

TO: The Honorable Ron Ryckman, Jr., Chairman
House Appropriations Committee

FROM: William W. Sneed, Retained Counsel
Kansas Entertainment Group

SUBJECT: H.B. 2537

DATE: March 15, 2016

Mr. Chairman, Members of the Committee: My name is William W. Sneed and I am retained counsel for Kansas Entertainment Group. Recently my law firm was retained by Hollywood Casino at Kansas Speedway ("Hollywood") to assist them in responding to a letter of inquiry they received from the Kansas Attorney General. In short, the question we received was whether H.B. 2537 would be an expansion of the Kansas Expanded Lottery Act ("KELA") requiring the repayment of Hollywood's \$25 million privilege fee, as well as other potential charges. As you can see by the attached letter, our conclusion to this question is yes.

As the attached letter is self-explanatory, I will not repeat its responses in this memo, but incorporate them by reference.

I am happy to discuss this at your convenience.

Respectfully submitted,



William W. Sneed

WWS:kjb
Attachment



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February 24, 2016

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Re: Proposed Legislation Amending KELA

Dear Deputy Attorney General Andaya,

Please allow me to provide a response to your February 11, 2016 letter addressed to Rick Skinner, General Manager of Hollywood Casino at Kansas Speedway ("Hollywood"). I am outside counsel to Hollywood, and respond on its behalf.

Hollywood has reviewed Representative Mark Kahrs' February 8, 2016 letter and the legal discussion set forth therein and agrees with his statement that House Bill 2537 currently pending before the Kansas Legislature would be an expansion of the Kansas Expanded Lottery Act ("KELA") requiring the repayment of Hollywood's \$25M privilege fee, as well as potential additional damages under both KELA and the Lottery Gaming Facility Management Contract entered into between Hollywood and the State of Kansas. While KELA does not make clear the date when the refund payment would be triggered, arguably it would be due the day KELA is amended. Our analysis follows:

Question 1: Would enactment of a bill, such as HB 2537, that permits a revoke on electronic gaming machines at a racetrack in Sedgwick County breach the management contracts between the Kansas Lottery and the Lottery Gaming Facility Managers and thereby result in imposing on the State of Kansas repayment of privilege fees plus interest, as specified in KSA74-8734(h)(19)?

Answer: Yes. KELA specifically provides that any management contract between the state and the Lottery Gaming Facility Manager must contain a provision prohibiting the state, until July 1, 2032, from entering into management contracts for more than four lottery gaming facilities or similar gaming facilities. KELA also requires the management contract to contain a provision requiring the state to repay to the lottery gaming facility manager an amount equal to

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the privilege fee plus interest compounded annually at the rate of 10%, if the state violates this prohibition.¹

In compliance with KELA, The Lottery Gaming Management Contract signed by the State of Kansas and Hollywood does contain the required provision. Paragraph 30 provides as follows:

Prohibitions Applicable to the State. The Kansas Lottery, acting on behalf of the State of Kansas, agrees by entering into this Agreement that:

a) Neither the Kansas Lottery nor the State of Kansas will enter into a management contract for, or otherwise authorize, more than four (4) lottery gaming facilities or similar facilities in the four gaming zones outlined in the Kansas Expanded Lottery Act with one lottery gaming facility in each gaming zone;

(b) Neither the Kansas Lottery nor the State of Kansas will designate additional areas of the state where operation of Lottery Gaming Facilities or similar gaming facilities will be authorized, other than those set out in the Kansas Expanded Lottery Act; or

c) Neither the Kansas Lottery nor the State of Kansas will operate an aggregate of more than 2,800 Electronic Gaming Machines at all pari-mutuel licensee locations.

Currently there are four management contracts for four casinos in the four designated zones. All of the pari-mutuel licenses that existed at the time KELA was passed have now lapsed and all pari-mutuel operations have closed. As noted by Representative Kahrs, voters rejected the placement of electronic gaming machines at Wichita Greyhound Park in 2007, and a second election is not timely nor permitted under KELA.² Thus, if any new legislation (such as House Bill 2537), allowed new elections such that the State could enter into any new management contracts, or if such proposed legislation designated any additional gaming zones, such legislation would be an expansion of KELA, and a breach that triggers the State's repayment obligations.

