \$77.5 million  
4 was the total amount Penn agreed to pay and Rocket agreed  
5 to accept in exchange for all of Rocket shares. Penn paid  
6 Appellant's charity about \$5.3 million as its pro rata  
7 share of the aggregate purchase price.

8 Turning now to the income tax law applicable to  
9 this appeal. Under federal and California tax codes,  
10 charitable contribution of property or other than money  
11 is -- with certain limitations is not important here --  
12 deductible in the year of the contribution. Non-cash  
13 charitable contributions, which includes shares of stock  
14 are reported as the fair market value of the property at  
15 the time of the contribution. Fair market value is the  
16 price at which the property would change hands between  
17 willing buyer and a willing seller.

18 Federal courts and U.S. Tax Courts have ruled  
19 that evidence of actual sales prices received for property  
20 within a reasonable amount of time before or after a  
21 charitable contribution with no intervening events that  
22 drastically change the value of the property is highly  
23 relevant evidence that should be considered when  
24 determining the fair market value of the contributed  
25 property.

1           The fair market value of publicly traded stock is  
2 usually determined by the listed market price on the date  
3 of the charitable contribution. However, in cases where  
4 shares are not publicly traded or are otherwise not a  
5 listed stock, such as Rocket Games, the strongest evidence  
6 of fair market value is the actual sales within a  
7 reasonable amount of time before or after the charitable  
8 contribution. IRS guidance tells us that the actual  
9 selling price within a reasonable amount of time before or  
10 after a charitable contribution may be the best evidence  
11 of the property's fair market value.

12           Applying the income tax law to Appellant's facts  
13 is pretty straightforward here. About one week after  
14 Appellant's charitable contribution of his Rocket Games  
15 shares, Penn agreed to purchase all outstanding shares of  
16 Rocket with an initial definite purchase price coupled  
17 with potential earn out payments contingent on Rocket's  
18 future earnings performance. The full final purchase  
19 price could fall within a range from only the initial  
20 purchase payment with no earn out payment to an additional  
21 \$90 million of contingent earn out payments.

22           Thus, the purchase price was uncertain one week  
23 after Appellant contributed his shares. About one year  
24 after Appellant's charitable contribution and the  
25 Penn/Rocket stock purchase agreement, Penn agreed to buy

1 out the potential earn out payments. Rocket agreed to  
2 amend the stock purchase agreement with earn out buyout in  
3 part to provide Rocket Games shareholders with certainty  
4 in regard to the contingent earn out payments.

5 It was at this point, about 14 months after  
6 Appellant's charitable contribution that Penn and Rocket  
7 determined the aggregate sale price for all of Rocket  
8 shares. The aggregate purchase price for the Rocket  
9 shares is highly relevant to determine the fair market  
10 value of Appellant's contributed shares. Penn and Rocket  
11 agreed to the aggregate purchase price about 14 months  
12 after Appellant's contribution. Fourteen months is within  
13 a reasonable amount of time after the contribution, and  
14 the purchase price of Rocket shares is relevant to  
15 determining the fair market value of Appellant's  
16 contributed shares.

17 The aggregate purchase price of Rocket shares is  
18 also the strongest, maybe even the best possible evidence  
19 of Rocket's fair market value at the time of Appellant's  
20 charitable contribution. Respondent based its fair market  
21 value determination on the highly relevant and strong  
22 evidence of the aggregate purchase price agreed to by Penn  
23 and Rocket. Meanwhile, Appellant contends that the actual  
24 sale of Rocket should not be considered when determining  
25 the fair market value of the shares because Penn's

1 purchase and determination of the aggregate purchase price  
2 occurred after the charity contribution.

3 Appellant's evidence, however, does not prove  
4 that Respondent's reliance on the actual sales price for  
5 fair market value is in error. First, Appellant contends  
6 that his appraisal of Rocket Games is the best evidence of  
7 its fair market value. However, Appellant's appraisal is  
8 less than reliable and this Panel should give it little  
9 evidentiary weight.

10 First, the appraisal states that it was done for  
11 gift tax purposes, but this is an income tax case. But  
12 more fundamentally, Appellant's appraisal excludes any  
13 consideration of Penn's actual sales price of Rocket  
14 Games. The appraisal analysis acts as if the sale never  
15 happened. The fact that Penn and Rocket agreed to an  
16 aggregate purchase price was known before the appraisal  
17 was complete. Rocket Games executives met with the  
18 appraiser during August 2017. The amended purchase  
19 agreement between Rocket and Penn was entered into and  
20 is -- on September 12th, 2017.

