

**TESTIMONY BEFORE SENATE FEDERAL & STATE AFFAIRS
COMMITTEE
In support of SB 427
April 3rd, 2018**

Mr. Chairman and members of the Committee:

I'm Mike O'Neal, appearing here today as legal counsel for the Greater Kansas Racing Alliance, comprised of farmers, ranchers, ag suppliers, veterinarians, Kansas businesses, trade associations and others who support the revitalization of the dog and horse racing industries in Kansas and the economic opportunities this would bring to the state as a whole.

My interest in racing dates as far back as 1986 with the passage of the pari-mutuel constitutional amendment. My legislative district included the Kansas State Fairgrounds in Hutchinson and we had an interest in running horses on the Grandstand track. The industry has over 100 years of history in this state. Indeed, horse and greyhound racing in Kansas predates the founding of Las Vegas!

I have watched the steady expansion of gaming over the years, including the Tribal compacts in the early '90's, through KELA in 2007 and even amendments and changes since to accommodate smaller investment projects and ease requirements on casinos. Nothing remains static and Kansas is always taking steps to stay competitive with surrounding states and respond to changing economic conditions.

This year's bill is an effort to fulfill the goal of these groups to make racing viable in Kansas while at the same time addressing questions and potential concerns that have been raised regarding changes in KELA, the Kansas Expanded Lottery Act. This is an emotional issue for all concerned. The harder this group fights, the harder the casino interests push back and the louder the rhetoric, claims, and threats become. My hope is to have a civil discussion of what we see as a mutual goal to fulfill the intent of the original law for the benefit of Kansas.

SB427 contains a preamble setting forth its purpose and intent. The bill acknowledges the existence of contracts currently in place with casino managers and provides a process by which legal issues, if any, can be expeditiously resolved. Where a claim is

made that would, if successful, expose the State to repayment of a privilege fee or fees and any accrued interest, provision is made to have the subject racetrack manager provide a letter of credit acceptable to the Ex. Dir. of the Kansas Lottery to cover any monetary liability the State may have in that regard. Repayment of the letter of credit comes only from a share of net new revenues from slots at the subject track. The track assumes any repayment risk.

SB 427 also provides a mechanism for another vote in Sedg. Co. on the issue of placing EGM's (slots) at Wichita Greyhound Park. It has been more than 10 years since the last vote.

SB 427 also changes the rate a racetrack gaming facility pays the State from 40% to the same 22% rate paid by casinos for the same type of gaming device. This is essential to the ability of racetrack facilities to open and operate economically. There is a compelling issue of tax fairness and the unconstitutionality of disparate tax treatment of identical items of property.

In anticipation of some of the questions I suspect will be asked, I have provided some answers in my written testimony (below) and, of course, I will be happy to answer any additional questions that may arise. In addition, I have attached Dr. Art Hall's report on the economic impact of restoring live horse and greyhound racing in Kansas from last year's hearing. Keep in mind that his report does not count revenue derived directly from gaming. His report tells the story of how the overall economy of the state is benefitted. No one needs to be reminded of the need to help our agriculture sector and those who supply that sector and depend on that sector for their livelihoods. No economic development incentives are requested. Private investment alone to reopen the tracks is estimated at \$160M.

Q: What about the AG opinion that a second vote in Sedg. Co. would constitute adding a gaming facility, thus violating the contract with the SC gaming zone Manager?

A: The opinion contains a major analytical flaw. The AG, instead of interpreting the phrase "additional areas of the state", erroneously singled out the word "additional". The word "additional" in the act does not modify the word "gaming". Rather, it modifies "areas of the state". The bill does not add "additional areas of the state" as Wichita is already an approved venue for a racetrack facility.

Q: Is the provision in KELA setting a deadline for a vote on EGM's at tracks directory or mandatory, such that a vote after that date would be prohibited?

A: The provision would, in all probability, be construed as directory and not mandatory. A statute is directory when the provisions establish "a manner of proceeding and a time within which an official act is to be done and is intended to secure order, system, and dispatch of the public business." See *Marais Des Cygnes*

Valley Teachers' Assoc. v. Board of Ed, USD #456, 264 Kan. 247 (1998), where a provision calling for a teacher evaluation prior to Feb. 15 was found to be directory vs. mandatory such that additional evaluations taken after that date were not invalid. The court stated that factors which would indicate that the provisions are mandatory are: (1) the presence of negative words requiring that an act be done in no other manner or at no other time than that designated, or (2) a provision for a penalty or other consequence of noncompliance. The court found neither existed. Instead, they found a provision that simply stated a time within which action was to be taken.

