

APR 11 30, 1992
Approved: *Edward F. Reilly, Jr.*

MINUTES OF THE SENATE COMMITTEE ON FEDERAL AND STATE AFFAIRS.

The meeting was called to order by Sen. Edward F. Reilly, Jr. at 9:00 a.m. on March 9, 1992 in Room 254-E of the Capitol.

All members were present except:
All members were present

Committee staff present:
Mary Torrence, Office of Revisor of Statutes
Jeanne Eudaley, Committee Secretary

Conferees appearing before the committee:
See attached list

Others attending: See attached list

Sen. Reilly called the meeting to order and called the committee's attention to SB 695, video lottery. The chairman called on Charles Yunker, Adjutant of the American Legion, who offered testimony (Attachment 1) in favor of SB 695. After Mr. Yunker's testimony, several questions were raised regarding ownership of the machines.

Sen. Reilly introduced the following people, who gave testimony supporting SB 695:

Jerry Shelor, Past Enterprises, Inc., (Attachment 2);
Stan Chilton, Kansas Automatic Merchandisers Assoc.,
(Attachment 3).

Sen. Reilly called the committee's attention to a memo from the Research Department to the Legislative Coordinating Council (Attachment 4) regarding video lottery and its effect on the parimutuel revenue. He also pointed out information on the fiscal note for SB 695 (Attachment 5). Senators questioned Mr. Chilton on lottery statistics from other states.

Sen. Reilly reminded the committee of a proposal suggested by Pete McGill of McGill & Associates to consider a pilot project utilizing the present gambling sites. He also commented on the competition between Missouri and Kansas, and stated that Missouri wants to get back what Kansas has taken away. Sen. Reilly asked the status of the bill in Missouri, and Mr. Chilton reported it is out of committee and that it is a similar bill requiring local option.

The Chairman reminded the committee of the abortion hearing in Room 313-S at 11:00 today.

The meeting adjourned at 9:55.

Attach.

STATEMENT ON
SENATE BILL 695

An act amending and supplementing the Kansas Lottery Act; concerning
Video Lottery Machine Games
By Charles M. Yunker, Adjutant
The American Legion, Department of Kansas

Thank you for allowing me this opportunity to testify in favor of Senate Bill 695. This legislation will provide the State of Kansas an additional source of revenue from volunteers who, of their own free will, participate by playing video lottery machines.

The only area of SB 695 which perhaps needs to be reviewed is contained in lines 19 and 20 of page 14 which requires video lottery machine operators to pay a fee of \$150.00 per machine or \$5,000, whichever is greater. Several of our American Legion Posts have expressed interest in purchasing machines through licensed distributors and they are willing to purchase maintenance agreements equal to those which will be required by the State to insure their continual operation during normal business hours.

This arrangement we believe will off-set the Kansas Lottery's fears of "owned" machines sitting idle should they malfunction as has been the experience in some cases in South Dakota. If a retailer is allowed to purchase and own lottery machines, and is required to purchase a maintenance agreement on those machines equal to non-owned machines, we believe the "\$150 per machine or \$5,000, whichever is greater" fee as defined on lines 19 and 20 on page 14 of SB 695 will prevent many retailers from owning their machines due to the \$5,000 or whichever is greater verbiage. We suggest that those retailers who wish to own their machines be charged a fee higher than the \$150.00 per year fee. Since each such establishment will be restricted to a

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maximum of ten machines perhaps an annual fee of \$500 per owned machine is more realistic provided such retailers are allowed a mixture of both owned and non-owned machines.

Therefore if a retailer chooses to purchase five machines for example they would pay \$2500 and if the usage of those machines warranted additional machines the retailer could at his option arrange for non-owned machines from a regular operator who would pay fees as currently outlined in lines 19 and 20 on page 14 of SB 685. Such an amendment could generate even more revenue for the State. Our suggestion may also require amendments to lines 19 through 20 of page 16 of SB 695. However we maintain our suggestion of allowing retailers to own their machines will be a benefit to small retailers whose traffic would only support a few machines. Those retailers would not be at the mercy of an operator to decide whether or not, or how many, machines a retailer would receive.

We urge your consideration of our proposal and thank you again for allowing me this opportunity to testify in favor of SB 695.

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TESTIMONY ON SB 695

MARCH 9, 1992

Mr. Chairman, members of the committee

My name is Jerry Shelor, representing Past Enterprises, Incorporated

LET US VOTE

I want to begin by apologizing to any legislators who may be offended by any remarks today. However, I want to be totally candid in my remarks.

I was the lobbyist for liquor by the drink who cried out "let the people vote" on this issue beginning in 1984.

I was a lobbyist who cried out "let the people vote" on pari-mutuel betting in 1986.

I am now a lobbyist, who again, against the approval of many legislators is saying "let the people decide", let them "vote" locally on whether or not video lottery or casino gambling should be allowed.

There is no doubt in my mind that if a scientific poll was taken and released today an overwhelming majority of Kansans would want to vote on this issue. If you recall, over 80% of Kansans wanted to vote on liquor by the drink in 1985 and nearly 80% of the people desired to vote on pari-mutuel in 1986.

As a citizen, I am somewhat perplexed and offended that after 50 days of the 1992 session, an almost insurmountable effort has been exacted to deny American Natives, the Indians, their opportunity to better their livelihoods and future. To date, there are more bills introduced to stop Indian gaming than support video lottery.

In my opinion, if you want to stop Indian Casinos in Kansas you must do three things:

1. Abolish lottery by constitutional amendment.
2. Abolish pari-mutuel by constitutional amendment.
3. Place the abolishment of lottery and pari-mutuel on this fall's ballot for a vote of the people.

Realistically, I don't believe this is going to happen.

Yesterday, you heard testimony regarding South Dakota's video lottery. The South Dakota video lottery experience appears to be a positive one. What was not mentioned was that video lottery lives side-by-side with Indian casinos with little difficulty or problems.

I am totally confused by those who say video lottery is a form of entertainment totally different from casino gambling. THERE IS NO DIFFERENCE. Today's electronic equipment creates video casino gambling. In fact, one can lose money more quickly on a video poker game than one can sitting at a table leisurely enjoying a dealer's distribution of cards.

Federal law will eventually dictate that casino style gambling will be given to the people who were here first, the Indians. They will not be denied their rights under federal law and I am 100% for them. There will be casinos in Kansas in the near future.

With that presumption, I am asking you to consider giving cities a local option to establish video lottery districts upon a majority vote of its citizens. The amendment would:

1. Provide the opportunity for hotel/restaurant/economic development of downtown areas in places like Wichita and Kansas City.

2. Produce revenues for Kansas.

The proposed amendment, at this point, places a no limit exemption on the number of video machines per establishment in a video lottery district. It is no different than the exemption presently given race tracks in SB 695.

I am going to end my remarks with two simple words: VOTE and TAXES.

"Let the people VOTE" locally, a simple democratic procedure, on a video lottery district and TAXES. If the legislature in its wisdom decides to abolish pari-mutuel, the lottery and fails to pass video lottery, what additional TAXES are we going to have to bear?

I am sure many of you as elected officials understand that many people, including myself, have had all the TAX increases we can stand over the last few years.

I urge you to consider a local option to SB 695 for video lottery districts. Our state and cities will financially benefit from your favorable decision.

2-19-92

Except that there shall be no limit on the number of video lottery machines in a district designated by the local governing body of any city, provided the qualified electors of the city have determined by a majority vote of those voting thereon to permit the establishment of such district.

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Attach. 2

Testimony on SB 695

by

Stan Chilton, Wichita, Kansas

For Kansas Automatic Merchandisers Association (KAMA)

March 5, 1992

Mr. Chairman, Honorable Committee Members, my name is Stan Chilton, and I speak for Kansas Automatic Merchandisers Association (KAMA).

KAMA is a state wide association of automatic vending and coin-operated video, jukebox, and amusement machine operators. I am chairman of a VLT committee of KAMA. I have owned Chilton Vending Company in Wichita, Kansas for over 45 years furnishing coin-operated amusement machines and jukeboxes for central and northeast Kansas businesses.

I would like to speak in favor of SB 695.

Since video lottery seems to mean different things to different people, I'd like to start by analyzing just what video lottery really is.

What is Video Lottery or Video Lottery Terminals (VLTS)?

Video lottery is simply video versions of lottery games the Kansas Lottery has offered for the last four years along with bingo, all of which are played on a video screen. The lottery presently offers poker either on a "pull tab" ticket or "scratch off" ticket. Black jack is offered in a scratch off ticket. Keno is a separate lottery game, and bingo is a game separate from all others.

Video lottery offers these very same games, but only the hi-tech video aspect is new.

A video lottery terminal consists of a video screen, coin and bill acceptor systems to initiate play, a printer to print winners tickets and a computer which ties the whole system into a central computer at Lottery headquarters whereby activity can be monitored on a 24 hour basis. These systems are generally housed in a video arcade type cabinet but may be put into any configuration cabinet the manufacturer wishes or happens to have on hand.

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Each VLT is computer controlled by telephone line to state lottery headquarters, allowing full and absolute total daily accountability for all monies. The central computer provides the security, integrity, control and audit trail accountability necessary to ensure public acceptability and trust. The central computer has the capability to turn the VLT off or on if necessary. This type system is as secure and accountable as any other government accounting system.

Is a video lottery terminal a slot machine?

A video lottery terminal is not a traditional casino slot machine. A traditional slot machine is played by inserting a coin or bill and pressing a button or pulling a handle. From that point on, all a player can do is watch and hope. A win on a slot machine is immediately paid automatically by the slot machine in noisy coins. A VLT does not directly dispense coins but issues a ticket to the winner that is paid by the establishment in the same manner as a comparable amount winning lottery, pull tab or scratch off ticket.

But in a poker or blackjack mode, a VLT player has the option of holding wanted cards, disposing others or drawing new ones. The player's judgement and mathematical probability skills increase the player's chance of winning. I have enclosed an interesting article on video poker titled "Video Poker -- A Game of Chance or a Game of Skill" that sets forth some of the different percentages a player may consider before holding or drawing new cards.

In a VLT, players may play from 25 cents to a maximum of 2 dollars per game, and maximum winning amount per game is \$1000. Players winning percentages are required to be at least 85%.

VLTs offer high entertainment value and low stakes gambling.

Video lottery offers states an opportunity to explore the avenue as a non-tax, stable base of voluntary large revenue.

What income can the state of Kansas expect from video lottery?

Accurate estimates of video lottery terminal earnings for Kansas are possible by using known actual earnings from other states' VLT earnings.

By using a direct population comparison, Kansas could expect VLT earnings to be 3.56 times actual South Dakota earnings, not considering Kansas population has 17% higher per capita disposable income. The 3.56 population comparison is the lowest comparable of any data found.

Assuming only 37 weeks VLT operation (1st fiscal year) if a VLT bill is passed, Kansas could expect almost 66 million dollars for the state's share in the 1st fiscal year.

	SOUTH DAKOTA ACTUAL NET INCOME OF VLT'S	SOUTH DAKOTA ACTUAL STATE SHARE	ESTIMATED STATE OF KANSAS VLT NET INCOME	ESTIMATED STATE OF KANSAS SHARE
1ST 12 MONTHS VLT OPERATION	\$73,756,330 Oct. 14, 1989 to Oct. 14, 1990	\$16,591,111 (At 22.5%)	\$262,550,443 (Assumes VLT's operational July 1, 1992 - 52 wks operation)	\$105,020,177 (At 40%)
2ND 12 MONTHS VLT OPERATION	\$114,224,435 Oct. 14, 1990 to Oct. 14, 1991	\$28,016,989 (At 22.5% to Dec. 31, 1990. At 25% from Jan. 1, 1991 to Oct. 14, 1991)	\$406,604,721	\$162,641,889 (At 40%)

But whether or not the first fiscal year state's share of 66 million dollars or the first 12 months state's share of 105 million dollars, the continuing (after first year) annual revenues are between 151 million dollars and 182 million dollars, depending on the actual start up date. This is the true story of video lottery -- 150 to 180 million dollars per year -- after the first year. And it has proven to be not only stable but ever increasing for the other states and also the Eastern Canadian provinces that have embraced video lottery.

Montana started video lottery in 1986 and the state's share has increased from 15% to 25% per year each of the last five years. According to a recent report, video gaming machine revenue is still increasing at the rate of 7% per quarter. A graph and copy of a newspaper report are attached.

South Dakota quarterly net VLT income is also increasing steadily. A graph showing South Dakota net VLT income per 1000 VLTs installed is attached.

Where do the large amounts of money generated by Video Lottery come from?

The commonly held assumption that there are only so many gambling dollars to go around does not apply to VLTs, because:

1. Probably less than 5% of the net VLT revenue comes from other existing legal gambling venues.

VLTs are sometimes blamed for loss of revenue from existing forms of gambling, but detailed analysis and study proves otherwise. In West Virginia's Mountaineer Park race track, VLTs had a positive impact by stabilizing the declining handle and increased food and beverage sales. Mountaineer handle statistics fared no worse with VLTs than Charles Town Races did without VLTs.

In South Dakota, track decline started in 1983 and resulted in a track closing in 1991, but not as a result of video lottery.

Attached is a copy of Gaming and Wagering Business Magazine article entitled "West Virginia VLT Test A Success; Tracks Gain" and a comparison sheet between West Virginia tracks taken from "West Virginia Lottery, Video Lottery Project". An article on South Dakota track racing is attached and was taken from a University of South Dakota study, "Gaming in South Dakota".

2. University of Wisconsin studies and reports from coin operated amusement machine operators in South Dakota, Newfoundland and New Brunswick, Canada, show that 35% of VLT income is transferred from existing present earnings of amusement video games, pinballs, darts, shuffleboards, and pool tables located in the taverns and clubs where the VLTs are placed. When a VLT is placed side by side with any amusement only machine, the VLT will cannibalize 50% to 70% of that amusement machine's earnings.

Of course, if the amusement machine is removed to make room for the VLT, almost 100% of machines' earnings are transferred to the VLT.

Although the operator and the establishment lose the major portion of their amusement machine revenue, it is made up and more by the superior earning VLT.

3. Thirty-five percent of expected VLT revenue is presently going into "gray area" video poker machines. When the gray area games are removed and VLTs are installed, this presently untaxed, unregulated revenue is transferred to the VLT. SB 695 bars these gray area games as illegal on sight, regardless if they are being used innocently.

This 35% estimate is figured on a basis of 3000 gray area games and using South Dakota's exact income at their 3000 machine level adjusted to 40% as State of Kansas share = 34.5 million dollars.

4. At least 10% of VLT net revenue is from "new" money from players in surrounding states without a VLT program. The enclosed graph taken from a South Dakota study, "Gaming in South Dakota," illustrates per capita earnings in Union County to be six times the state average (in solid black).

North Sioux City and Vermillion, South Dakota are both in Union County in the south east corner of South Dakota just across the river from Sioux City, Iowa, and also very close to North-Eastern Nebraska.

The remarkable per capita increase can only be explained by a tremendous "crossover" of players from Sioux City, Iowa, which has no VLT program. Sioux Falls, South Dakota, is second in per capita VLT earnings and is also near the Iowa border.

Kansas could expect at least 10% of total VLT revenues from "crossover" players with most of this play coming near the Kansas-Missouri border (and especially Kansas City, Missouri, an area with almost as much population as the entire state of South Dakota.

5. Fifteen percent of VLT income is generated by new players who have no interest in playing regular lottery games, but are attracted to VLTs because of lower cost of play and higher win percentage as well as being able to affect the outcome of the game by using their skill and logic.

To summarize, VLTs being placed in bars, taverns, and restaurants with over 30% alcoholic beverage sales, do not directly compete with existing lottery products, 90% of which are sold in grocery stores and convenience stores.

Will VLTs lead to casino gambling in Kansas?

No. There will be a limit of 10 VLTs per licensed business establishment. SB 685 prohibits any advertising of VLTs and use of any words suggestive of a casino including the word "casino."