21 The appraisal is dated September 29th. Yet,  
22 despite being issued after the full amount of this  
23 purchase price was known, the appraisal makes no mention  
24 of the sale of Rocket Games to Penn. This omission is  
25 important. IRS guidance to taxpayers preparing appraisals



1 to support charitable contributions for income tax  
2 purposes, which is Revenue Procedure 66-49, says that the  
3 actual selling price within a reasonable time, before or  
4 after the evaluation date, may be the best evidence of its  
5 fair market value. But Appellant's appraisal omits what  
6 the IRS says may be the best evidence of the fair market  
7 value of Appellant's contributed shares. For this reason,  
8 the appraisal should be given limited evidentiary weight.

9 Next, Appellant contended that unforeseeable  
10 events subsequent to his charitable contribution caused  
11 the aggregate purchase price to be less than he hoped for  
12 and, therefore, the purchase price of Rocket Games is not  
13 relevant to the fair market value of his contributed  
14 shares. Appellant contends that the removal of its apps  
15 from a platform for several weeks was unforeseeable, and  
16 that the app removal caused Rocket Games to lose an  
17 unspecified amount of potential revenue.

18 Platform's host removed Rocket Games apps because  
19 the app configurations violated the platform's guidelines.  
20 However, apps are frequently removed from the platform for  
21 a lot of reasons, and it's not an unusual occurrence.  
22 Also in Rocket's case, some of the apps were never  
23 returned to the platform, indicating that they were in  
24 violation of the platform's guidelines. While the  
25 platform's enforcement of the guidelines may have

1 surprised Rocket's management when it happened, it does  
2 not appear to be an event so unusual that it was not  
3 contemplated as a possibility by Rocket's management.

4 Now, even if the apps' removal was unforeseeable,  
5 Appellant provides no clear and convincing evidence that  
6 this drastically changed the value of Rocket Games. It is  
7 probable that Rocket would have earned more revenue than  
8 it did if the apps were never removed. But there's never  
9 evidence that it changed the aggregate purchase price paid  
10 by Penn. Appellant also told us today and contended in  
11 his briefing that Penn failed to follow through on an oral  
12 agreement to capitalize app development expenses.  
13 Appellant contends that Rocket would have received a  
14 higher contingent earn out payment than Penn's buyout of  
15 the earn out of payments.

16 It appears that Appellant believed that Rocket  
17 Games had an oral agreement with Penn that he hoped would  
18 have led to a higher earn out payment. However,  
19 documentary evidence provided by Appellant demonstrates  
20 that Rocket Games executives were uncertain of the terms  
21 of an oral capitalization agreement with Penn. SMS  
22 messages in October 2016 and January 2017 show Rocket  
23 Games executive discussing attempts to reach agreement  
24 with Penn to capitalize app development expenses,  
25 including doubts about the number of amortization years.

1     Because this oral agreement was never litigated, we do not  
2     have the benefit of Penn's understanding of a  
3     capitalization agreement, which may have been different  
4     from Appellant's understanding.

5             Further, Appellant provided no evidence  
6     demonstrating that the failed capitalization agreement  
7     changed a potential earn out payment or drastically  
8     changed the purchase price of the shares.  Additionally,  
9     Appellant contended today that Penn reported the  
10    transaction -- reported a fair value.  Appellant's  
11    representatives stated there was a fair market value  
12    statement in the 10-Q.  However, going to Exhibit C,  
13    page 3, Penn wrote that it's a preliminary fair value of  
14    the contingent purchase price, and it was estimated to be  
15    \$56 million at acquisition.

16            This language demonstrates that Penn and Rocket  
17    did not have a firm purchase agreement.  They did not have  
18    a firm purchase price.  Everything was contingent after  
19    the \$60 million initial payment.  The 10-Q does not state  
20    the fair market value of Rocket shares at the time of  
21    contribution.

22            And finally, Appellant testified today that  
23    revisions to a financial adviser contract -- or Appellant  
24    stated in his opening briefs that revisions to a financial  
25    advisor contract demonstrated that Rocket Games believed

1 the aggregate purchase price would be at least \$100  
2 million. Respondent does not doubt that Appellant hoped  
3 that Rocket's contingent earn out would be larger than it  
4 was. But unrealized hopes for a larger earn out payment  
5 does not mean that the actual earn out payment and actual  
6 Rocket purchase price are not relevant in determining the  
7 fair market value of Appellant's charitable contribution.