Under KELA, the manner and timing of a vote is subject to exceptions where a substantially similar vote has taken place in the geographic area. In addition, no provision was added describing any consequence or penalty for not following the procedure outlined. The 180-day deadline for a vote was directory, not mandatory and nothing in the act prevents a subsequent vote. Even so, provision is made in the bill to protect the state in the event a suit by the SC zone manager is successful.

Q: Did the AG say that the casinos could sue for monetary damages other than return of privilege fee and interest if legislation passed?

A: No. What the AG's opinion said was that "in the absence of enactment of new legislation to allow placement of EGM's at the Wichita racetrack facility", the Manager would have a claim for damages from lost market share. The AG clearly said that legislation could allow a re-vote in Sedg. Co. and that could give rise to a claim by the Manager in the South Central zone. He said, "it cannot be determined with certainty what the remedy would be for a breach under Paragraph 59. However, we think it likely the Manager would demand refund of the privilege fee under general principals of contract law..." (Interestingly, the provision in Paragraph #59 of the SC gaming contract the AG references does not appear in Paragraph #59 of the contract for NE Kansas.)

Q: Do the casino contracts contemplate that there will be changes from time to time in KELA?

A: Yes, and of course there have been. There is a specific provision in the management contracts addressing contract amendments in the event of changes in the law, as follows:

"This Agreement will also be modified, in whole or in part, in order to comply with future statutory enactments or judicial interpretations of applicable law by a court of competent jurisdiction. This Agreement is subject to modification, in whole or in part, or cancellation, as deemed necessary by the Executive Director to comply with any future statutory enactments, subsequent regulatory changes, or judicial interpretations of applicable law by a court of competent jurisdiction occurring after this Agreement's execution, without additional consideration being exchanged between the parties..." (Paragraph #59)

Q: Reference has been made to possible remedies under Paragraph 65 of the casino contracts. Would passage of this bill create any additional financial exposure to the State?

A: No, that paragraph creates certain circumstances under which a Manager could cease management activities if the State took certain listed actions, such as: reducing the term of the agreement, increasing minimum percentages, failure to pay Manager compensation, prohibiting the sale of alcohol, precluding operation of table games, a court invalidating the prohibitions against the State allowing additional or expansion of lottery gaming zones, the lottery gaming facility operating at a loss, or the Lottery deciding to deactivate or cease operation of enough games as to make operation no longer commercially feasible.

Q: Is a Manager's sole monetary remedy against the State return of the privilege fee plus accrued interest, in the event a court would find a breach of contract by virtue of passage of this legislation?

A: Yes, the contracts themselves refer to return of privilege fee plus accrued interest as the "sole monetary remedy" for breach of the State's promise to not authorize more than 4 lottery gaming facilities in the 4 zones, not designate additional areas of the state where lottery gaming facilities could operate, or approve the operation of more than 2,800 EGM's at all pari-mutuel licensee locations.

Q: Does interest accrue from the date the privilege fee was originally paid or from the date of breach?

A: Interest would accrue from the date of an alleged breach. There is no provision in KELA that states that interest accrues from the date of payment of the privilege fee. In such circumstances, interest accrues from the date of breach. This is your Revisor's opinion as well and is supported by rules of statutory construction.

Q: Would passage of this legislation constitute a breach of the State's contracts with the casinos?

A: No. The legislation does not add additional gaming zones or add counties to existing zones, nor does it increase the number of allowed slots at the tracks.

Q: What about the argument that allowing another vote on slots at Wichita Greyhound Park would be authorizing a "similar gaming facility"?

A: The term "similar gaming facility" in KELA is tied to "lottery gaming facilities" not racetrack facilities. The best illustration of this, among a host of other factors, is there is a prohibition in KELA from having more than one lottery gaming facility "or similar gaming facility" in the same gaming zone. If a racetrack facility were also a "similar gaming facility" then KELA would have been violated when the casino was

approved in the NE zone since the Woodlands already existed. This was never the case, and wouldn't be the case. Also, the tracks would have but a single game in common with lottery gaming facilities. "Similar gaming facility" contemplates a facility virtually identical in character to a lottery gaming facility.

Q: Has there been an independent study showing the potential economic impact to the state in the event of passage of this legislation?