Most businesses will remove a like number of pinball, amusement, video darts, etc., to make room for the incoming VLTs; thus, the total number of machines should increase very slightly. A "casino" description is not appropriate for an establishment that offers only regular lottery games and a maximum of 10 VLTs. (South Dakota law limits VLTs to 10, but actually averages less than 5 VLTs per location.)

Will video lottery create an atmosphere or situation conducive to organized crime?

Susan Walker, South Dakota lottery director, in a letter (attached herewith) to a Vermont Legislative Liaison service, answers:

"Since 1964, with the advent of modern day state-operated lotteries, this has been a myth fostered by lottery opponents. There has never been an indicia of evidence of organized crime infiltrating any of the thirty-three state-operated lotteries, including South Dakota's video lottery. The South Dakota legislation provides for comprehensive background investigations, including financial and criminal history checks, of all licensees. Further, owners or operators of video lottery machines must be residents of the state. Because of the electronic security features and computerized accounting system, skimming and money laundering are simply not possible thereby eliminating the principal inducement for criminal involvement."

Alcohol and video lottery don't mix.

Answer by Susan Walker in above-referenced letter:

"A statewide survey was commissioned by South Dakota Lottery in 1990 to all establishment locations and the findings reported to Lt. Governor Walter D. Miller as Chairman of the South Dakota Tax Commission. The findings were as follows: (1) 74% of respondents reported that their total beverage sales had remained about the same; (2) 18% experienced an overall decline; and (3) 8% experienced an increase in beverage sales. The requirement that video lottery machines be located in establishments with an on-sale premises consumption license was to ensure play in age-controlled environments. It was designed primarily as a means to monitor under-age play by prohibiting machines in general public access areas."

Many Video Lottery players will become compulsive gamblers.

Answer by Susan Walker in above-referenced letter:

"There have been no scientific studies or evidence that would indicate that South Dakota has a higher than average rate of

compulsive gambling behavior. Counseling professionals have also stated that they do not single out video lottery machines as being compulsive per se.

In summary, video lottery machines has proved profitable and successful in the State of South Dakota. All machines are linked to a central computer system, which provides daily accounting and security information. South Dakota pioneered the first state video lottery program on October 16, 1989. Since that time, video lottery has generated \$29 million to the state general fund. The South Dakota regulatory framework for an efficient and successful state and private sector partnership."

The VLT success stories from South Dakota, Montana, West Virginia, and the Canadian provinces of New Brunswick, Newfoundland, Nova Scotia, and Prince Edward Island, prove that the public enjoys playing video lottery. Louisiana begins VLT operation later this year. VLT legislation is currently pending in Wisconsin, Iowa, Illinois, Maine, New York, Michigan, Minnesota, Indiana, Idaho, Massachusetts, Vermont, and neighboring Missouri.

With the private sector's small business person as the state's partner in a VLT program, everyone benefits. All studies to date and actual results of operator run VLT programs show at least 4 to 8 times more income to the state.

The continuing success of video lottery is fact and cannot be denied. This success proves the public enjoys playing video lottery not only for its low price theme of play, but also for its entertainment value.

Video lottery taps a relatively untouched regular lottery market, a market where regular lottery revenues amount to less than 3% of the state's lottery revenue.

Video lottery produces the large revenue needed by the state, which in Kansas's case, is 150 to 180 million dollars per year to the state annually after the first start up year. And the revenue is received by the state twice per month, not all at the end of the year.

VLTs are the future of the lottery business. They are proven and the facts presented here are true and documented. Thank you for allowing my testimony.

Scalping: it happens when the prize is up

By La Fleur

As the Florida lottery's jackpot grew at a record rate during September, culminating in a \$106.5-million prize, so did the number of private entrepreneurs reselling the \$1 ticket for \$5.

Reports surfaced around the country of private individuals flying or driving to Florida to buy up tens of thousands of lotto tickets for scalping.

Florida lottery secretary Rebecca Paul recounts one incident in which an executive employed by its on-line system vendor, Control Data Corp., encountered a scalper on a Manhattan street selling Florida lottery tickets at \$5. "Now he happened to know what a ticket looked like and they were our tickets," said an irate Paul.

A scalper can enjoy blockbuster

business whenever lotto fever strikes because lottery players are willing to pay a premium to get a chance at a mega-jackpot. Furthermore, the scalper only risks prosecution by the state in which the ticket is scalped.

Paul would like to stamp out all resale of lottery tickets, believing it represents "a tremendous danger" to the credibility and integrity of the lottery industry.

"But once it [a lottery ticket] leaves the state of Florida, Florida has no jurisdiction over any other state," she added. "It is illegal to sell a Florida lottery ticket for more than the purchase price. But once they take it to New York or some other place, it's under that state's jurisdiction."

Since scalping tickets generally occurs during times of record jackpots, Michigan lottery commis-

sioner Michael Carr dismisses it as a small problem in relation to mail order lottery subscription firms.

"If somebody comes up to you and asks you to buy a Florida lottery ticket for \$5 and you're willing to do it, I don't see how the state of Michigan is harmed," said Carr. "If you're sucker enough to do it, then that's that."

"Scalping goes on for sporting events, entertainment events. It's very hard to get a good seat at popular concerts these days. Scalpers are controlling all the good seats. Nobody seems overly concerned about that. After all, these people just want to play [the lottery] for the pleasure. I think we've got a much bigger problem with the mail order houses reselling lottery tickets."

One solution to scalping tickets would be an agreement among state lotteries to permit resale of one another's \$1 tickets for \$1.50. This would cut the scalpers out of the business because lottery play-

ers could now legally purchase out-of-state lottery tickets.

In Florida, the lottery is studying possible intergovernmental agreements with several different Latin jurisdictions to resell Florida tickets and share profits.

"The only way to put the scalpers out of business is to figure out a way to handle out-of-state ticket sales legally," said Paul. "That's one of the things we're working on with other countries who've come to us to ask for help in getting out of this problem. I don't know any other way to do it other than to let that government and their lottery keep the same percentage of profit as they would on their own lottery."

Other lottery executives suggest reciprocal agreements between lotteries for reselling tickets in the United States could only lead to unbridled competition among the states and further, that small-population lotteries with little lotto games would suffer most in the long run.

Lottery state gubernatorial races

The 1990 gubernatorial contests in 23 lottery states may result in a number of lottery executives being unseated. Here's the rundown on lottery states where elections occurred:

Jurisdiction	Incumbent Won	Party Changed	Administration Changed (same party)
Arizona			
California	X		
Colorado	X		
Connecticut		X ²	
Florida		X	
Idaho	X		
Illinois			X
Iowa	X		
Kansas		X	
Maine	X		
Maryland	X		
Massachusetts		X	
Michigan		X	
Minnesota		X	
New Hampshire	X		
New York	X		
Ohio		X	
Oregon			X
Pennsylvania	X		
Rhode Island		X	
South Dakota	X		
Vermont		X	
Wisconsin	X		

Incumbent victories: 10
Party changes: 9
Administration changes (same party): 3
Recounts: 1 (Arizona)

¹ Governor's race too tight to call; to be decided in runoff vote in early 1991
² Gov.-elect Lowell Weicker, Jr. ran as an independent

Indiana lottery to join Lotto America lineup

The Indiana lottery is celebrating its first anniversary by joining the multistate Lotto America game.

With jackpots routinely reaching \$18-\$20 million, Lotto America is expected to become Indiana's big-money game. The game will complement an existing product mix that includes a variety of instant games, an all-time little lotto and the numbers game.

The Indiana lottery was created by legislation approved by the 1989 Indiana general assembly. Ticket sales began five months after the bill was signed into law.

First-year sales are expected to top \$500 million, with profits dedicated to capital construction projects; to support of pensions for police officers, firefighters and teachers; and to offset vehicle excise taxes.

W. Virginia VLT test a success; tracks gain

The West Virginia lottery grossed \$2.1 million during a four-month test of video lottery terminals (VLTs) at Mountaineer Park racetrack, exceeding the \$2 million estimate of state officials.

During the trial period, weekly VLT sales skyrocketed from \$58,000 in June to \$204,144 for the week ended Sept. 29.

The VLTs (vendor: Scientific Games) have also had a positive impact at the track. Since their introduction, Mountaineer Park of-

officials said, on-track handle has stabilized and lodging, food and beverage sales have increased by as much as 30% over the same period last year.

West Virginia lottery director E.E. "Butch" Bryan expects to license additional parimutuel facilities to offer video gaming now that the four-month testing period is completed. Wheeling Downs officials currently are negotiating with the state, with a contract expected to be completed this month.

Lottery Appointments

Bill Forney has been named the new advertising manager for the Arizona lottery. Forney was previously with the state's department of law, cated by Nancy Elkins, who left the lottery after seven years to pursue other interests.

Idaho lottery. Klinger joined the lottery in 1989 after serving with the state's department of law enforcement and the Idaho Bureau of Investigation.

Mark Klinger has been named deputy director of security of the

Kurt Wise has been named director of public relations for the Indiana lottery.

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VIDEO LOTTERY PROJECT
Mountaineer Park: Chester, WV

One Year Results
June 9, 1990 through June 8, 1991

Mountaineer Park

Handle and Attendance Statistics

Comparison to Charles Town Races

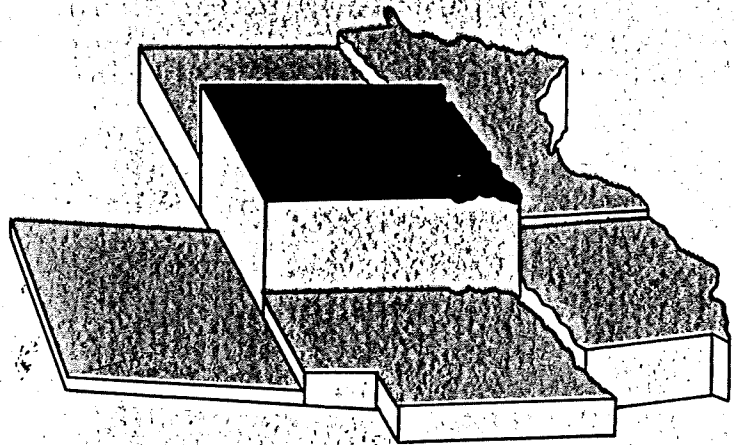
	<u>1 Year Prior to Video Lottery</u> <u>June 1989 through May 1990</u>	<u>With Video Lottery</u> <u>June 1990 through May 1991</u>	<u>Percent</u> <u>Increase/Decrease</u>
<u>Handle Statistics</u>			
Mountaineer Park	\$48,994,215	\$45,815,837	-6.48%
Charles Town Races	\$97,579,729	\$89,693,830	-8.08%

Attendance Statistics

Mountaineer Park	425,843	395,003	-7.24%
Charles Town Races	748,054	700,759	-6.32%

**Study of
South Dakota Gaming**

November 1991



Published by Business Research Bureau, University of South Dakota

Gaming in South Dakota

A Study of Gambling Participation and Problem Gambling

AND

**A Statistical Description
and**

Analysis of Its Socioeconomic Impacts

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Greyhound racing has historically taken place in two locations in South Dakota. The Black Hills track near Rapid City and Sodracs in the southeast corner of the state are the only greyhound tracks in South Dakota. The traditional operating season for these operations spanned the late spring to early fall each year. Business volume at the Sodracs track is heavily dependent on population centers in South Dakota, Iowa and Nebraska. Black Hills vacation travelers accounted for much of the volume for the western South Dakota track.

The Black Hills track was not in operation in 1991 after experiencing declining public interest for many years. Total betting dropped from a high of about \$8 million in 1983 to only \$2.5 million in 1990. Although still operating in 1991, the Sodracs track has experienced a drop in betting to \$2.7 million in 1991 from about \$26.4 million in 1983.¹ Although the decline in greyhound racing interest can be partially attributed to competition from other forms of gaming, the downward trend in this industry began many years before 1987.

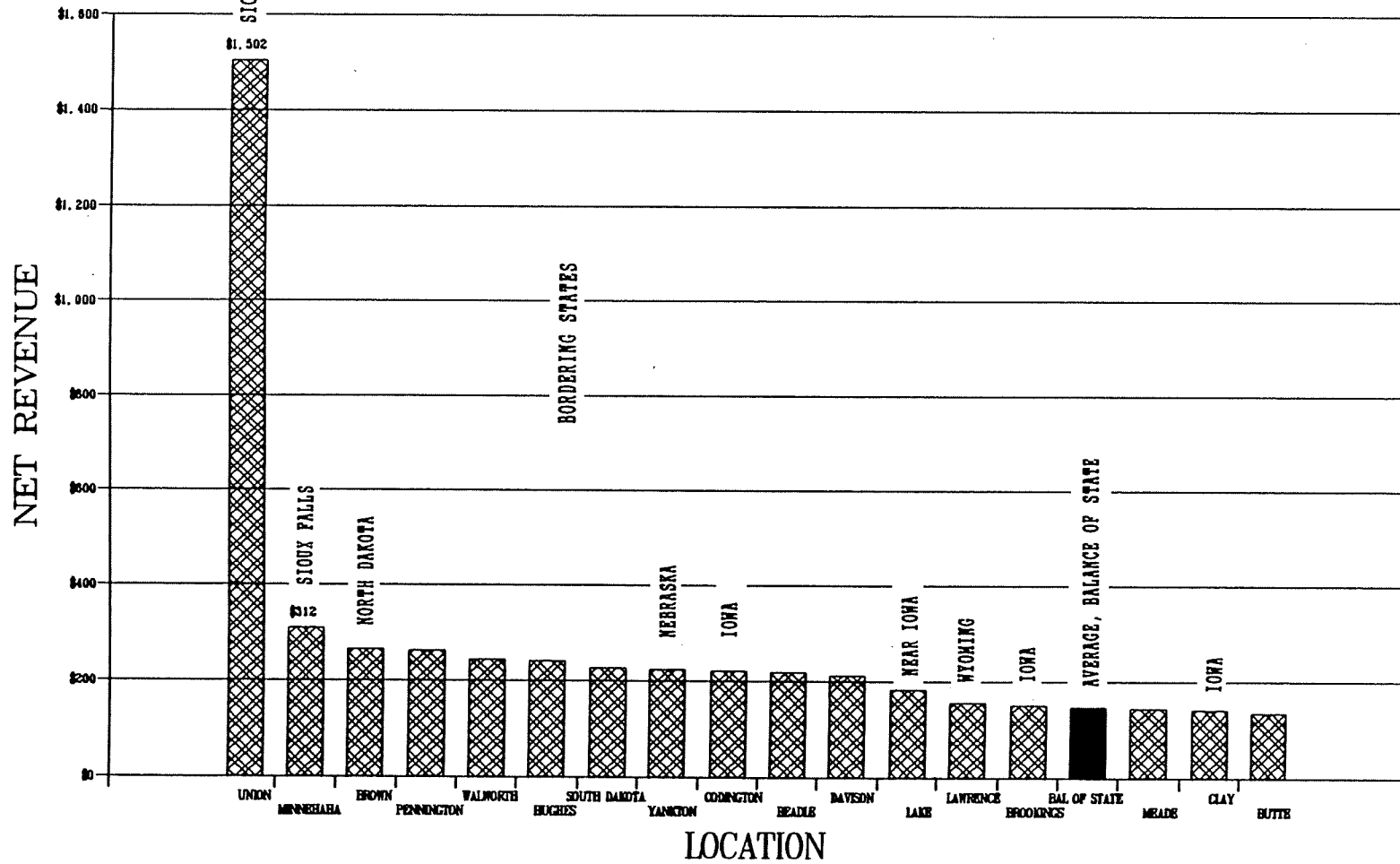
Historically, horse racing took place at Park Jefferson in Union County, Fort Pierre, Aberdeen and Rapid City. Both Park Jefferson and Rapid City discontinued operations in the nineteen eighties leaving only Fort Pierre and Aberdeen as centers of horse racing activity. Today fifteen week-end race days are divided between these two tracks in April and May.¹

Horse racing betting volume has steadily decreased in South Dakota during the last decade. Betting on live horse racing now only totals about \$500,000 for the two remaining tracks in the State. In 1981, the total horse racing handle was about \$3.7 million. In fiscal year 1991, Simulcast, remote video racing from out of state tracks generated total spending of \$4.2 million.