8 In summary, Appellant provided no support that  
9 events after his charitable contribution were  
10 unforeseeable or that they drastically effected the  
11 aggregate purchase price of Rocket shares. The aggregate  
12 purchase price of Rocket Games is very relevant evidence  
13 of the fair market value of his contributed shares.

14 In conclusion, FTB determined that the fair  
15 market value of Appellant's charitable contribution was  
16 the charity's pro rata share of the aggregate purchase  
17 price paid by Penn. The aggregate purchase price is  
18 highly relevant to determining the fair market value of  
19 Appellant's charitable contribution because it was  
20 determined within a reasonable amount of the time after  
21 Appellant's charitable contribution, and there were no  
22 intervening events that drastically changed Rocket's  
23 value. The aggregate purchase price is strong evidence of  
24 the fair market value of Appellant's charitable  
25 contribution.

1 Appellant's appraisal meanwhile is less than  
2 reliable because it did not consider the sale of Rocket  
3 shares when analyzing fair market value. It ignored what  
4 the IRS tells us may be the strongest evidence of fair  
5 market value. In short, Appellant has not demonstrated  
6 with the preponderance of the evidence that FTB's  
7 determination is in error. Thus, Respondent's actions  
8 should be sustained.

9 Thank you and I'm ready to answer any questions  
10 from the Panel.

11 JUDGE AKIN: Okay. Thank you, Mr. Miller. Let  
12 me see if my Panel has any questions for you.

13 Judge Akopchikyan, did you have any questions you  
14 wanted to ask Franchise Tax Board?

15 JUDGE AKOPCHIKYAN: No questions. Thank you.

16 JUDGE AKIN: Okay. And Judge Ridenour?

17 JUDGE RIDENOUR: Also, no questions. Thank you.

18 JUDGE AKIN: Okay. I do have one or two quick  
19 questions. The first, you noted that the appraisal  
20 indicated it was for gift tax purposes, rather than income  
21 tax purposes. I just wanted to clarify. It seems like a  
22 charitable contribution is a gift. I guess I would like a  
23 little more insight as to why FTB thinks that's an issue  
24 or may be an issue.

25 MR. MILLER: Tax is -- thank you for the

1 question. Gift tax is a completely separate chapter in  
2 the Internal Revenue Code. Personal income tax is in  
3 Chapter 1. Gift tax, different chapter. Furthermore,  
4 California does not have a gift tax anymore. We repealed  
5 it in 1982. Furthermore, the appraisal does say it is for  
6 a gift tax and that if it continues in such further, then  
7 it's not usable for any other purposes. Another purpose  
8 would be income tax. I hope that responds to your  
9 question.

10 JUDGE AKIN: Yes. Thank you. One follow-up  
11 question to that. Would the value be different for income  
12 tax purposes versus gift tax purposes as far as Franchise  
13 Tax Board is aware?

14 MR. MILLER: As far as Franchise Tax Board is  
15 aware, no, because we administer the income tax. We do  
16 not administer the gift tax which, again, California does  
17 not have. So no, we do not know the differences, and  
18 I'm -- I do not offer an opinion of that.

19 JUDGE AKIN: Okay. Understood. That is all of  
20 my questions at this point.

21 I know we have some hearings this afternoon, so  
22 unless any party indicates to me that they need a break, I  
23 think at this point I'd like to move onto Appellant's  
24 closing statement. If anyone does feel like we need a  
25 break first, please just raise a quick hand.

1           Okay. We'll move forward then to Appellant's  
2 closing statement.

3           Mr. Schinner, I believe we allotted 10 minutes  
4 for your closing, and you may begin when you are ready.

5           MR. SCHINNER: Thank you, Your Honor.

6

7                           CLOSING STATEMENT

8           MR. SCHINNER: I just want to address a few  
9 points that Mr. Miller raised.

10           In terms of the appraisal, it is for charitable  
11 gift tax and gift tax purposes as Mr. Gelpi previously  
12 testified. There were four tranches of stock that were  
13 gifted; the largest being a gift to a charity, and the  
14 others to family members. So the appraisal did assess the  
15 value for charitable gift to a nonprofit organization. It  
16 is -- it's for income tax purposes. It's a charitable  
17 gift deductible under Section 170 of the code. So it's  
18 the same standard. It's a valuation of fair market value  
19 of the stock on the date of the donation.