Paragraph 31 of Hollywood's management contract reads:

¹ KSA 74-8734(h)(19).

² See KSA 74-8743(a) and (e).

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State Payment for Breach. Manager will be entitled, as its sole monetary remedy, to payment in an amount equal to the actual privilege fee paid by Manager, plus interest on such amount, compounded annually at the rate of ten percent (10%), if the State of Kansas violates any provision in Paragraph 30 above during the term of this Agreement.

In addition, paragraph 8 of Hollywood's management contract further clarifies that Hollywood is entitled to "seek repayment of Managers' privilege fee if the Kansas Expanded Lottery Act were to be amended or repealed by a legislative body..."

By seeking to alter the language of KELA—including decreasing the percentage of electronic gaming machine ("EGM") income that pari-mutuel licensees are required to pay to the expanded lottery act revenues fund from 40% to 22%, and removing altogether the requirement that 15% of EGM income be used for gaming expenses—HB 2537 constitutes a substantial amendment to KELA. Upon the enactment of HB 2537, KELA would, therefore, have been "*amended* or repealed by a legislative body," in violation of paragraph 8 of Hollywood's management contract, thereby entitling Hollywood to seek repayment of its privilege fee, and pursuant to paragraph 24, "to seek reimbursement or damages from the Kansas Lottery."

Hollywood paid a \$25 million privilege fee to the state in 2008. Under both KELA and the management contract, the state would be required to refund this fee to Hollywood along with interest compounded at the rate of 10% a year. The interest amount alone to date would exceed \$19 million if the new legislation were to pass, so the State would be required to pay Hollywood an amount in excess of \$44 million.

Under KELA and presumably similar provisions in the other State management contracts, the other three existing Kansas casinos would also be entitled to a return of their privilege fees and compounded interest calculated from the date of payment.

Question 2: Would such a breach of contract subject the state to additional liabilities for damages?

Answer 2: Under Hollywood's management contract, a breach of paragraph 30 caused by the authorization of gaming at Wichita Greyhound Park would entitle Hollywood to the monetary remedy set forth above. It is not clear whether further monetary damages for lost profits would be available as damages for this breach. However, since the return of the privilege fee is a specific remedy for a specific breach, then it is possible that if an expansion of KELA

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caused the state to breach any of its other contractual obligations to Hollywood, then Hollywood could seek all contractual remedies provided by law, including any lost profits.

That breach of Hollywood's management contract would subject the State to additional liabilities for damages is further supported by Exhibit F to the contract, which sets forth the standard contractual provisions to be included in all State contracts. Although these provisions are rarely negotiated or altered, in Hollywood's contract, the State agreed to revise certain language respecting damages. In specific, the State agreed to include "except as otherwise provided in the contract" language to its otherwise full disclaimer of liability. By doing so, the State expressly acknowledged that the provisions of the contract could potentially subject the State to additional liabilities for damages.

Question 3: Would such a breach of contract occur at the time the bill is enacted?

Answer 3: The breach of paragraph 30 occurs at the time the state signs a new management agreement or designates an additional area where gaming is authorized. Thus, a breach would exist upon the enactment of the new legislation. A breach of the management contract pursuant to an amendment of KELA would accrue at the enactment date.

Aside from exposing the State to potentially substantial liability, the enactment of HB 2537 would allow additional gambling a mere five miles from the Hollywood facility. The State would not realize any increase in gaming tax revenue or jobs for its residents, however, as the two facilities would share the exact same market.

In addition, Hollywood makes substantial statutory and charitable contributions to the Unified Government of Wyandotte County (the "UG"), which contributions are based largely on Hollywood's gaming revenue, including the revenue generated from EGMs. The reduction in Hollywood's gaming revenues that would result from HB 2537 would necessarily effect a proportionate decrease in revenues flowing to the UG.

We hope this assists you in formulating your response. Please do not hesitate to contact me if you have any questions about the foregoing analysis.

Sincerely,


Korb Maxwell