Because of the present marginal financial status of the remaining dog and horse racing operations, virtually no revenue accrues to state government. Gross wagering is divided between winnings to bettors and added purse allowances to race participants.¹

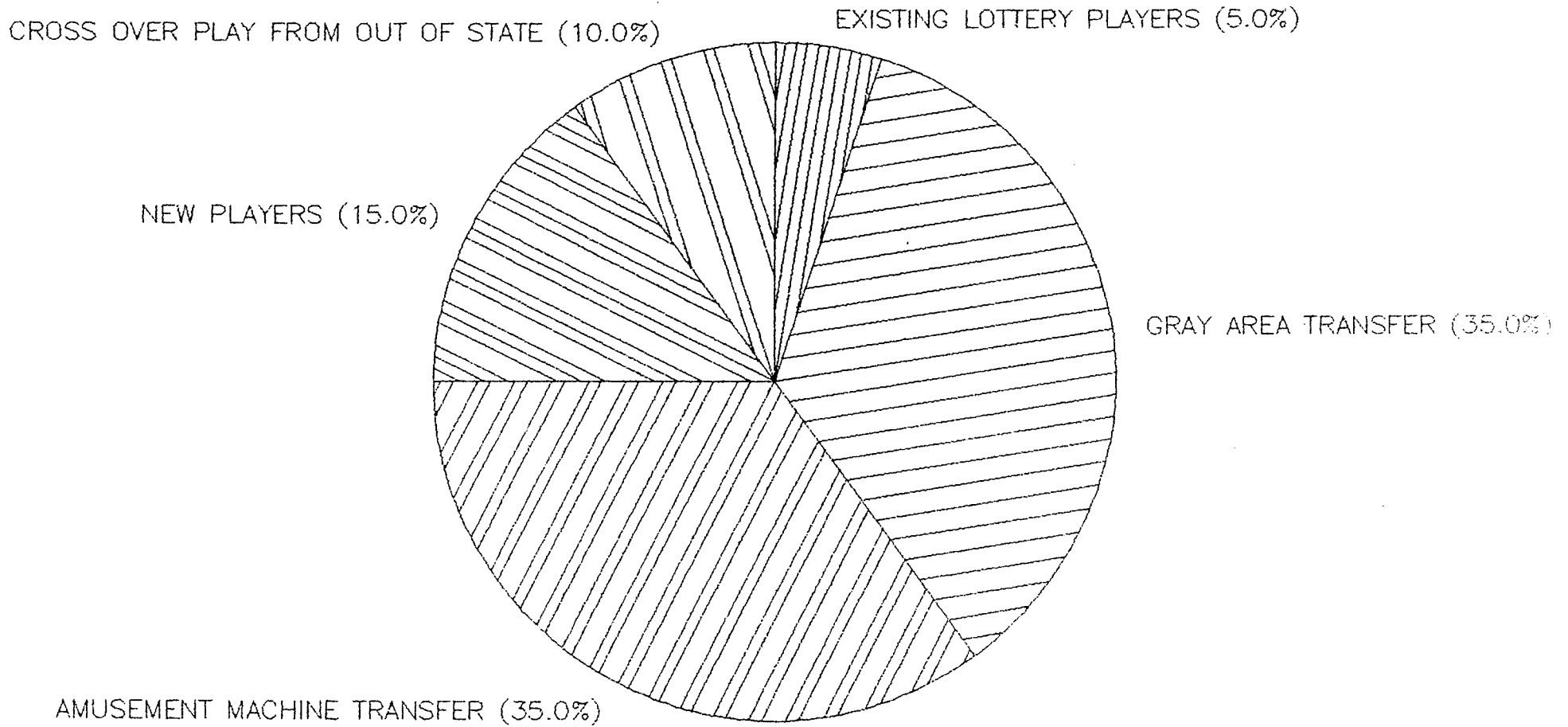
GRAPH 12

NET VIDEO REVENUE
PER LOCATION PER CAPITA



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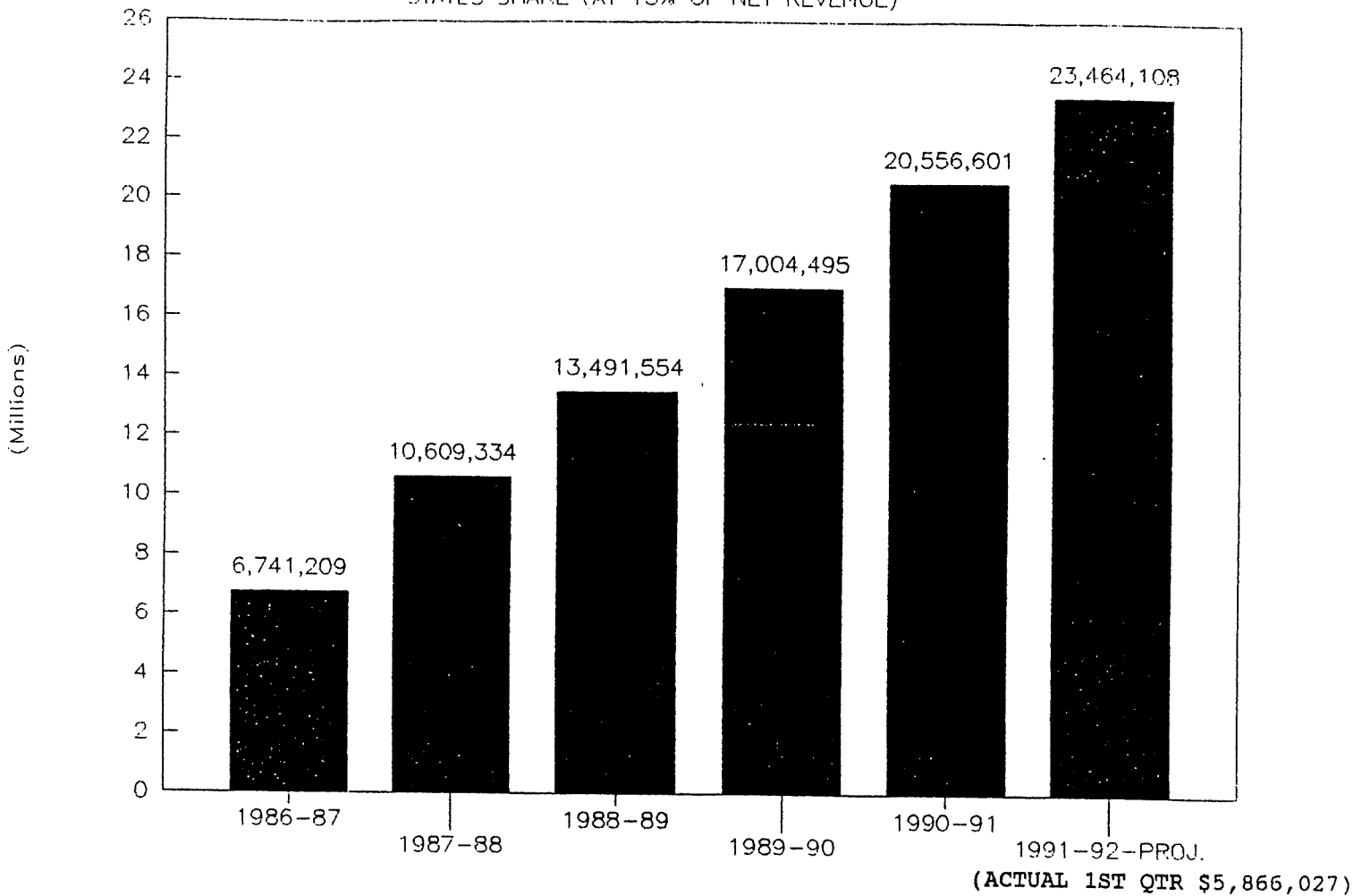
STATE OF KANSAS
ESTIMATED SOURCES OF NET VLT INCOME



ATT. 3
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MONTANA VIDEO LOTTERY REVENUE

STATES SHARE (AT 15% OF NET REVENUE)



FRIDAY **Missoulian**

FEBRUARY 7, 1992

MISSOULA, MONTANA

50 CENTS

State says gambling is paying off

HELENA (AP) — Montana's gambling industry continues to be a good bet for growth, a new state report shows.

Tax collections from video gaming machines doubled during the last four years, and revenue is growing at the rate of about 7 percent every three months, according to the Gambling Control Division document.

The number of permits for the machines increased by 13 percent to 12,509 during the past two years. About six out of 10 machines are poker and the rest are keno.

"There is a steady growth, and I don't see any reason to expect a change in that," Bob Robinson, division administrator, told the Gaming Advisory Council on Thursday.

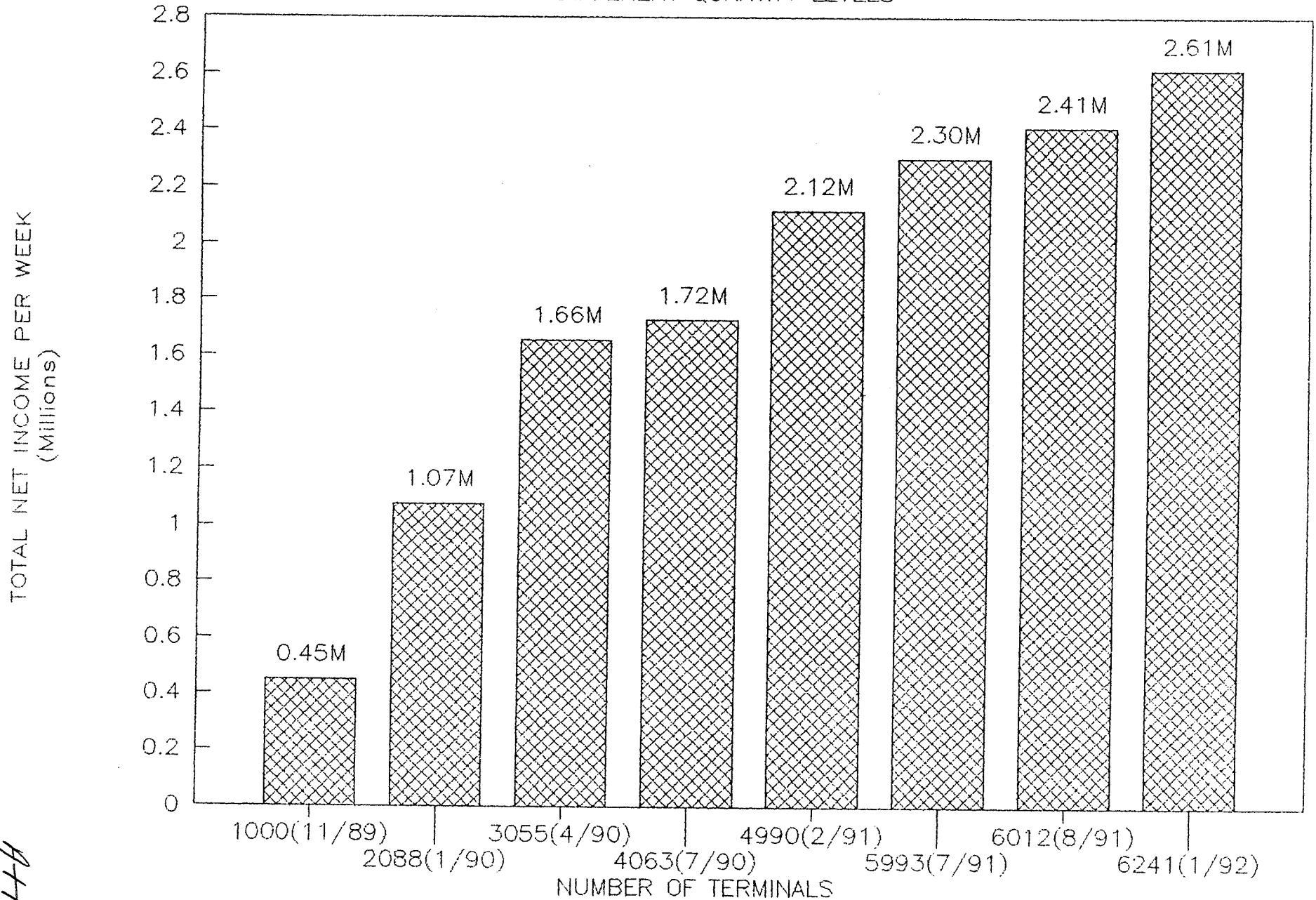
The state collected \$10.5 million in taxes from video gambling machines in the year that ended June 30, 1988. That amount grew to \$13.3 million the next year, \$17 million the following year and to \$20.5 million last year.

From the most recent tax collections, local governments received \$13.7 million, and \$6.8 million was deposited in the state treasury.

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SOUTH DAKOTA VLT INCOME REPORT

AT DIFFERENT QUANTITY LEVELS



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Video Poker

Game of chance or game of skill?

By John "Jack" Miller

Many states have laws prohibiting games of chance; the problem is defining a game of chance. Some state officials have looked at a video poker machine and said "that looks like a slot machine, and slots are games of chance, and games of chance are illegal."

Well, looks can be deceiving. Sure, a video poker machine looks like a slot machine, but is it or isn't it a slot machine? I say it is not a game of chance. Well, not entirely.

By now you are probably scratching your heads and saying "Okay, Miller, make your point." To do that, we need to reach a common understanding of a few key terms.

Let's assume that the video poker machine is of the type used in Nevada. That is, it pays for a single coin bet, one coin for jacks or better, two coins for two pair, three coins for three of a kind, four coins for a straight, six for a flush, nine for a full house, 25 for four of a kind, 50 for a straight flush, and 500 for a royal flush. This pay table makes it a 95.5% payback machine, according to industry standards.

Video poker machines used in Nevada are of various types and makes, although they do have a number of features in common. Upon insertion of a coin, they all access a Random Number Generator that produces at least 10 symbols representing the faces of playing cards. Then they check electronically to ascertain there are no duplicates of value and suit. Finding none, they arrange these symbols in positions from 1 to 10, or higher, depending on the machine. Should a duplicate card be identified, the Random Number Generator replaces it with another symbol and repeats the duplicate-checking process. Playing a single coin or multiple coins has no effect on the card arrangement.

When the player exercises his option to play the game and pushes "Deal"—or otherwise activates the game—the first five cards, generally speaking, are displayed on the video screen. The player then exercises his option to hold or discard any or all of the displayed cards. If the player discards two of the cards shown and selects "Draw," the cards numbered six through seven in the remaining stack are displayed. If the player discards three of the cards shown and selects "Draw," then the cards numbered six through eight are displayed.

These video poker machines are programmed using a standard 52-card deck. Therefore, the odds for a video poker player to receive any particular hand in the first five cards displayed are in theory the same as they would be in a conventional, noncomputerized poker game.

To this point, the video poker ma-

chine clearly qualifies as a game of chance.

Continuing the video poker game, the player must in most cases select from the displayed five cards those that should be held to make a winning hand. If, for example, the cards displayed are three fives, a jack and a two, there is little choice but to discard the jack and two in hope of drawing a fourth five or a pair of some denomination, for four of a kind or a full house. In any event, the player will be paid for the three of a kind he's holding. Even the novice player is most likely to hold the three fives.

Let's assume that the five cards displayed consist of a six, nine, 10 and jack of hearts, while the fifth card is a jack of clubs. Most video poker machines return the bet if the player receives jacks or better. In this case, the player must decide if he wants to discard the certain pair and take a chance on receiving a fifth heart, for a flush.

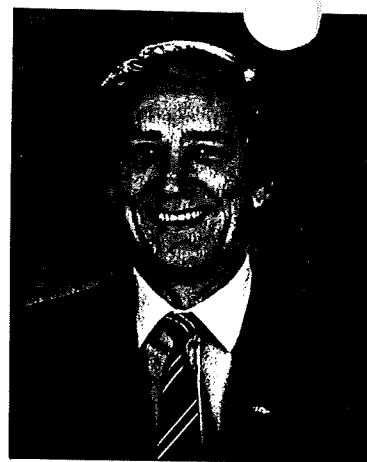
The odds of receiving a hand that cannot be improved on in the first five cards displayed are very low. Thus the option to draw cards is exercised in most every case. This means that the skilled player must use his skill, while the average player must rely on his best judgment and luck.