20           In addition, Mr. Miller said that these changes,  
21 such as Apple Store's policies were not contemplated --  
22 excuse me. There's nothing to indicate that these were  
23 not considered by management at the time of the sale. He  
24 testified consistently throughout this hearing that he did  
25 not -- he was blindsided by this development by Apple.

1 The parties did not take into account the change in policy  
2 by Apple.

3 If the parties had taken it into account, it  
4 would have been reflected in the purchase price. In fact,  
5 Penn would have been obligated to disclose the material  
6 fact to the public. No one contemplated this fact, and  
7 we've met the burden to show that this was not a foreseen  
8 event. Likewise, he testified that the change in the  
9 characterization of the expenditures did have a material  
10 impact on the value of the gift and these -- on the value  
11 of the company in terms of meeting its earn outs.

12 And this was not contemplated at the time the  
13 transaction was entered into it. And if it had, Mr. Gelpi  
14 testified he thought the company would have been valued  
15 less than a \$100 million, and they would not have achieved  
16 some of these earn outs, he would not have sold the  
17 company. So these things were not contemplated at the  
18 time of the sale.

19 Mr. Miller further testified -- reported that the  
20 standard is that events subsequent to the transaction that  
21 are both reasonable in time and not subject to intervening  
22 events can be utilized as evidence, as probative value.  
23 Well, we've established that 14 months later was not a  
24 reasonable time. There were a lot of intervening events  
25 that were not contemplated at the time of closing. So



1 Mr. Miller himself cites the standard that you only  
2 consider subsequent events if there is no intervening  
3 events. There were intervening events.

4 The FTB has not met its burden of proof to show  
5 that there were intervening events and that you can use  
6 the amended stock purchase agreement 14 months later.  
7 We've established through testimony and evidence and  
8 through documentary events that there were intervening  
9 events that should not be given any weight to the  
10 transaction that was entered into 14 months later.

11 I gave anecdotes of what can happen in a matter  
12 of weeks these days, whether it's Silicon Valley Bank  
13 collapsing, First Republic Bank collapsing, Facebook  
14 dropping by \$80 million because of a change in Apple's  
15 policy regarding privacy. Just this week there was an  
16 announcement on -- and I'm happy to share the screen --  
17 but there was an announcement that Penn just entered into  
18 a say, transaction with ESPN for \$2 billion. It's a  
19 venture called ESPN Bet. That happened several years  
20 after this event, but certainly Penn's use of the  
21 technology in the gaming that they acquired from Rocket  
22 had an impact on this.

23 Should we go back and amend the value of the gift  
24 because of something that five years later, you know, a \$2  
25 billion deal? No. The tax system is designed to provide

1     predictability and stability. And if we are constantly  
2     looking at subsequent events, we don't have that  
3     predictability and certainty.

4             Here, we have -- the parties had an appraisal as  
5     of a date certain. Penn had a public obligation to  
6     provide to its investors as well as the Securities &  
7     Exchange Commission. They had to put a value on that  
8     transaction of the ear out. An earn out is inherently  
9     contingent and speculative, but you have to put a value on  
10    it, both for the claiming a charitable deduction under the  
11    income tax laws, as well as informing the public under the  
12    Securities laws. You have to put a value as of a date  
13    certain, and that's what the parties did.

14            They -- you can't rely on subsequent events  
15    otherwise it renders the tax system unpredictable. And  
16    this will have a chilling effect on the charitable  
17    industry. People rely on, as of the date certain, there's  
18    a valuation given to that stock. You look at any  
19    intrinsic evidence you can, whether it's an appraisal, a  
20    stock purchase agreement, and that's the value the parties  
21    rely upon.

22            Mr. Gelpi testified he reported it based on the  
23    appraisal. He didn't think he had an obligation. That's  
24    because there's a policy under the tax law. You put on  
25    your tax blinders. You look at an annual tax year.

1       That's the value of the gift. You don't look at  
2       subsequent events, otherwise it renders the tax system  
3       unpredictable and chaotic.

4               Mr. Gelpi followed the laws. He got an  
5       appraisal. He reported the valuation based on his best  
6       evidence at the time of the gift. And what he didn't --  
7       he could not have contemplated a change of circumstances  
8       based on Apple's developments, based on an acquirer who  
9       changed the landscape, as well as the entire legal  
10      landscape change for gaming in general. So if we're going  
11      to apply this system, we can't look at evaluation whether  
12      there's an increase or decrease.