A: Yes, one. Performed by Dr. Art Hall, economics Professor at K.U., the study showed that passage of the bill would have a significant positive impact on the state's economy as a whole and especially within the struggling agricultural community, with significant growth in jobs, tax revenue and income. There have been no studies or testimony presented thus far suggesting a negative economic impact to the state.

Q: What about the provision reducing the amount the tracks have to pay in slot revenue to the same amount as the casinos?

A: First, the legislation does not increase the percentage casinos pay to the state. Second, there could be no claim for loss of profits, or the like, because KELA doesn't authorize such recovery and, more importantly, did not grant casinos an exclusive right to slots. KELA clearly intended there to be both casinos and tracks with slots in 3 of the 4 zones. The casinos are not guaranteed an exclusive on slots and are not guaranteed a certain minimum amount of revenue. Competition was intended. A gaming monopoly was not.

Add to that the fact that the significantly different tax treatment for slots at casinos and for slots at tracks raises serious constitutional questions. Indeed, on facts virtually identical to those we have here, the Iowa Supreme Court struck down provisions in their law that treated slots at tracks and slots at the riverboat casinos differently. *See Racing Assoc. of Central Iowa et al v. Fitzgerald, 675 N.W. 2d 1 (Iowa 2004)*.

In *Fitzgerald* the disparity was 22% for the boats vs. 36% at the tracks. The court reasoned that the item being taxed was identical. It was the location of the item that triggered the tax. This, they found, was unconstitutional. The Kansas situation is identical. Think about the slot machine at the Legends location vs. the exact same slot machine across the Interstate at the Woodlands. (Of interest is the fact that Hollywood Casino in Maryland has been seeking legislation to reduce its tax rate to that of some competing casinos in the state who were granted lower rates)

The circumstances today are vastly different than they were in 2007. Then, we had tracks but no casinos. The law facilitated the co-existence of both and casinos were built. Today we have casinos but no operating tracks due to the fact that the disparate tax rate made operating tracks at a profit not commercially feasible. This legislation serves, once again, to facilitate the co-existence of both, thereby staying

true to the original intent of the law. A casino monopoly in Kansas was never intended.

In that regard, for a candid and concise background on the history of gaming in Kansas, read former Ex. Dir. of the Kansas Racing and Gaming Commissioner, Stephen Martino's article "*Allocation of Gaming Licenses and Establishment of Bid Processes: The Case of Kansas, 2008 and 2009*" in UNLV Gaming Research & Review Journal, Vol. 14, Issue 1. He co-authored with Wm. Eadington, PhD, Prof. of Economics, College of Business, Dir., Institute for the Study of Gambling and Commercial Gaming, University of Nevada, Reno.

In the article they explain "lawmakers have typically created economic environments where permitted gambling is largely under-supplied relative to potential demand." They noted that this can be done in a variety of ways, including issuance of a "monopoly license" for a geographic area, restrictions on the number of licenses or locations, geographic locations, restrictions on what can be offered at certain locations, and limiting casino gaming to government-owned and/or operated facilities. (They suggested KELA as a model)

The article candidly points out that "[w]hen casino gaming is purposely under-supplied, or when potential licensees are offered an exclusive franchise to exploit a casino market, the result is often a situation where 'economic rents', or excess profits, can be earned indefinitely into the future." They note that [c]ompetitive markets would have the effect of bidding away excess profits over time, allowing participants the opportunity to earn only 'normal' profits in the long term. Constraints on competition or supply prevent competitive market conditions from having this effect." (Journal at page 38)

The Kansas plan, KELA, was designed as a hybrid, granting exclusivity for casinos in 4 zones for a wide array of games, while setting up co-existing racetrack facilities in 3 zones with the ability to offer but a single game, slots. Clearly, with no tracks in operation today, the casinos naturally have an interest in protecting this de facto monopoly situation, although entirely unintended by KELA. The above article explains why. Any competition would have the effect, over time, of limiting "excess profits" to "normal profits". Yet, KELA contemplates the co-existence of these entities. This bill restores the original intent of KELA and, if you will, rights the wrong to provide a level playing field where the "whole can become greater than the sum of its parts". In short, with the rate for tracks set at 40%, the state gets 40% of zero revenue, since the tracks can't open and operate at that rate. Reducing the rate to coincide with the casino rate on that same game means the state will enjoy the benefits of 22% of revenue that will actually flow as a result of the reopening and operation of the tracks.