The skilled player also knows there are nine remaining hearts in the deck of 47 cards, giving him a 19.15% chance of obtaining the heart necessary to make his hand a winning hand and receive five coins back for each coin wagered. The skilled player also knows that there are two other jacks in the deck, giving him three chances to obtain one of these or a 12.75% chance of increasing the assured payout. However, the skilled player also knows that the remaining 47 cards consist of four each of the following cards: aces, twos, threes, fours, fives, sevens, eights, queens and kings, and three each of the following: sixes, nines and 10s. By discarding the six, nine and 10 of hearts, he knows that he has lost nothing, he will receive his bet back, he has a 12.75% chance of drawing at least one other jack and he also has the chance of getting another pair, three of a kind or possibly two of the jacks, giving him four of a kind. All of these possibilities will increase his payout. The skilled player would hold the two jacks. If the six of hearts was a seven of hearts, the player would need an eight of hearts to fill an inside straight flush, a 2.12% chance added to the now 17.02% chance for any other heart for the flush. If the six of hearts was an eight of hearts, the player would be open on either end for the seven or queen of hearts to obtain the straight flush, increasing the chance for the straight flush to 4.25% plus the

17.02% for the flush. With the payout being 50 to 1, the skilled player would discard the jack of clubs because of the payout odds.

The odds of receiving a hand that cannot be improved on in the first five cards displayed are very low. Thus, the option to draw cards is exercised in most every case. This means that the skilled player must use his skill, while the average player must rely on his best judgment and luck in most every hand played.

Video poker machine percentages are set by the pay table odds, which are calculated to allow the casino ("house") to win a certain percentage of each dollar wagered over an indeterminate period of time. It is a fact that the manufacturers of these video poker machines set the pay table odds based on the skilled player. One merely needs to examine the set percentage of a particular device and compare that to the actual win percentage to determine whether the machine is



John "Jack" Miller

machines, video poker machines and other gaming devices. To my knowledge, the authorities have in all instances rested their cases on one key fact: Each offending video poker machine was equipped with a "Knock-Off Switch." This piece of add-on equipment enables the operator to cancel or "knock off" any credits built up by a player. These "Knock-Offs" have progressed from the switch on each game to the remote switch behind the bar and most recently to handheld units similar to a TV channel changer or garage door opener. The "Knock-Off" switch has only one use: to convert an amusement game to a gambling game, in violation of the law. That is why the games were seized in the first place and why their operators were convicted. Whether it is of the coin in-coin out type or dispenses tickets, a video poker is a gambling device. It is, however, more a game of skill than a game of chance.

John "Jack" Miller is the president of Integrated Gaming Specialists. He has spent 33 years as a sworn law enforcement officer, 11 of which were with the Nevada Gaming Control Board as an Enforcement and Special Investigations agent. He also ran the New Game Laboratory for the state and has testified at all court levels in Nevada, including federal, as an expert in slot machines and other gambling games. He has represented the state as an expert and game instructor in Michigan, Wyoming, Washington, Australia, Canada and the Bahamas as well as Nevada and has lectured to civic and political groups.

Bally names Laura Rezek new marketing manager

Bally Gaming Inc., Las Vegas, Nev., has announced the appointment of Laura J. Rezek to the position of marketing manager. Her responsibilities will include all advertising, sales promotion planning and materials, trade shows and public/press relations.

Ms. Rezek's coin-op experience includes the posts of marketing manager for Williams Electronics Games, Inc. and advertising director for Bally/Midway, the amusement games division pre-

viously owned by Bally Manufacturing Corp. Ms. Rezek has also worked for two Chicago ad agencies.

Commenting on the appointment, Bally Gaming vice president of marketing, Robert M. Dickenson, said "Laura brings a fresh bank of knowledge and creativity to Bally Gaming. Her talent and enthusiasm will make her a key member of the marketing team as we continue to prove our dedication to excellence in the gaming industry."

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207 East Capitol • Suite 200 • Pierre, SD 57501 • (605) 773-5770

April 10, 1991

Anthony Otis
Legislative Liaison Services
P.O. Box 1462
Montpelier, VT 05601-1462

Dear Mr. Otis:

I am writing at your request to share information and respond to claims regarding the operation of South Dakota's video lottery program. I will respond to each claim presented in your letter, with the hope that misunderstandings of this new product can be dispelled based on our experience.

Claim 1: Video Lottery will create an atmosphere or situation conducive to organized crime.

Response: Since 1964, with the advent of modern day state-operated lotteries, this has been a myth fostered by lottery opponents. There has never been one indicia of evidence of organized crime infiltrating any of the thirty-three state-operated lotteries, including South Dakota's video lottery. The South Dakota legislation provides for comprehensive background investigations, including financial and criminal history checks, of all licensees. Further, owners or operators of video lottery machines must be residents of the state. Because of the electronic security features and computerized accounting system, skimming and money laundering are simply not possible thereby eliminating the principal inducement for organized criminal involvement.

Claim 2: The personnel at licensed locations will be subjected to assaults or be unable to control unruly players.

Response: There have been no reports in South Dakota of assaultive behavior related to disputes over access to machines or claims of machine malfunctions. The machine's recall feature quickly and fairly resolves any player claims that a machine has not properly awarded credits.

Claim 3: Alcohol and video lottery don't mix.

Response: A statewide survey was commissioned by the South Dakota Lottery in 1990 to all establishment locations and the findings reported to Lt. Governor Walter D. Miller as Chairman of the South Dakota Tax Commission. The findings were as follows: (1) 74% of respondents reported that their total beverage sales had remained about the same; (2) 18% experienced an overall decline; and (3) 8% experienced an increase in beverage sales. The requirement that video lottery machines be located in establishments with an on-sale premises consumption license was to ensure play in age-controlled environments. It was designed primarily as a means to monitor under-age play by prohibiting machines in general public access areas.

Claim 4: Video lottery and the cash in machines has provided a tempting target for criminals leading to increased burglaries of licensed establishments.

Response: The incidence of burglaries of licensed establishments and machines have been minimal. From the period of January 1, 1990 to January 1, 1991, four percent or 57 of the 1,249 licensed establishments and three percent or 169 of the 4908 machines had been burglarized. It should be noted that over twenty burglaries were committed by two individuals. This quarter, burglaries are down 75% from the previous period due in large measure to the fact that machines are emptied daily and security systems have been installed in the vast majority of establishments.

Claim 5: There has been an increase in bad checks given to establishments.

Response: Again, according to our survey respondents, 68% have experienced no increase in the incidence of bad checks since video lottery. After nearly a year of operation, estimated bad checks totalled 4/10ths of one percent of total cash in (\$163,000). Any increase in bad checks cannot be attributed solely to video lottery. Like many other states, South Dakota and its citizens have experienced the recessionary pressures of the national economic downturn.

Claim 6: Many South Dakotans have become compulsive gamblers due to the introduction of video lottery.

Response: There have been no scientific studies or evidence that would indicate that South Dakota has a higher than average rate of compulsive gambling behavior. Counseling professionals have also stated that they do not single out video lottery machines as being compulsive per se.

MEMORANDUM

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Attach. 4

Kansas Legislative Research Department

Room 545-N - Statehouse
Topeka, Kansas 66612-1586
(913) 296-3181

Revised
January 20, 1992

To: Legislative Coordinating Council

Re: Video Lottery

This memorandum responds to a request by the Legislative Coordinating Council on May 29, 1991, to review information already prepared on video lottery and to refine material on this subject matter and generate revenue estimates in order to provide as much "hard data" as possible for the 1992 Session.

This memorandum is divided into six sections. The first section provides background information about video lottery games and raises policy questions which are further addressed in the ensuing sections of the memorandum. The second section reviews the major provisions of legislation authorizing video gambling in the states of Montana, South Dakota, Oregon, Louisiana, and West Virginia. The third section raises policy concerns and issues stemming from legislation governing regulation of video gambling machines, as well as implementation of this form of gambling. The fourth section examines revenues generated by video lottery games in South Dakota, Montana, West Virginia, and Oregon (projected) where state-regulated video gambling machines are in operation. The fifth section addresses possible implications of video lottery for state revenues in Kansas, using assumptions extrapolated from South Dakota's experience. South Dakota was chosen as a basis for comparison because video lottery in that state is regulated by the South Dakota Lottery and has been in operation since October, 1989. Moreover, 1991 Sub. for S.B. 449 was patterned after South Dakota's video lottery law. The Kansas bill was passed out of the Senate Committee on Federal and State Affairs but was subsequently killed by the Senate during the 1991 Session. The sixth section raises major policy questions to be considered by the Legislature in formulating legislation.

It should be noted at the outset that a provision in the *Kansas Constitution* (Article 15, Section 3c) authorizes the Legislature to "provide for a state-owned and operated lottery." This provision has certain implications for video lottery implementation in Kansas (to be further discussed below). One major implication is that video lottery statutes in other states might not be completely compatible with this constitutional provision.

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SECTION I – BACKGROUND

Where Are Video Lottery Games Regulated?

Video gambling is currently regulated by the states of South Dakota, Montana, and West Virginia, and by Manitoba, Alberta, New Brunswick, Prince Edward Island, Newfoundland, and Nova Scotia, Canada. Oregon and Louisiana authorized regulation of video lottery in 1991 but have not yet initiated games. In South Carolina, cash-payoff poker machines are legal but not state regulated. In most states, including Kansas, possession of video gambling machines is legal but cash payouts to winners are illegal under federal and state laws.¹

What Are Video Lottery Machines and Video Lottery Games?

Video lottery is an electronic game of chance. An example would be a machine that "deals" a hand of draw poker. Video gambling machines or devices are either part of an automated network or they are not. For example, in Montana the machines must have internalized meters but they are not hooked to a centralized computer. By contrast, South Dakota regulates video lottery terminals (VLTs). A VLT in that state is an "on line" coin-operated video gambling machine that allows one to play bingo, keno, blackjack, and draw poker games. VLTs do not pay out money but instead generate vouchers from an internal printer. The voucher is then given to the owner of the establishment who pays the winner.²

In South Dakota, West Virginia, and the Canadian provinces the VLT, which is hooked up by modem to the central computer in the state lottery, transmits data to the central headquarters each day. The computer prints information that includes such items as cash deposited into the VLT, net income, number of credits played, number of credits won, and game play statistics, such as winning combinations and frequency of play. In Oregon, the State Lottery decided in November, 1991 to connect VLTs via dedicated telephone lines to the central computer; the intent is for VLTs to transmit data on a continual basis to the computer, instead of at certain intervals, as is the case with the "dial-up" mode of linkage.³

¹Throughout the memorandum, reference is made to "gray machines" which are video lottery machines not licensed or certified by a government which regulates video lottery games. For example, if Kansas were to regulate video lottery machines, machines currently in operation which would not become certified by the state would be considered "gray machines." "Gray machines" may be operating either legally or illegally.

²Payouts to winners from video lottery games are generally set in statute at a higher maximum percentage (80-92 percent) of total gross revenues than they are for other types of lottery games. However, the tendency of individuals to play more video lottery games after they have won lowers the percentage of actual payouts or prizes to 55-64 percent of total gross revenues.

³West Virginia uses a dedicated line to link its VLTs to the central site but data are not polled on an ongoing basis.

*Gray machines are those NOT regulated +
recognized by State + NOT on line*

*A++ 4
2*

The advantage of an on-line system, in contrast to a decentralized system, is greater security because more information is being imparted to regulators on an ongoing basis. The disadvantage is the initial installation expense.

What Is a State's Primary Objective for System Implementation?

There are several options for configuring a state video lottery system and each state has embarked upon a different course of action. However, prior to making determinations about configurations, states are faced with the central policy question about their primary objective for involvement in video lottery. Is the primary objective to ensure maximum security and regulation of a formerly illegal activity? Alternatively, is the primary objective to maximize state return from a new revenue source?

States and those Canadian provinces which regulate video lottery games have made different choices in their implementation strategies and those choices were largely dictated by their policy objective. These two objectives are not mutually exclusive and, as will be evident from the discussion below, all governmental participants in video lottery systems have concerns related to each objective.

Which Entities Run Video Lottery Programs?

Video lottery programs are operated by either private parties (operators) or state or provincial governments. Montana, South Dakota, West Virginia, New Brunswick, and Prince Edward Island have implemented systems in which private operators purchase video lottery machines and install, service, and repair equipment at licensed retail locations. Louisiana intends to have private operator participation, as well. By contrast, Nova Scotia, Newfoundland, Manitoba, and Alberta have government-operated programs and Oregon intends to do the same. There are no private operators in those programs and the government has direct responsibility for the purchase, installation, service, and repair of the VLTs.

At least in theory, greater state control suggests fewer outside participants (operators, service, and maintenance personnel) and greater system security which might be offset to varying degrees by less aggressive market penetration and more modest gross revenues (points addressed below). Once again, the state's primary objective for involvement in video lottery would affect its decision on who should operate the games.

Which Agency or Agencies Oversee Video Lottery Games?

In Montana video lottery operations are regulated by the Department of Justice and in Louisiana by the Department of Public Safety and Corrections.⁴ In South Dakota, West Virginia, and Oregon, oversight of operations is the responsibility of these states' lotteries. Because the *Kansas Constitution* requires lottery games to be operated by the state (see Attorney General's Opinion No. 87-38), one might assume that, at a minimum, the responsibilities associated with the operation of video games would ultimately have to be the domain of the Kansas Lottery. Law enforcement

⁴Both states also have Lottery Commissions.

entities could become involved in associated regulatory activities. To the extent that the role of the Kansas Lottery historically has been to promote participation in lottery games, such a separation of responsibilities might be considered by the Legislature if the basic policy objective is to regulate a heretofore illegal business rather than to maximize participation and revenue.

What Are Options for Operation of Video Lottery?

If one assumes that the Kansas Lottery would own and operate video lottery games in accordance with the *Kansas Constitution* (see above), there are several options which the Legislature might consider in assigning such oversight responsibility:⁵

1. The Lottery could own or lease VLTs and provide placement and maintenance services to retailers.
2. The Lottery could own or lease VLTs and contract for services to retailers.
3. The Lottery could administer the games with retailers owning the VLTs. Services could be provided either by the Lottery or operators.
4. The Lottery could contract with operators for the placement of games within retail establishments. Operators could own VLTs or gaming devices and provide all applicable service.
5. The Lottery could contract with operators for the placement of VLTs within retail establishments. Retailers could own and operate VLTs. Operators could provide applicable services.

South →
DAKOTA
has same

SECTION II – LEGISLATION ON VIDEO LOTTERY

Montana

Video gambling is currently regulated by the Montana Gambling Control Division of the Department of Justice under the Attorney General and has been subject to regulatory oversight since 1985 with the enactment of the Video Draw Poker Control Act. In 1987 the Legislature expanded regulation over video gambling machines to include, in addition to draw poker, keno and bingo. Only keno machines were "grandfathered in" upon enactment of the laws governing video lottery. Video gambling machines may be placed in a room or area of a licensed operator's premises where alcohol is sold or consumed (also includes convenience stores and truck stops) and must be located within

⁵If one does not automatically assume that the Lottery would own and operate video lottery games, the word "Lottery" in the options below should be replaced by the word "state." Options 3-5 might be of questionable constitutionality if certain factors are not addressed sufficiently in implementing the statute. Attorney General's Opinion No. 92-1 cites some of the elements necessary for state control of video lottery games.

Att. 4
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the operator's control to prevent the play of machines by persons under age 18.⁶ An operator is allowed to place any combination of up to 20 machines (poker, keno, or bingo) on the licensed premises. Unless permitted by local ordinance, no video gambling machine may be played between 2:00 a.m. and 8:00 a.m.

The statutorily-prescribed percentage of credits won to credits played must be at least 80 percent. Not more than \$2 may be played per game and free games or credits may not be awarded in excess of the following amounts: \$100 a game for draw poker and \$800 a game for keno or bingo.