13             He played by the rule. He claimed the proper  
14      deduction. And the FTB has not met its burden of proof,  
15      providing any evidence, whether it's expert testimony, its  
16      own independent appraisal, other than something that  
17      happened 14 months later based on change of circumstances.  
18      When the United States Supreme Court in the Ithaca case  
19      says you don't look at intervening events unless it was  
20      foreseeable. These were not foreseeable.

21             And so we -- our position is that the Franchise  
22      Tax Board has failed to meet its burden, and the Panel  
23      should respect the deduction that was taken, and Mr. Gelpi  
24      should be able to claim the full deduction and the carry  
25      over into 2017 and subsequent.

1 Thank you, Your Honor.

2 JUDGE AKIN: Okay. Thank you.

3 Before we conclude the hearing, I will give the  
4 Panel of Administrative Law Judges one last opportunity to  
5 ask any final questions they may have for either party or  
6 Mr. Gelpi.

7 Judge Akopchikyan, did you have any final  
8 questions for either party?

9 JUDGE AKOPCHIKYAN: No final questions. Thank  
10 you all.

11 JUDGE AKIN: Okay. And Judge Ridenour?

12 JUDGE RIDENOUR: Yes, I do actually have a  
13 question for Appellant's -- Mr. Gelpi's rep. Can you  
14 please clarify for the record what Appellant's position is  
15 regarding the reasonable amount of time. Should like a  
16 foreseeable -- sorry -- an unforeseeable event happen the  
17 next day, is that still like a reasonable amount of time?  
18 I'm just trying to gather like this law regarding a  
19 reasonable amount of time and then unforeseen events, how  
20 they should correlate when we look at the law.

21 MR. SCHINNER: Sure. I believe it's a  
22 two-standard prong that you can only look at subsequent  
23 events that are reasonable in time and that were not  
24 foreseeable. So you have to meet two prongs. Reasonable  
25 as we know is a subjective standard, but I think in this

1 context -- and again, I've given numerous examples. The  
2 market widely fluctuates on a daily basis.  
3 Fourteen months later is not reasonable. I believe I can  
4 find various cases that might say 14 months would be  
5 reasonable, but those are from 20, 30, 40 years ago.

6 What we're dealing with is a very dynamic market.  
7 The gaming industry is cons -- the legislative landscape  
8 is changing dramatically on a daily, weekly, monthly  
9 basis. And so reasonable in this context can be no more  
10 than a few weeks. But regardless of whether 14 months is  
11 reasonable or not, you have to show that it was  
12 foreseeable and there weren't intervening events. So you  
13 have to meet both prongs. There were intervening events  
14 that were not foreseeable. We've explained those.

15 Mr. Gelpi explained he did not foresee Apple  
16 coming along and changing its rules. He did not foresee  
17 who had acquired the business and changing its methodology  
18 of how to meet the earn outs. So regardless of the length  
19 of time which, again, 14 months is well past a reasonable  
20 period, there has to be a period where all the events were  
21 foreseeable. That's not the case here. So they fail on  
22 both prongs.

23 JUDGE RIDENOUR: Thank you very much for  
24 clarifying. I appreciate that.

25 MR. SCHINNER: Thank you.

1 JUDGE RIDENOUR: No further questions.

2 JUDGE AKIN: Okay. Give me one moment to look at  
3 my notes. I think I might have one final follow-up  
4 question.

5 Okay. This question is for Appellant, and I'm  
6 not sure if Mr. Schinner or Mr. Gelpi would be, you know,  
7 better to answer this. So I'll let you decide that. But  
8 Franchise Tax Board argues that the appraisal is not  
9 reliable in part because it didn't consider, you know, the  
10 sale, which it argues is the most, you know, reasonable  
11 determination of the value of the company.

12 I guess I'm wondering if the appraisal did  
13 consider the sale because I believe it was approximately,  
14 you know, the donation, the charitable contribution was  
15 approximately one month before the sale. So I'm wondering  
16 if the appraisal did consider that sale, maybe just not  
17 the subsequent modifications to the sales price. I don't  
18 know if you have any clarification for us on that point.

19 MR. SCHINNER: Well, I'll address it, unless  
20 Mr. Gelpi has any additional light. But again, under the  
21 appraisal rules you look at the information that's  
22 available as of the date of the gift. The sale was  
23 subsequent. But, obviously, the buyer was using the same  
24 financial information that the appraisers used. And in  
25 shorthand, you're typically -- there's different

1 methodologies in the appraisal, the enterprise value,  
2 discounted cash flow.