Each operator must pay an annual machine permit fee of \$200; the fee must be prorated on a quarterly basis. Fifty percent of the fee is retained by the Department of Justice for administrative purposes and the remainder is returned on a quarterly basis to the local governmental jurisdiction in which the machine is located.

A licensed operator also must pay the Department of Justice a video gambling machine tax of 15 percent of the gross income from each video gambling machine; this is 15 percent of the money put into the machine minus credits paid out in cash and minus amounts stolen from machines if such amounts are uninsured and under investigation by a law enforcement agency for theft. Of the 15 percent received, one-third is credited to the State General Fund and two-thirds are remitted to local governments.

Each manufacturer-distributor of video gambling machines must pay an annual license fee of \$1,000. Statutory provisions allow the Department to charge one-time application processing fees for such licenses. Licensed operators who are not licensed as manufacturer-distributors may sell up to 20 machines within a calendar year under certain specified conditions.

The Department of Justice is authorized to inspect, test, approve, disapprove, or place a condition upon a video gambling machine prior to its distribution and placement for play by the public. The manufacturer-distributor is required to pay the Department for costs of examining the machine.

There are criminal penalties for violations of this Act.

Given the decentralized nature of system (machines are not on-line to a central computer), the scope of participants which includes operators, and the absence of statutes to prohibit vertical integration, the state apparently viewed its primary objective as that of reaping some but not maximum revenue from regulation of activities that were previously illegal. Because Montana (July 1, 1987) was the first state or province to regulate video lottery, its configuration lacks the sophistication and initial capital outlay found in states with on-line systems.

South Dakota

The South Dakota Lottery has licensed and regulated video gaming activities since October 16, 1989. Video games presently authorized are blackjack, poker, bingo, and keno. VLTs

⁶In Montana's statutes, the term "operator" encompasses retailer responsibilities in contrast to the meaning of that term in other states' video lottery statutes.

must be located in licensed establishments at which alcoholic beverages (liquor, malt, and wine beverages) are dispensed and consumed. Laws for licensed establishments initially allowed convenience stores to qualify for licensure, but the 1991 Legislature essentially eliminated the entry of convenience stores into video lottery by tightening restrictions on eligible establishments. Establishments licensed prior to January 1, 1991 were "grandfathered in."

VLTs must be located in areas that are monitored at all times by the owner, manager, or an employee of the licensed establishment to prevent access to or play of VLTs by persons under the age of 21. If a licensed establishment allows multiple uses of its premises which serve various age groups, a permanent physical barrier (statutorily defined) must be erected to prevent under-age individuals who are unaccompanied by individuals of 21 years or older from gaining access to VLTs. No more than ten machines may be located at any licensed establishment. No licensed VLT may be played except during hours when on-premise consumption of alcohol is allowed.

Players may wager a minimum of \$0.25 per game and a maximum of \$2.00. The maximum payout per game is \$1,000 if \$2.00 is wagered. The payback value of one credit is at least 80 percent of the value of the credit.

Manufacturers, distributors, machine operators, and retail establishments must be licensed and license fees are retained by the state. The Lottery requires an application fee of \$50. Annual license fees are: \$5,000 for manufacturers; \$5,000 for distributors; for operators, the greater of \$1,000 or \$100 for each machine licensed; and \$100 for establishments. Vertical integration of licensees (and therefore multiple types of licenses) is prohibited, except for retailers functioning as operators provided that such retailers meet operator licensee requirements. The state's portion of net machine income is currently 35 percent, recently changed from 25 percent.

The Lottery is required to examine prototypes of video lottery machines and associated equipment of manufacturers seeking a license.

There are criminal sanctions for violations of this Act.

Although South Dakota provides for measures to ensure security in the regulatory system (on-line VLT system, background checks on licensees, prohibitions against vertical integration, unannounced spot-checks by state inspectors of VLTs), the state's dominant objective appears to be the use of video lottery games as a source of additional revenue. However, operators are active participants and realize a substantial share of net proceeds. The on-line system, while more secure than Montana's decentralized system, is, at least in theory, not as secure as a state-owned and operated system with dedicated lines linking VLTs to a central computer.

West Virginia

The West Virginia Lottery regulates, on a trial basis, VLTs which are located exclusively at Mountaineer Park (a horsetrack and convention center) in Chester. The Lottery maintains security, approves licensing in accordance with procedures followed for all lottery retailers, and ensures expenditures of funds are made in accordance with the legal contract between the Lottery and Mountaineer Park. All terminals are tied through a dedicated line into a central computer system in Charleston although game activity is monitored periodically. There is no legislation specifically authorizing video lottery operation because such activities appear to be covered by a

general statute and the state's *Constitution*, according to an opinion of the West Virginia Attorney General issued on February 14, 1991.

Louisiana

The Video Gaming Division of the Gaming Enforcement Section of the Office of State Police within the Department of Public Safety and Corrections regulates video draw poker devices. These devices must contain meters to record revenues, prizes, credits, and other game performance data. They also must be linked to a central computer for purposes of polling or reading device activities and for remote shutdown of device operations.

These devices may be placed in a licensed establishment (restaurant, bar, tavern, motel, hotel, club, or other premises) where alcoholic beverages are sold for on-premise consumption. The statutes also provide that areas of adult patronage and truck stop facilities may install devices even if alcoholic beverages are not sold on the premises. Draft regulations on video poker include off-track betting or licensed parimutuel wagering facilities in the definition of "licensed establishment."

If installed in a truck stop, video draw poker devices must be placed in an area which is segregated for adult patronage only and the facility must meet certain usage and physical criteria. A licensed establishment may have no more than three devices except if there is more than one lounge or facility in an establishment, in which case the maximum number of devices per lounge is three. However, there is no limit on the number of devices at truck stops or at licensed establishments at which licensed off-track betting and parimutuel wagering are permitted. No person under 18 may play or operate a device at a licensed establishment.

No more than \$2 may be spent per game, nor may awards or credits per game exceed \$500. The statutorily-prescribed percentage of credits won to credits played must be at least 80 percent.

Annual licensing fees are the following: \$5,000 for manufacturers; \$3,000 for distributors; \$2,000 for service entities; \$1,000 for device operation; \$1,000 for device owners; and \$100 for licensed establishments. The device operation fee, payable by the device owner, is levied for each machine placed at a licensed establishment. That fee may be paid in quarterly installments. The draft regulations for video draw poker state that "the primary purpose of the license/application fee is to defray the costs of conducting background investigations and any other security or financial investigations conducted on applicants." Video poker devices are exempt from taxes, fees, or licensing restrictions imposed by any governmental entity except that a local governing authority may levy an occupational license tax, not to exceed \$50 per device.

In addition, the device owner is required to remit to the Video Gaming Division a franchise payment in an amount equal to 22.5 percent of net revenues (gross revenues less the value of prizes) derived from the operation of each video poker device.

All fees, fines, and penalties collected by the Division are credited to the Video Draw Poker Device Fund and distributed pursuant to appropriations as follows: 75 percent is applied to the Division's enforcement responsibilities and 25 percent is provided to local governing authorities in which devices are operated. The distribution is to be based upon the proportion of the total amount each local unit contributes to the statewide total. These funds also must be used for enforcement purposes.

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With respect to devices located at parimutuel wagering facilities, a specified funding formula is applied to supplement purses for horsemen. This formula is different for owners of licensed establishments who are not licensed device owners than for establishment owners who are likewise device owners.

There are provisions for suspension and revocation of licenses. In addition, there is a provision for the Division to conduct any investigations, hearings, and inquiries deemed necessary to fulfill its responsibilities.

Louisiana's video poker system is expected to be a hybrid on-line operation. The intent is to link to the central computer via dedicated lines video poker devices which are located in busy places, such as in truck stops and at race tracks. In less busy places, those devices will be linked to the computer through a dial-up system.

In response to the policy question of overriding objective, in Louisiana it appears to be maximizing security although not to the extent anticipated by Oregon which uses only dedicated lines to connect VLTs to the central computer and which does not permit private operators. To date, the Department of Public Safety and Corrections has developed draft rules and regulations which must be approved by a legislative oversight board.

Oregon

The Oregon Lottery is authorized to regulate video lottery games. Although this authorization existed as early as 1989 there was no statutory prohibition against private possession of video gaming devices (defined statutorily as "gray machines"; see Footnote No. 1) until the enactment of 1991 H.B. 3151. This bill makes it a crime for a person to possess such devices on or after December 1, 1991. This ban resulted from concerns about law enforcement problems that were expected to arise from the operation of a legal, publicly-sanctioned system coexisting with "gray" games. A recent court case challenged the constitutionality of H.B. 3151, but it was dismissed in October, 1991 and is currently being appealed.

A VLT may operate only in the establishment of a video lottery game retailer under contract with the Lottery. The Lottery Commission adopted rules which specify the terms and conditions for such contracts. A VLT must be placed in an establishment licensed by the Oregon Liquor Control Commission to sell alcoholic beverages primarily for on-premise consumption by persons of at least 21 years of age. Access to terminals must be restricted to persons who are at least 21 years old. No more than five VLTs may be placed in authorized liquor establishments. The establishment is the licensee. For example, if an airport is the licensee for VLTs and it houses five bars, only five VLTs can be located within the entire airport facility.

The revenue distribution also has been left, for the most part, to rule and regulation authority. The only allocation requirements prescribed by statute relate to county entitlements. Pursuant to 1991 H.B. 3151, an amount equal to 6 percent of net revenues generated from video lottery games in a county must be distributed to that county as administrative expenses, to be expended for gaming law enforcement (3 percent) and community mental health programs to treat gambling addiction (3 percent). In addition, 2.5 percent of net receipts is to be allotted to county economic development programs pursuant to 1991 S.B. 562. Of that 2.5 percent, 80 percent will be distributed to each county in proportion to the gross receipts from video lottery games in each county while the remaining 20 percent will be distributed in equal amounts to each county.

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The Lottery's rules authorize the Lottery to own and maintain video lottery machines and serve as the regulatory, enforcement, and licensing agency for video lottery games. For the most part, the Lottery will assume all those responsibilities but might contract for some of those services in outlying areas of the state. These regulations allot 8.5 percent of net revenues or receipts to counties, as required by statute; the balance would be divided between retailers (35 percent) and the state (56.5 percent) for administration, operation, and maintenance of the system and for various economic development projects. State funding for those purposes would be subject to appropriations. Finally, the Lottery is assuming in its rules a theoretical percentage payout of not to exceed 92 percent of gross revenues.⁷

In addition to its projected share of video lottery net revenues, the state will receive proceeds from a tax of \$100 imposed on each device which is classified as a game of chance (amusement tax).

Oregon statutes provide the Lottery with considerable rule and regulation authority concerning: types of games (only video poker games will be offered initially); number and value of prizes in each game; method for determining winners in each game; the retail sales price for a ticket or share; a validation system and means of paying prizes; method for determining the manner in which tickets should be sold to the public; basis for approval of in-state manufacturing and servicing of video devices; selection of retailers; and other facets of regulatory oversight. The Lottery also is to contract for an outside review of the cost of operating video lottery games.

On December 16, 1991, the Lottery selected its central site computer vendor. By the end of December, 1991, the Lottery intended to select a vendor for all state-owned VLTs.

To a greater extent than other states addressed above, Oregon appears to have based its system's configuration on the primary objective of ensuring maximum security in its regulatory oversight responsibilities. Examples of adherence to this objective include: the ban on "gray machines"; the requirement that VLTs be placed only in licensed establishments which sell alcoholic beverages for on-premises consumption; a limitation on the type of games offered; and the decision to designate the Lottery as the sole source of game operations. Adherence to this objective also is reflected in the Lottery's commitment to a provision in the state's constitution that rules and statutes implemented by the Lottery "insure the integrity, security, honesty, and fairness of the Lottery." Oregon's implementation plan reflects greater concern for security and system control than for maximizing revenues.

⁷ The *Oregon Constitution* specifies that "at least 84 percent of the total annual revenues from the sale of all lottery tickets or shares shall be returned to the public in the form of prizes and net revenues benefiting the public purpose."

SECTION III – POLICY CONCERNS

In conversations with various contact persons from states with video lottery authorization, staff obtained information about concerns related to the location of video gambling machines, reduced revenue for parimutuel wagering and other forms of entertainment, problems with conflict of interest, and problems with ensuring Lottery system security. A summary of those issues follows.

Location of Machines

The Public Relations Director for the South Dakota Lottery noted that instant lottery ticket sales "took a 25 percent hit" in the first year of video lottery. She ascribed this reduction in sales to the fact that VLTs are often located in convenience stores which were able to get liquor licenses in South Dakota. These stores have traditionally been the primary site for sales of instant lottery tickets. Many of these stores did not intend to sell liquor for consumption on the premises but due to a "loop-hole" in the law obtained liquor licenses which therefore enabled them to house VLTs. The law authorizing video lottery in South Dakota initially licensed convenience stores, but a law enacted during the 1991 Session would in effect prohibit licensure of those stores unless they were "grandfathered in."

Parimutuel Competition and Competition With Other Forms of Entertainment

Dana Nelson, Executive Director of the Kansas Racing Commission, served in the capacity of Executive Director of the Racing Commission in South Dakota until February, 1991. He observed that video gambling was devastating to the racing industry in South Dakota where one dog track closed after video lottery was introduced and a second track experienced a 15-17 percent reduction in handles after the first year of video lottery. Greyhound simulcasting likewise experienced a serious revenue reduction. (See Section IV for an analysis of the possible impact of video lottery on racing revenues in South Dakota.) Mr. Nelson expressed uncertainty as to whether the two race tracks in Kansas could be sustained with a 15-17 percent reduction in handles. He noted that racetracks have fixed costs (note payments, utilities, property taxes, and administrative costs) and that, given fixed costs, reductions in revenues probably could not be offset by a reduction in expenses.

The in-house auditor for the West Virginia Racing Commission indicated that video gambling machines at Mountaineer Park are authorized and regulated by the Lottery. There are approximately 150 video gambling machines, many of which are located at a motel facility less than a mile from the racetrack in the Park. According to the auditor, parimutuel wagering is down approximately 10 percent since the installation of video gambling machines. (After a full year of video lottery operations at Mountaineer Park, the handle was down 6.48 percent from the prior year and attendance was down 7.24 percent.) The auditor explained that the state's gaming officials argue, however, that the reduction would have been even worse without the video gambling machines. (Revenues from wagering were not as reduced at this track as at another in the state.) Approximately the same time as the video gambling machines were installed in Mountaineer Park, four or five off-track wagering sites were authorized in Pennsylvania, within 50-60 miles of Mountaineer Park. These sites are considered to be in the marketing area of the racetrack.

On July 27, 1991, the Lottery and racetrack owners signed a contract which allows a portion of revenues derived from video gambling machines to be applied to purses, thus offsetting one effect of reduced revenues at the racetrack. (Note that a similar provision is in Louisiana's law.)

Not only does parimutuel wagering appear to be affected by the presence of video lottery games, but other forms of entertainment might be likewise affected. Restaurant owners who own and lease video lottery equipment in South Dakota opposed a proposal (subsequently adopted by the Lottery Commission) to increase the state's share of net lottery proceeds from 25 percent to 35 percent. They claimed that video lottery games reduced drink sales and revenue from pool tables, pinball machines, and other amusement devices.⁸ Moreover, at hearings on the proposed Oregon rules, although no precise figure was offered or study conducted to support a particular estimate, testimony indicated a reduction in income to coin operators of 50 to 80 percent of their total sales.⁹ (Coin operators are individuals who have owned video machines and other types of gaming machines or leased them to bars and taverns.) Finally, the Oregon Lottery Commission projected that video lottery games could produce an \$8 million drop in revenues of other lottery games.

Conflict of Interest

There is no prohibition against vertical integration of licensees in the Montana statutes as there is, to a certain extent, in the South Dakota statutes.¹⁰ What is meant by "vertical integration" in this context is that operators may not be manufacturers or distributors, nor may manufacturers and distributors own, manage, or control a licensed establishment. The Montana Gambling Control Division has experienced problems with undisclosed interests in business and reporting on income sources and will be considering the imposition of a prohibition against vertical integration.

Security

An administrative officer for the Montana Gambling Control Division explained that Montana has been considering an on-line system for video gambling. As previously noted, machines in Montana are metered but are not part of a central site automated system. According to the administrative officer, some problems with tampering with machines, such as the bill acceptors, have been reported and meters do not always function properly. The administrative officer observed that an on-line system could be more effective in identifying such problems and instilling more security into the regulatory process. Montana is considering conversion to an on-line system.

⁸William Koupal, "South Dakota: Video Lottery Tax May Rise," *State Tax Notes*, December 2, 1991, page 473.

⁹Memorandum to the Oregon Lottery Commissioners from Gary Williams, Hearings Officer, regarding Determination of Economic Effect Upon Small Businesses, November 21, 1991.

¹⁰In South Dakota, despite other prohibitions against vertical integration, retailers may also be operators. Retailers who are also licensed as operators sometimes experience problems, not with conflict of interest, but with obtaining service contracts for their VLTs, according to the Public Relations Director for the South Dakota Lottery.

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The Oregon Lottery utilized a report with recommendations on security matters prepared by the Oregon State Police, Department of Justice (1991). This report (on file in the Kansas Legislative Research Department) noted certain recommendations that:¹¹

1. all terminals be approved by Underwriters' Laboratories;
2. bill acceptors be used in lieu of coin operated machines because their ability to detect noncurrency is superior to coin acceptors;
3. bar codes be used as a method of validating winning tickets; with an on-line system, security would be heightened and no ticket could be copied and claimed twice;
4. the Lottery logo appear on the video screen of each device via the software and be controlled by the central system, thus preventing duplication from another source (this would serve to distinguish gray machines or unlicensed machines);
5. the system be on-line and use dedicated lines; if coupled with data encryption during transmission, security would be maximized;
6. an in-house central site system be operated which would involve the purchase of the system and possibly the employment of a vendor to serve as a consultant, upgrade the system, and train Lottery personnel;
7. if the vendor operates the system, the Lottery closely monitor daily operations with particular attention to electronic funds transfer; by not operating its own site the Lottery could be subject to shutdown in the event the vendor is subject to a lawsuit, restraining order, bankruptcy, or receivership; and
8. any operator participation include a yearly review, including examination of income tax returns and other financial information to prevent cheating of the entire system through the retention of illegal games with look-alike devices at retail locations and the skimming of money from the retailer.

The Oregon report on security measures also noted that a major concern of the Atlantic Lottery, which operates video lottery in New Brunswick and Nova Scotia, is the continued use of "gray machines" despite their ban from those provinces. Apparently local police have not enforced the ban because it is a low priority. Consequently, according to the report, there has been widespread use of these machines not only in drinking establishments but also in convenience stores,

¹¹These recommendations were attributed to James Maida, President of Gaming Laboratories International, Inc., a company which performs various hardware and software tests to insure that terminals and games operate within set specifications. These recommendations were used to support the Oregon Department of Justice's position that private operators should not be permitted. Mr. Maida claims that these recommendations were taken out of context and misrepresent his position. These recommendations apparently assumed that costs were not a factor. Therefore, one should probably view those recommendations in the context of realizing the objective of security regardless of attendant costs.

bowling alleys, and other locations accessible to the general public. The report maintains that lax enforcement has resulted in competition between the two systems -- one illegal, the other legal. The Atlantic Lottery also advised that it has been difficult to keep operators from participating who have been involved with unlawful gambling prior to the inception of the video lottery law. Incidents of illegal video gambling operations in Canada, Nevada, Oregon, and Montana are cited in the Oregon report. Drawing from experiences in Oregon and other states, the report concludes with the following recommendations:

1. The ban on gray machines should be strictly enforced.
2. If the Lottery chooses to run a video lottery system, private operators should not be permitted. The Lottery itself should operate the central site and the field operations.
3. If operators are allowed to participate in the video lottery system, no one who has been involved in any gambling offense, any felony, or any crime involving theft or deception should be allowed to participate in the video lottery endeavor.¹²

According to the Public Relations Director of the South Dakota Lottery, security has not been a problem. She cited the safeguards of an annual in-depth licensing procedure which examines the personal and financial profiles of all system participants and provides for unannounced inspections of VLTs conducted by five inspectors statewide.

SECTION IV - REVENUES (OTHER STATES)

South Dakota

In South Dakota, revenues from VLTS are treated as follows: From all moneys generated from VLTs (gross revenues), actual cash paid out (prizes) is subtracted. Although the statutory minimum prize payout is 80 percent, player behavior affects the actual percent of gross paid out. This translated in South Dakota in the first year of operations (October 16, 1989-October 20, 1990) to 63.9 percent of gross revenues or \$132.3 million paid out in prizes of gross revenues of \$207.1 million.¹³ Net machine income is the cash into the terminal minus all cash paid out in prizes which totaled \$74.8 million (36.1 percent) in the first year of operations. In South Dakota, the state's share of net machine income during the first year was 22.5 percent. (The state's share was subsequently changed to 25 percent and on December 12, 1991, the Lottery Commission voted to

¹²Countering the above concerns with security, James Maida of Gaming Laboratories International indicated in the December, 1991 issue of *Play Meter*: "As I've said numerous times this year, video lottery terminals and systems are virtually impossible to cheat. Don't let anyone tell you differently. After all, would more than 7,000 machines be installed to date if the video lottery system was easily cheated?"

¹³These sales figures were cited in *South Dakota's Facts and Figures* (10/20/90).

increase it to 35 percent effective through administrative rules in January, 1992.) The 22.5 percent share for the first year totaled approximately \$16.8 million. The remaining 77.5 percent of first year net revenues (\$58 million) was shared by video operators and video establishments. In South Dakota, video operators are licensed by the Lottery to purchase and place video lottery machines and associated equipment in establishments.

South Dakota FY 1991 Profiles

July 1, 1990-June 30, 1991

Net Revenue (after payout of prizes)	\$107 million
State's share of net revenue	\$25.1 million*
Number of establishments	1,358
Number of operators	67
Number of operators/establishments	43
Number of distributors	9
Number of manufacturers	14
Number of terminals	5,763

* 22.5 percent prior to 1-1-91 when 25 percent went into effect.

Data received on October 15, 1991 suggest that after two years of operation, video lottery in South Dakota may be approaching saturation in terms of the number of establishments, operators, operators/establishments, distributors, and manufacturers. The number of establishments increased by two, whereas the number of all other types of participants declined since June 30, 1991. The number of terminals increased from 5,763 to 6,116, bringing the ratio of terminal to establishment from 4.2 (June 30, 1991) to 4.5 (October 15, 1991)

The South Dakota Lottery does not, with the exception of operators' fees, segregate revenues received from licensure by game. Initial fees and renewal fees for operators (exclusively video lottery) in FY 1990 totaled \$426,000; in FY 1991, it totaled \$657,500. For all lottery games (instant lottery, Lotto America, and video lottery), licensure for retailers (manufacturers, distributors, establishments, and first-time operators' application) totaled \$128,300 in FY 1990 and \$252,970 in FY 1991.

The state's share of net revenue from nonlicensure sources continues to increase. In the first four months of FY 1992 the state's share of net revenue was \$9,989,121. If this amount is annualized the total is almost \$30 million. However, since the state's share of net revenue was subsequently increased from 25 percent to 35 percent in January, 1992, state lottery officials expect

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additional revenue of \$6.2 million in FY 1992 and \$13 million in FY 1993. Given the fact that the number of establishments remained fairly constant during the first four months of FY 1992, the increase in revenues can be attributed to an increase in terminals.

However, one might predict a flattening of revenues for the years after FY 1992 because the median net revenue per terminal continues to increase but at a slower rate over time. In FY 1990, it was \$12,064. In FY 1991, it was \$18,567. Based on the first four months in FY 1992, the annualization amount would be \$19,599.

According to the South Dakota Lottery, 69.4 percent of all terminals are found in bars (32.6 percent), lounges (17 percent), and restaurants (19.8 percent). Terminals are also located at other sites authorized to sell liquor for consumption: bowling alleys (3.7 percent), fraternal clubs (8.2 percent), liquor stores (2.3 percent), recreation (3.4 percent), motels or hotels (4.0 percent), and other establishments, mostly grocery and convenience stores (7.0 percent). The remaining 1.8 percent of terminals are reported as "not enrolled," meaning that they are inactive.

The budget for the Lottery to oversee operations was \$937,000 in FY 1991 and an estimated \$1.1 million in FY 1992. There was a one-time initial start-up cost of \$1.5 million for the video lottery central computer system. There were 13 positions at the outset of video lottery operations and that number has not increased.

At least two other games regulated by the state appear to be affected by video gambling. Prior to October, 1989 the Lottery only offered instant lottery. In FY 1988 the state's share for instant lottery was \$7.8 million and, in FY 1989, \$6.3 million. In FY 1990, the state's share for instant lottery was reduced to \$5.2 million, although the state's share for both games was \$15.6 million. In FY 1991, the state's share for both instant lottery and Lotto America totaled \$3.9 million (\$2.7 million for instant lottery and \$1.2 million for Lotto America which started in November, 1990). However, the state's share for all three games, including video lottery, was approximately \$29 million in that fiscal year.

Parimutuel wagering (greyhound and horse racing) revenues have likewise declined. In 1990 South Dakota had two race tracks for greyhounds: Sodrac and Black Hills. Black Hills' handles dropped from over \$4 million in 1989 to \$2.5 million in 1990 and the track closed in 1991. Sodrac's handles dropped from almost \$5.5 million in 1989 to almost \$4.6 million in 1990. Greyhound simulcast handles declined less dramatically from 1989 (\$7.5 million) to 1990 (\$7.1 million). However, the decrease from 1990 to 1991 was particularly notable -- approximately 52 percent. Likewise, Sodrac's live racing handle decreased in that interval by over 40 percent. Horse racing handles have also declined each year since 1989 at the tracks in Ft. Pierre and Aberdeen. However, simulcast of horse races has caused total handles for horses to almost double from 1990 to 1991.

The extent to which video lottery games affect parimutuel wagering is an open question because in certain parts of the country where statewide video lottery games are not available, parimutuel wagering handles also have declined.¹⁴ It appears that parimutuel wagering could be correlated to economic downturns and competition from other forms of entertainment.

¹⁴From 1990 to 1991 handles were down 25-30 percent at greyhound tracks in Wisconsin, 35 percent in Dubuque, Iowa, 34.4 percent in Jacksonville, Florida, and 17.4 percent in Orlando. Horsetrack betting for the same period was down 35 percent at Canterbury Downs, Minneapolis and Prairie Meadows, Iowa even closed because of reduced revenues.

Montana

Unlike South Dakota, revenues to Montana are used primarily for oversight responsibilities of the Department of Justice. They are derived from: the video gambling machine tax (15 percent of the gross income of each machine with two-thirds returned to local governments); annual license fees of manufacturer-distributors (\$1,000 annually); and the annual machine permit fee (\$200 on a quarterly basis with half going to counties).

The table below illustrates moneys collected from each source:

Montana Video Gambling Machine Permits*

<u>Year</u>	<u>Poker No. of Permits</u>	<u>Video No. of Permits</u>	<u>Bingo No. of Permits</u>	<u>Total No. of Permits</u>	<u>Total Amount</u>
FY 1990	6,223	4,803	22	11,048	\$2,209,600
FY 1991	7,411	5,317	0	12,728	2,545,600

* The number of permits apparently overstates the number of actual machines since each time a machine is relocated another permit must be issued. The actual number of machines is not tracked.

Manufacturer/Distributor Licenses

<u>Fiscal Year</u>	<u>No. of Licenses</u>	<u>Total Fees</u>
FY 1990	125	\$ 125,000
FY 1991	132	132,000
FY 1992	119	119,000

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Video Gambling Machine Tax Collection and Distribution

<u>Fiscal Year</u>	<u>Total Revenue (In Millions)</u>	<u>Local Government (In Millions)</u>	<u>General Fund (In Millions)</u>
FY 1990	\$17.0	\$11.3	\$5.7
FY 1991	20.7	13.8	6.9

Total video gambling machine net (now statutorily defined in Montana as "gross") income (money put into machines minus prizes) was \$113,360,000 in FY 1990. The average net income per machine (permittee) was \$10,261. Based on the reported machine net income, the Department of Justice estimated that the total amount wagered was \$251,800,000. This amount was calculated by using the estimated payback to players of approximately 55 percent. For FY 1991, video gambling machine gross income totaled \$137,044,407. Assuming an estimated 55 percent payback, the total amount wagered was \$304,543,126. The average net income per machine (permittee) was \$10,767. The tax collected on machines for the first quarter of FY 1992 was \$5.8 million. Given this is 15 percent of video gambling machine statutory gross income, that income, if annualized, is \$154,666,667.

Oregon

The Oregon Lottery Commission currently estimates that annual net receipts from video lottery games will be \$219 million. (Net receipts are defined as "the amount of money that is received from the sale of video lottery games after payment of prizes but prior to any other payment.") On November 25, 1991, the Lottery Commission decided to authorize the Lottery to operate the video lottery games. Therefore, private sector operators will not receive a portion of net revenues generated from such games. Counties receive 8.5 percent of net revenues and, according to the Lottery's rules, retailers will receive 35 percent and the state the remaining 56.5 percent, although the internal allocations for the state have yet to be determined.

Counties (8.5%)	\$ 18,615,000*
State (56.5%)	123,735,000
Retailers (35%)	76,650,000
TOTAL	<u><u>\$ 219,000,000</u></u>

* There is some discussion of subtracting 2.5 percent for county economic development activities from \$219 million (\$5,475,000) and from that total taking 3 percent for each of the other programs sharing the allocation to counties. This means that gaming law enforcement would be allotted \$6,405,750, as would community health programs to treat gambling addictions. See page 8 for further discussion on the allocation of the 8.5 percent for counties.

In addition to the state's share of video lottery proceeds, the state will receive proceeds from amusement taxes paid on amusement devices (including VLTs). The Lottery Commission apparently intends to install approximately 10,000 devices. As the tax is \$100 per device, the Commission would receive \$1 million. "Gray" games were banned on December 1, 1991 and there are an estimated 5,000 "gray machines." Prior to that date these machines (classified before the ban as a game of chance) had paid \$100 annually. This translates into a total of \$500,000 in amusement taxes due to the ban which must be subtracted after 1991 from the \$1 million collected on new machines.

A financial study conducted on the Oregon Lottery (October, 1991) projects state operator administrative expenses¹⁵ to be \$22.6 million assuming 2,600 locations and 10,500 terminals.

West Virginia

The West Virginia Lottery authorized video lottery games at Mountaineer Park in June 1990. Therefore, only the first year of operations (June 9, 1990-June 8, 1991) has been reported. The first year realized gross sales of \$8,071,658; a 70 percent prize payout of \$5,619,221; funding to the Lottery (and transferred in part to other state agencies) totaling \$995,215; and allocation to Mountaineer Park of \$1,457,222. At the end of the first year of operations, there were 150 terminals in Mountaineer Park realizing a median net revenue per terminal of \$16,350. In the first year of video lottery operations, the contract between Mountaineer Park and the Lottery provided allocations of gross machine income of 65 percent for prizes, 14 percent to the state, 9 percent for Mountaineer Park, 6 percent to the track for initial investment capital, 3 percent for advertising, and 3 percent to the Lottery for operations. The formula governing allocations of net lottery proceeds (after payment of prizes) was renegotiated in July, 1991 and the following allocation formula is currently in effect: Mountaineer Park -- 70 percent; horsemen -- 10 percent; and Lottery -- 20 percent. A contact person from the Lottery noted that the Lottery had made no upfront investments in the video lottery games. In FY 1991, video lottery accounted for 9 percent of all gross lottery sales.

SECTION V – KANSAS PROJECTED REVENUES

A significant amount of discussion of video lottery in Kansas has centered on its potential revenue generating ability. Most of that discussion has been based on the experience of South Dakota. Clearly, an alternative revenue projection could be made based on Montana's experience since its policy objective appears to be aimed more toward regulation than toward maximizing state revenue. Under any circumstance, using another state's experience as a basis for revenue projection prior to definition of statutory parameters is problematic. At least some reasons for being cautious about basing expectations on South Dakota's experience are outlined below.