3 But these are all financial driven -- driven by  
4 financials, the same information that Penn relied on. So  
5 I'm not -- I can't speak as to what the appraiser took  
6 into account relative to the sale. There's no specific  
7 mention of it, only because the sale closed afterwards.  
8 But I can say that the financial information would have  
9 been identical to what Penn relied upon and perhaps not  
10 coincidentally, the values are essentially the enterprise  
11 value that Penn reported to the public, which is \$116  
12 million.

13 The value that Allied came up with was around  
14 \$111 million. So they came out to about the same numbers.  
15 So I think it's a bit of a red herring in terms of  
16 splitting hairs on the dates because they're using the  
17 same financial information. And certainly, they would not  
18 have -- it would not have been appropriate to consider the  
19 events subsequent to the sale.

20 But whether the sale was considered or not, it  
21 came up to the same valuation anyway, and Mr. Gelpi, you  
22 know, reported a tax deduction that was based on the  
23 appraisal, which actually was based on an enterprise value  
24 less than what was reported.

25 MR. GELPI: If I may add to that, Your Honor?

1           We certainly disclosed, you know, all that  
2           information about the -- the transaction that we're  
3           negotiating and other letters of intent that we had at the  
4           time. I'm not a tax appraisal specialist, but the  
5           methodologies that they used, used all the information  
6           that they had at the time, one of which was comparable  
7           transactions based on the profitability of the company  
8           over the past 12 months. Others were using the financial  
9           forecast.

10           So the professional that appraised it was aware  
11           that that information was available and, to my  
12           recollection, repeatedly chose to focus on the best  
13           information he had as of June 30th.

14           JUDGE AKIN: Okay. Understood. Thank you.

15           And just out of fairness I do want to provide  
16           Franchise Tax Board an opportunity to respond to that if  
17           they wanted to.

18           Mr. Miller?

19           MR. MILLER: Yes. Well, Appellant's appraisal  
20           does not -- does not include the sale. It does not even  
21           include the agreement one week after the contribution.  
22           When the appraisal is dated, true the evaluation date is  
23           about the time of the contribution. However, the  
24           appraisal itself was done after the full sale price was  
25           known.



1           It did not include the best evidence available  
2       which is a sale of non-listed stock. What was the  
3       agreement between the buyer and the seller for that stock,  
4       that would be the fair market value. It did not even  
5       consider that. It used different things, different  
6       information. Appellant's representative did note that  
7       Penn -- or said that Penn used the same information that  
8       the appraiser had.

9           However, when Penn did its 10-Q, which Appellant  
10      read from during his testimony, the 10-Q includes a lot of  
11      contingent language. It does not state a certain fair  
12      market value. At best, it does a fair value, which is a  
13      book value, not a market value. And so -- so Appellant's  
14      appraisal ignoring the actual sale between the parties is  
15      something that causes it to have little evidentiary value.

16           Thank you.

17           JUDGE AKIN: Okay. Thank you. I don't have any  
18      further questions. So I think we're ready to conclude the  
19      hearing unless there was anything that a party wanted to  
20      add before we wrap up here.

21           MR. MILLER: No.

22           MR. GELPI: No, Your Honor.

23           JUDGE AKIN: Let me just double check with my  
24      Panel members to make sure they don't have any final  
25      questions. You can just shake your heads no if you don't.

1       Okay. Both indicating no. Okay. Give me one seconds to  
2       pull my notes back up.

3               Okay. So with that, we are ready to conclude the  
4       hearing. I want to thank both parties and Mr. Gelpi for  
5       attending today and presenting the information and  
6       testimony that was presented.

7               The Panel of Administrative Law Judges will meet  
8       and confer and decide the case based on the arguments and  
9       the evidence in the record, along with the testimony that  
10      was presented today. We will issue our written decision  
11      within 100 days from today, and the record is now closed,  
12      and the case is now submitted for an opinion.

13              The next hearing will begin at approximately  
14      1:00 p.m.

15              Thank you everyone and have a good afternoon.

16              (Proceedings adjourned at 12:14 p.m.)

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in the outcome of said action.

I have hereunto subscribed my name this 30th day  
of August, 2023.

ERNALYN M. ALONZO  
HEARING REPORTER