This discussion of potential state revenue from video lottery includes projections for the first two 12-month periods of operation. As stated elsewhere, it appears that South Dakota (which began video lottery in October, 1989) has almost reached a leveling-off point in regard to placement

¹⁵The term "operator" is defined here as engaging in the following activities: acquisition and financing of terminals; insurance of equipment; maintenance of equipment; purchase of equipment parts; sales and troubleshooting; and administrative overhead costs (mainly FTEs).

of terminals and expansion to new retailers. There is no way of knowing how "maturity" will affect the ability of video lottery games to attract and retain players.

These projections attempt to take into account commerce across state lines. For that purpose, two per capita revenue figures for South Dakota were derived. One calculation includes the approximately 100,000 population of Sioux City, Iowa which is on the South Dakota border. The other includes only the 696,004 persons reported by the 1990 U.S. Census. Those two per capita figures were used to derive two projected video lottery net revenue figures for Kansas. One figure is a per capita calculation based solely on the 2,477,574 population of Kansas as reported by the 1990 U.S. Census. The other figure is a per capita calculation that also includes the population of neighboring Missouri counties of Jackson, Platt, and Clay (Kansas City metropolitan area); Buchanan (St. Joseph) and Jasper (Joplin). Those counties were chosen because of the concentration of population in them and the fact that there is commerce across the state line in those areas.

	<u>Kansas Population Only</u>	<u>Kansas + Missouri Counties</u>
1st Year	\$ 266,266,480	\$ 328,482,361
2nd Year	406,606,468	501,614,220

* Net revenue represents the amount of money that goes into video lottery machines, minus the amount paid out in prizes. Revenue to Kansas would be some percentage of net revenue, presumably set in statute. Kansas' current lottery law requires that no less than 30 percent of gross lottery sales revenue be transferred to the State Gaming Revenues Fund.

Initially South Dakota collected 22.5 percent of video lottery net revenue as a tax. That assessment totaled \$16.8 million during the first 12 months of video lottery operation. If that percentage is applied to the figures above for Kansas, receipts would be estimated to range between \$60 million and \$74 million during the first year. Each percent of net revenue would be approximately \$3 million.

The Legislature should bear in mind that revenue from video lottery probably would be realized by the state at an accelerated rate throughout the first year as terminals are installed and

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the player base expands. If the Kansas experience were to mimic that of South Dakota exactly, with video lottery play beginning in October, only slightly more than half the annual revenue for the first 12 months of operation could be expected during the first fiscal year.

Inclusion of Sioux City population in the South Dakota player base results in a slightly lower weekly per capita revenue figure for South Dakota, but the addition of over a million Missouri people to the Kansas player base increases the revenue projection significantly. This should illustrate that the validity of a revenue projection is often extremely subjective, especially when there is no way to predict which relevant variables will affect play in different areas.

A number of factors may impact the amount of revenue realized from video lottery machines and the relationship between that revenue and the population of the state. Clearly, one factor is the presence of concentrations of population on the borders. Another is the number of tourists who visit the state and who participate in lottery games. The South Dakota Lottery was unable to provide an estimate of the number of tourists in South Dakota's player base; however, South Dakota's tourist industry has a long history. South Dakota also has casino-style gambling in one town, Deadwood. A lottery official said most of the gambling hall operators did not install video lottery terminals until they had reached the maximum number of other games. He also commented that video lottery games do "OK" in Deadwood, but the perception is that tourists play them more than South Dakotans.

Player behavior accounts for differences in net revenue which is the amount of money wagered that machines retain. That is because, to some degree, the amount of money retained is a function of how machines are played. When people do not play for extended periods of time, payout as a percent of money played is higher; therefore, the amount of money retained is lower. More player turnover results in less cash retained in machines.

During the first year of video lottery operation in South Dakota, the Lottery reported that net machine income represented 36.1 percent of total cash wagered in VLTs. The gross amount wagered during the first 12 months was \$207.1 million which equates to \$444 in wagers during the year per person over the age of 21 (persons under 21 cannot legally play video lottery in South Dakota).

Using that same ratio of net to gross, the net figure in the table above for the Kansas population only would require gross revenue of \$737.6 million. That equates to \$406 in wagers during the first year for every Kansan over the age of 18 (currently, persons under the age of 18 are prohibited from participating in the Kansas Lottery) or \$433 in wagers during the first year for every Kansans over the age of 21. In order to generate the net amount shown in the table above for the second year for Kansas population only, the annual per capita wager for the population over the age of 18 would increase to \$620. If play were restricted to persons over the age of 21, annual per capita wagers would have to average \$662.

Another variable that impacts revenue is the number of machines and their locations. As discussed earlier in this memorandum, every state that has authorized the conduct of video lottery games has placed some restriction on where terminals can be located and the number of terminals that can be placed in a single establishment. By the end of the first year of video lottery operation in South Dakota, there were approximately 4,600 machines located in 1,252 establishments. In South Dakota video lottery terminals are currently restricted to those places that sell liquor for on-premise consumption. Kansas does not appear to have liquor laws that are analogous to those of South Dakota, but if video lottery games were limited to entities licensed to serve liquor or cereal malt

beverage (CMB) for on-premise consumption, there would be a potential group of 3,000 establishments, approximately 1,600 of which are Class A or B clubs or drinking establishments. The remainder are "beer bars" and other restaurants that only serve CMB.

In South Dakota an average of approximately four terminals per establishment were placed during the first year of video lottery operation. That experience would translate to placement of 12,000 terminals in Kansas during the same time period if all on-premise establishments are permitted to have VLTs under Kansas' law. If, however, placement is allowed only in clubs and drinking establishments, there would have to be approximately eight VLTs per establishment to reach the 12,000 figure. As another example of the lack of precision involved in projecting revenue that might accrue to the state, applying the South Dakota average annual net revenue per terminal figure to 12,000 VLTs results in an estimate of annual net revenue of only approximately \$194 million. A state share of 22.5 percent of that amount would be approximately \$43.7 million.

In connection with developing estimates of potential state revenue from video lottery games, the Legislature might want to consider the impact on other sources of state revenue. Competition with, and potential diversion of, funds from other lottery games and from parimutuel wagering appear to be a real possibility, and are somewhat difficult to predict. According to reports from other states, all of these types of wagering compete for at least some of the same discretionary entertainment dollars. As was previously noted, instant lottery ticket sales were adversely affected by the introduction of video lottery games. An official of the South Dakota Lottery stated that the Lottery might have prevented some of that loss by increasing the instant ticket prize amount to 65 percent prior to implementing video lottery. The prize percentage did not increase to that level until after video lottery was implemented. The same Lottery official indicated that while the parimutuel wagering handle was in decline prior to the advent of video lottery, video lottery probably exacerbated the decline. VLTs were initially located at both parimutuel tracks in South Dakota. (See the discussion of this in Section IV on South Dakota.)

There also could be an impact on sales and excise taxes forgone as consumer spending shifts from goods and services to video lottery. An obvious excise tax that might be impacted is the "drink tax" imposed on liquor sold by the drink. Projecting the magnitude of any such offsetting revenue decline would be very difficult at best.

In summary, any projection of potential additional state revenue from video lottery is problematic for several reasons. First, the amount of revenue that might accrue to the state is dependent on a number of variables, many of which will not be clearly defined until statutes are enacted. Probably the most important issue to affect those variables is the state's policy objective: whether to regulate a previously illegal activity or to maximize state revenue. Certain variables to be considered include: the percentage of wagers returned in prizes; types of establishments eligible to become retailers; limits on the maximum number of terminals per establishment; minimum age of players; means of distribution of terminals and promotion of games; prohibition of competing, illegal games; and monitoring, management and security of the system. Second, player acceptance and behavior is a crucial variable in determining whether video lottery becomes a significant, reliable, ongoing source of revenue. Third, other revenue sources could be affected at an unpredictable level. Fourth, video lottery has not been implemented in a sufficient number of states for a clear picture of revenue potential to emerge.

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SECTION VI – LEGISLATIVE POLICY CONSIDERATIONS

The following questions might be addressed in formulating video lottery legislation for Kansas:

General Policy Framework

1. Should the state promote a policy which would encourage Kansans to spend money for video lottery gambling?

Policy Implication. In support of state promotion of video lottery, it could be argued that Article 15, Section 3c of the *Kansas Constitution* authorizes state operation of a lottery, as ratified by the voters in 1986, and that video lottery is just another type of lottery game. In addition, there are apparently thousands of video lottery machines being played in the state, although financial payouts from video lottery games are currently illegal. State regulation or operation of such games could conceivably reduce the illegal activities while allowing the state to share in the profits. Arguably, participants in state video lottery games might otherwise use their money for recreational purposes from which the state would not benefit. Consequently, it might be more appropriate for the state to derive some benefit from those recreational dollars.

In opposition to state promotion of video lottery, reports from other states (as indicated above) suggest that moneys available for recreational activities, and particularly gambling activities, are not unlimited. Indeed, to some extent, additional revenue from video lottery are offset by decreased revenues from other lottery games and parimutuel wagering. Moreover, video lottery may have an adverse impact on nongambling revenues, such as the sales tax, although there is no accurate method of capturing that impact. Admittedly, at least in the short term (if South Dakota's experience can be generalized to other states), net video lottery revenues to the state offset reductions in revenues from those other activities. Moreover, demographic information from the Kansas Lottery on recent claimants for "instant scratch" prizes indicates that households with incomes of \$15,000 to \$25,000 were most representative of the claimant population. These households, while over the poverty threshold, are certainly vulnerable to economic downturns. While it is conceivable that video lottery games may attract a higher proportion of affluent consumers than would other types of lottery games, more analysis would be needed to substantiate that assumption.¹⁶ The same question applies to video lottery as it did in 1986 when other forms of gambling were being considered: is good public policy for the state to encourage gambling?

2. What is the state's primary objective for involvement in video lottery games?

Policy Implication. The configuration of a state's video lottery system is determined to a large extent by the response to this question. If the state has as its primary objective ensuring

¹⁶The profile of the average video lottery player in South Dakota is a male, in his mid-30s, with a \$25,000 plus income, and little interest in playing regular lottery games. See Erik Calonius, "The Big Payoff from Lotteries," *Fortune*, March 25, 1991, page 110.

maximum security in the regulatory process and safeguarding the system against illegal activities, it would design a system, like Oregon intends to do, that assigns most of the control to the state. In such a system, ensuring that a formerly illegal activity is properly regulated takes precedence over the infusion of greater amounts of revenue into state coffers. Such an objective might be motivated by state constitutional provisions requiring regulation of the Lottery to insure integrity and security, as is the case in Oregon. There also may be an assumption that more revenues will be realized in the long term because fewer categories of participants would be seeking to realize a profit from these activities and because strong enforcement would ensure honesty and accountability.

Alternatively, if the state has as its overriding objective increased revenue collections, a more decentralized process with many participants, potential for greater market penetration, and less direct state control might be the appropriate approach. This conclusion is based on an assumption that very active and aggressive promotion of video lottery games would not occur under centralized state operation. While one study attempts to make the argument that greater market penetration is correlated with private operator participation, those conclusions might not be firmly based on currently available data.¹⁷

However, just because under one scenario maximizing security takes precedence over revenue enhancements, and under the other scenario revenue enhancements take precedence over maximized security, does not mean that those goals are mutually exclusive. States have obviously reached some accommodation of these two policy positions.

3. What agency should administer video lottery games?

Policy Implication. Although video lottery games are regulated by the Department of Justice in Montana and the Department of Public Safety and Corrections in Louisiana, it seems likely that such games would be under the administrative control of the State Lottery in Kansas, primarily because Article 15, Section 3c authorizes the Legislature to "provide for state-owned and operated lottery." However, other agencies probably could be included statutorily in certain aspects of enforcement and regulation. Involvement of enforcement agencies might be one means of accommodating the apparent conceptual conflict created by having the Lottery be both the promoter of video games and a regulator of various industry subgroups.

4. Should private operators or state government operate and maintain video lottery games?

Policy Implication. This question gets to the heart of issue of state control of video lottery games and also depends on the state's primary objective for involvement in video lottery games. In Attorney General's Opinion 92-1, it was noted that contractual agreements with private

¹⁷This is the *Study of Operating Data of Video Lottery Programs in The United States and Canada*, September, 1991 (Arthur Andersen). Questions about methodology include the difference in governmental structures between Canadian provinces and the states and the difference in limitation on the number of terminals in the Canadian provinces. Moreover, if problems exist with "gray machines," as they do in Nova Scotia, the existence of those machines could be expected to affect market penetration because these machines serve as a disincentive for retailers to become involved with legitimate games. The methodology might have been more solid if only the Canadian provinces had been subject to comparison given the similarity in governance, configuration, and start-up dates (all since December, 1990.)

operators to place and maintain privately-owned VLTs would not necessarily violate the requirement for state control and ownership of lottery games, included in the *Kansas Constitution*, provided that the state meets certain conditions to demonstrate control over the games and machines. Once again, there is a trade off between increased security and greater access to information versus increased cost to the state. There are other factors which affect a response to this question. Under a state-run scenario, the state would have to invest more money upfront to hire staff and purchase equipment (assuming these functions are not contracted out) but it would recoup a larger percentage of gaming proceeds as the private operators would not be sharing in the proceeds and making a profit from them.

According to one recent study, video lottery games run by private operators have significantly higher market penetration than such games run directly by states. (See Footnote No. 17.) Assuming this finding is correct, net proceeds would be greater when games are by operators. If operators are involved in the games, the state would probably share some of the net proceeds with operators and would need to dedicate moneys for licensing, oversight, and enforcement activities related to operator participation. If the state runs games itself, using the model of Oregon, it could incur greater administrative and capital outlay expenses which would at least initially exceed revenue intake; however, the state would most likely partake of a greater portion of net revenues since no private operators would be involved.

With respect to eliminating "gray machines," operators might be more effective than the state in promoting cooperation of machine owners to not use them. However, the opportunity for operators to cut private deals with retailers would not necessarily be eliminated under either the state-run or operator-run scenarios.

Obviously, operators will not be able to earn income, at least legally, from video lottery games if they are not authorized by the state to operate games. The Oregon Lottery estimated that under its rules which eliminate private operator participation in video lottery games, the average operator will not have the opportunity to earn a gross income of \$515 per week per retailer from state regulated video lottery games.¹⁸

Finally, if the state decides to operate video lottery games and the Legislature subsequently bans them, the state would have considerable capital outlay investments (ownership of machines) that operators otherwise would have under the operator-run scenario. This presumes, of course, that compensation for banned machines in that event is not a contractual provision in any agreement between the state and operators.

Retailers

1. Should Class A clubs (country clubs, fraternal, and social organizations), Class B clubs (dinner clubs), drinking establishments, and caterers be authorized to permit video lottery games in their facilities? Should retailers who sell cereal malt beverages (CMBs) and/or alcoholic beverages exclusively for off-premises consumption, such as liquor stores, convenience stores, or grocery stores, be authorized to permit video lottery games in their facilities?

¹⁸Memorandum to Oregon Lottery Commissioners from Gary Williams, Hearings Officer, concerning Determination of Economic Effect Upon Small Businesses, November 21, 1991.

Policy Implication. As of November 30, 1991, there were 1,641 licensees which sold alcoholic beverages for consumption on the premises. The bulk of such establishments were drinking establishments (828). Clubs constituted another 760 on-premise liquor licensees. Clearly, if additional types of establishments are permitted to offer video games, the number of terminals should increase, resulting in increased revenues. In particular, with convenience stores, there may be difficulty in ensuring that minors are not playing and there may be some adverse fiscal impact on other types of lottery games, as was reported in South Dakota.

Also to be considered is that in Kansas individuals under 21 years old may go into a bar or drinking establishment, even if they cannot consume alcohol. This could make enforcement of laws relating to age restrictions of video lottery players somewhat difficult.

2. Should an establishment's eligibility for video lottery certification be dependent upon its possession of a current certificate to sell other lottery products?

Policy Implication. There are arguments to support and oppose such a requirement. In support, this requirement consolidates lottery sales activities and makes it easier for the state to exercise appropriate oversight. It also could allow the Lottery the opportunity of creating an incentive system related to sales of a variety of products that might mitigate some effects of product competition. In opposition, this requirement might result in lower revenues from other lottery games since, to some extent, those games will compete with each other.

3. Should background investigations be conducted of persons who intend to contract with the Lottery as video lottery retailers, machine manufacturers, distributors, or operators?

Policy Implication. Personal and financial background investigations are conducted on manufacturers, distributors, operators, and retailers in South Dakota. This type of investigation is performed annually. It would appear that the more extensive the investigation and the more frequently it is done, the more likely the integrity of the games would be upheld. More oversight activity translates into greater expenses. Conversely, lax security could result in foregone revenues to the state due to illicit activities by private sector participants.

Security personnel at the Kansas Lottery currently conduct background investigations on vendors who print lottery tickets and retailers who sell tickets.

4. Should there be a limit imposed on the number of machines which may be placed in any one establishment?

Policy Implication. Limits on the number of video lottery machines or terminals placed in licensed liquor establishments vary among the states. In Montana, up to 20 machines are authorized per establishment; in South Dakota, the limit is ten; in Louisiana, at least in licensed establishments and with some qualifications, the limit is three; in the Canadian provinces and Oregon, the limit is five. Such limits prevent development of establishments that would be essentially "video casinos" containing multiple rows of VLTs.

A related issue is that the states do not necessarily define "licensed establishment" in the same manner. In Oregon, for example, an airport would be treated like a licensed establishment. In Louisiana video lottery games may be placed in truck stops and facilities which authorize

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parimutuel wagering. In West Virginia those games are authorized for placement at Mountaineer Park, a horsetrack and convention center.

5. Should VLTs be permitted on racetracks?

Policy Implication. As previously noted, video lottery machines are permitted at racetracks in West Virginia and Louisiana. In both cases, the horsemen are authorized a portion of net proceeds. The assumption is that parimutuel revenues will be affected adversely where video lottery games compete directly with them. However, the attraction for some people may be the opportunity to play those games at the tracks. In the first year of video lottery (June, 1990 through May, 1991) handles were down from the year prior to the games' introduction by 6.48 percent at Mountaineer Park, West Virginia compared to 8.08 percent reductions for the same time period at Charles Town Races, West Virginia where video lottery games are not available. The unanswerable question is: to what extent do VLTs contribute to or mitigate declines of wagering when placed at racetracks?

Division of Revenue

1. What percentage of total video lottery revenues should be allocated for lottery prizes for winning tickets or shares?

Policy Implication. Statutory percentages vary but the minimum appears to be 80 percent. In actuality, the winning percentage is considerably lower due to replays. Montana estimates annual paybacks to players of 55 percent and South Dakota realizes paybacks of not quite 64 percent. Nonetheless, paybacks for individual games could be greater and statutory provisions should allow for such fluctuations.

2. Should annual fees be set for video lottery machine manufacturers, distributors, operators, service personnel, and retailers and machines (provided that all the above are authorized participants under state law)? If such fees should be imposed, how much should they be?

Policy Implication. The higher the fee, the more the state collects but the greater the entry barrier for some potential participants. Conversely, more retailers might become involved in video lottery if entry barriers are not prohibitive. The trade off might be to impose lower certification fees and forego upfront revenue from such fees but realize greater net proceeds from an increased number of terminals and higher market penetration. Another consideration is the possibility that annual fees would become the stable, ongoing source of operating income for the regulatory portion of the state's responsibilities.

3. Should a one-time application fee be imposed?

Policy Implication. An application fee might eliminate frivolous applications for participation in the operation and other aspects of a video lottery program. In addition, it could defray part or all of the costs associated with processing of such applications.

4. What percentage of net VLT income should the state retain?

Policy Implication. For those states which decided to regulate video lottery games through their lotteries, the percentage of income allotted them is generally based on net revenues from video games (total revenue after prizes have been subtracted). The percentage the state takes depends, to a certain degree, on the involvement of other participants. In South Dakota, the state's share of net proceeds is now 35 percent and the remaining 65 percent is split between operators and retailers with no state involvement. If there are no private operators, as in Oregon, the state assumes the operator's portion of net proceeds. In Oregon, the state's share is projected to be 56.5 percent.

For those states, such as Montana, which are intent on collecting revenues from now legalized activities but adhere to a decentralized system with provisions for licensure and enforcement, the state's share is collected exclusively in the form of fees and taxes.

If states take a portion of net proceeds from video lottery games, that could use a portion of such proceeds for nonregulatory purposes. As previously noted, Louisiana and West Virginia provide for compensation to horsemen to offset projected revenue shortfalls caused by competing video lottery games. Video lottery proceeds in South Dakota are credited to the State General Fund and are not earmarked but are subject to appropriations for projects determined by the Legislature. Oregon had originally earmarked its video lottery proceeds but subsequently rescinded that statutory provision and proceeds are credited to the General Fund and subject to appropriations.

Suppliers, Operators, and Other Industry Participants

1. Should there be any prohibitions against vertical integration in the video lottery industry?

Policy Implication. Montana does not have prohibitions against vertical integration but, due to reported abuses, is considering them. Such prohibitions are contained to some extent in South Dakota's statutes although retailers may also be operators (a policy consideration if the state opts for operator participation). The intent of prohibitions against vertical integration is to dilute the control of private entities over video lottery games and thereby reduce the potential for illicit activity associated with those games. The operating assumption of such policies is the wider the array of private participants in providing video products and services, the greater the potential for abuse. Therefore, these prohibitions, coupled with the state's commitment to adequately enforce them, should be considered an option if a multi-tiered private system of distribution and operation is implemented.

2. Should "gray machines" be banned? Should "gray machines" be "grandfathered in"? If not, what should be done to ensure that a video lottery machine is not a "gray machine" and has been certified by the Lottery?

Policy Implication. The argument for banning "gray machines" is that, if not banned, they will compete with state licensed machines and there will be inducements for operators to offer establishment owners a higher revenue return since the state's share would not be involved. Naturally, this course of action will impact negatively market penetration of state licensed machines. However, it is not sufficient to ban "gray machines" if the state does not adequately enforce the ban. In the Oregon State Police report to the Oregon Lottery Commission on security issues, it was reported that a major concern of the Atlantic Lottery (New Brunswick and Nova Scotia) was the continued use of "gray machines" despite the ban and the failure of the local police to enforce the

ban. Another problem that might arise is the seizure without compensation to owners of "gray machines," which were purchased prior to state regulation.

With respect to "grandfathering in" "gray machines," the policy consideration is that all machines should meet uniform standards established by the state. If they fail to do so, these machines would only succeed in undermining the integrity of the program.

Finally, the question arises as to how to inform players that they are playing on state-approved machines and not on "gray machines." To that end, a recommendation by the Oregon State Police would require the screen on the machine to display the state logo at all times during operation and require the capability of the Central Site to change the color of the logo within 250 lines of color. If it is feasible to manufacture machines with this feature, such a safeguard might be an option for consideration.

Games

1. Should a county be allowed to prohibit video lottery games?

Policy Implication. All current lottery games in Kansas are available on a statewide basis. Therefore, any provision to authorize counties the option of prohibiting video lottery games is a departure from the policy governing other forms of lottery games. However, if video lottery machines can only be placed in establishments which sell alcoholic beverages, "dry" counties, which do not permit sales of liquor by the drink at eating establishments, might not want these machines at dinner clubs. Moreover, video lottery games, if not adequately monitored by the state, could involve opportunities for participant abuse, resulting in increased criminal activity in counties. These games also could impact adversely other already established forms of entertainment in a given locale.

2. Should limits be placed on the bets and prizes for a single game?

Policy Implication. Provisions vary among states with respect to the highest amount bet and the highest amount for which credit may given per game. Montana, South Dakota, Louisiana, and Oregon set the limit for a bet per game at \$2.00 but treat credits differently. In Montana credits may not be awarded in excess of the following amounts: \$100 a game for draw poker and \$800 a game for keno or bingo. In South Dakota, credits or free games may not be awarded in excess of the value of \$125 per credit value of \$0.25 played. In Louisiana, awards or credits per game may not exceed \$500. In Oregon, the maximum prize paid for any game will be \$600. One might argue that the greater the amount available for prizes per game, the greater the inducement to play, and, potentially, the greater the amount in gross revenues that will be generated.

Regulation

1. Should the video lottery machine be automated and connected to the regulatory agency's central computer?

Policy Implication. A response to this question is affected by a response to the second question, General Policy Frameworks section. If VLTs are part of an automated network, the regulatory agency has more direct control over, and easier access to, information about machine performance. However, automated networks are undoubtedly more expensive than decentralized

unautomated systems, such as the one in Montana. If a state chooses to use an automated system with dedicated lines linking VLTs to the mainframe computer in the Lottery, as Oregon intends to do and Louisiana intends to do to a more limited extent, information will be transmitted immediately and security will be tighter and control over the system will be greater than is the case with the dial-up arrangements, found in South Dakota. In that state, information on machine performance is transmitted on a periodic basis. However, costs associated with dedicated lines could be greater than those associated with dial-up linkages if all other conditions are equal. To establish that fact for a given state, a cost-benefit analysis might be advisable.

Furthermore, to the extent that all of the machines on-line have to be compatible, one or two vendors may have a defacto monopoly on providing equipment.

2. What measures should the Lottery undertake to ensure that VLTs and associated equipment meet acceptable standards for certification?

Policy Implication. This question is relevant to states which permit more than one manufacturer or distributor of video lottery equipment. South Dakota statutes, for example, include several provisions to ensure that VLTs meet certain standards. A manufacturer or distributor may not distribute a machine for placement in the state unless it has been approved by the Lottery. A manufacturer licensed by the state must submit to the Lottery information specified in statute for purposes of testing and analyzing the machine or associated equipment. The Lottery may also request that two working models of a machine be transported to the location the Lottery designates for testing, examination, and analysis, all of which would be done at the manufacturer's expense. Other statutory provisions address reporting of test results, procedures for allowing manufacturers to modify previously approved models, the need for machines to conform to prototypes, hardware and software requirements, transportation of machines, required training programs for operators and service personnel, and machine maintenance requirements. The more extensive the requirements concerning the condition and maintenance of the machines and the training of those licensed to operate and service them, the fewer problems the state should encounter with respect to machine operations. This assumes, of course, that the state commits to enforcing those requirements.

3. On what basis should lottery devices be deemed "illegal"? What judicial recourse should be available in the event that "illegal" devices are seized?

Policy Implication. There should be some basis for determining noncompliance of machines. South Dakota's law permits seizure or sealing of machines if these machines are found to be in noncompliance with the specifications required for Lottery approval. A notice and hearing must be conducted on the violations prior to making determinations.

STATE OF KANSAS

Attach. 5
Reilly



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JOAN FINNEY, GOVERNOR

GLORIA M. TIMMER, Director

March 5, 1992

KBI Impact

The Honorable Edward Reilly, Chairperson
Committee on Federal and State Affairs
Senate Chamber
Third Floor, Statehouse

Dear Senator Reilly:

SUBJECT: Fiscal Note for SB 695 by Committee on Federal
and State Affairs

In accordance with KSA 75-3715a, the following fiscal note
concerning SB 695 is respectfully submitted to your committee.

SB 695 would authorize the Kansas Lottery to offer video
lottery. Video lottery machines could offer a variety of
games, including poker, blackjack, bingo, and keno. Players
would have to be at least 21 years old, and winning players
would receive free games or credits redeemable for cash. The
maximum wager would be \$2 per game, and the maximum prize would
be \$1,000 per game. The machines could be operated only at
retail liquor stores, establishments (or defined areas of)
which derive at least 30 percent of sales from beer or
alcoholic liquors for on-premise consumption, licensed
racetrack facilities, and the State Fairgrounds during the
annual fair. A drinking establishment licensed to retail video
lottery could not have more than 10 machines.

To qualify as a retailer, manufacturer, distributor, or
operator, the person would have to be at least 18 years old and
meet certain financial and criminal background standards, as
well as others. A video lottery retailer would be required to
be licensed also as a retailer of instant lottery tickets, and
an operator would be required to be a state resident. Licenses
as a retailer, manufacturer, distributor, and operator would be
mutually exclusive -- the only exception being that a person
could be licensed as both a manufacturer and a distributor.
Video lottery machines would be monitored through a central
communications system, but the system would not have to be an
on-line system.

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Retailers, manufacturers, distributors, and operators could be charged an application fee not to exceed \$500. Annual fees would be charged, but could not exceed, \$500 for a retailer, \$20,000 for a manufacturer, \$5,000 for a distributor, or \$5,000 for an operator.

On average, between 85 percent and 95 percent of video lottery wagers would be paid back as prizes. Of the net video lottery income, the state would receive 40 percent, the retailer would receive 30 percent, and the operator would receive 30 percent. All fees and the state's share of net income (less operating costs) would be credited to the State General Fund.

Tampering with a licensed video lottery machine or possessing an unlicensed machine would be a Class D felony. Permitting anyone under 21 years of age to play video lottery would be a Class A misdemeanor upon the first conviction and a Class D felony upon subsequent convictions.

The Kansas Lottery estimates the state's annual share of net income to be \$73,695,899, and first-year expenditures to be \$2,414,375. Assuming 12 months of operation, the Lottery estimates transfers of \$71,281,524 to the State General Fund. Based on South Dakota's experience with video lottery, the Kansas Lottery also notes the possibility of a 25 percent decrease in sales of existing games. The *FY 1993 Governor's Budget Report* estimates instant, pull-tab, and on-line sales of \$72 million in FY 1993, 30 percent, or \$21.6 million, of which would be credited to the State Gaming Revenues Fund.

The *Governor's Message* estimated the state's share of net income from video lottery to be \$50 million annualized and \$30 million in FY 1993, assuming seven months of operation.

The Lottery's revenue estimate, detailed below, is based on a per capita ratio of the net income received by the state of South Dakota in the first year of video lottery operation. The fee estimates assume three manufacturers at \$20,000 each, three distributors at \$5,000 each, operators with 8,500 machines at \$150 each, and 1,700 retailers at \$100 each.

State Share of Net Income	\$72,175,899
Manufacturer Fees	60,000
Distributor Fees	15,000
Operator Fees	1,275,000
Retailer Fees	<u>170,000</u>
Total	\$73,695,899

The estimate of the state share of net income is further detailed below. Prior to the introduction of video lottery,

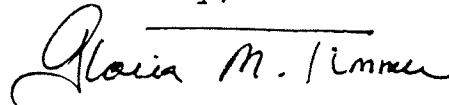
South Dakotans wagered a per capita average of \$17.65 on instant game sales, compared to a per capita average of \$12.36 for Kansans. A Kansan's propensity to wager may then be assumed to be 70 percent ($\$12.36 \div \$17.65 = .70$) of a South Dakotan's. During the first year of operation, the state of South Dakota received net income which averaged \$104 per capita. Adjusting this average by the propensity to wager results in a Kansas net income average of \$72.83 per capita ($\$104 \times .70 = \72.83). Given the 1990 Kansas population of 2,477,547, total net income would be \$180,439,748, of which 40 percent, or \$72,175,899, would be the state share.

	<u>South Dakota</u>	<u>Kansas</u>
Instant p/c Sale (FY 1991)	\$17.65	\$12.36
Relative Propensity to Wager		.70
p/c Net Income	\$104.00	\$72.83
Kansas Population		2,477,547
Total Net Income		\$180,439,748
State Share (40%)		<u>\$ 72,175,899</u>

The Lottery's expenditure estimate is detailed below. Expenditures for capital outlay and many of the background checks would not be recurring costs.

Computer/Software	\$1,500,000
Background Checks	425,000
12 FTE Positions	394,755
Other Operating Expenditures	<u>94,620</u>
Total	\$2,414,375

Sincerely,



Gloria M. Timmer
Director of the Budget

cc: Gary Saville, Lottery

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