

House Gaming Oversight Committee
Department of Revenue
Stephen H. Stetler, Secretary
May 21, 2009

Chairman Santoni, Chairman Schroder and members of the House Gaming Oversight Committee, thank you for again allowing me the opportunity to testify before you today regarding HB 1317, the Governor's proposal to provide tuition funding by introducing video lottery terminals in Pennsylvania bars and restaurants.

To begin with, I would like to address a few questions raised during past hearings, and then move on to an explanation of how this proposal would work.

The committee has asked if we would support a ban on political contributions, similar to what was written into the slots law. As I'm sure you are aware, since that time, the Pennsylvania Supreme Court has ruled that the ban written into the slots law is unconstitutional; however, I would like to assure the committee that we remain committed to exploring any safeguards that would ensure the protection of the public interest in the Tuition Relief Act.

Another question raised was how the net profit figure of \$86 per day, per machine was calculated. Based upon information from Louisiana, Montana, West Virginia and South Dakota, we estimated that 35,400 active video lottery terminals would generate approximately \$31,500 per machine annually. Further breaking down an annual \$31,500 net profit per machine, we arrived at approximately \$86 per day, per machine.

We also had some discussion on how the legalization of video lottery terminals would reduce the number of illegal gaming devices that are currently active. First, it is our understanding that law enforcement currently needs to observe a payout from an illegal gaming device in order to seize it. Second, as I indicated before, video lottery terminals will likely have a higher payout than the illegal devices. As a result, they would be more attractive to play.

The committee also asked whether HB 1317 provides the appropriate administrative resources. The bill provides the Department of Revenue with \$20 million for start-up costs, which breaks down to \$3 million in personnel costs and \$17 million for operational costs, which includes the installation of the Central Computer System. Moving forward, licensees would be required to pay a nonrefundable application fee of \$500, as well as an annual fee of \$500 per machine. We are confident that these resources are sufficient for the department to perform its duties under the bill.

Having addressed those points, I will now turn to an overview of HB 1317.

Under this proposal, regulating these terminals is expected to generate \$128 million in its first year of operation. Once fully implemented, video lottery terminals are estimated to

generate up to \$550 million annually. These funds would be dedicated to helping state-system and community college students pay for higher education.

Presently, the use of illegal gaming devices is an active and thriving industry in private clubs and bars across the Commonwealth. Although the notion has been put forward, the introduction of video lottery terminals in Pennsylvania is not an expansion of gaming; rather it is a regulated replacement of an already existing illegal business that has operated free-range for far too long. By moving forward with this proposal, Pennsylvania would join the ranks of at least nine other states that have already taken the initiative to put an end to illegal gaming devices by establishing a regulated and controlled industry that serves to benefit their citizens. In addition to providing this much-needed relief to our young people who are seeking to better themselves -- and in turn, our Commonwealth -- by pursuing higher education, this bill would give the Commonwealth the tools to remove unscrupulous operators and impose penalties upon those who violate the law.

Bars, taverns, private clubs and other businesses with valid liquor licenses would be eligible for licenses to have up to five video lottery terminals per establishment. Licensees would be required to pay a \$500 application fee in the first year and a \$100 renewal fee each year after. In addition, the licensee would be responsible for paying \$500 per terminal, per year. Those applying would be held to the same licensing standards as Lottery retailers, which would require them to be current on all state taxes, have funds on hand to pay prizes and never have been convicted of a crime related to gambling or fraud, among others. Liquor Control Enforcement Agents and the Pennsylvania State Police would be responsible for enforcing the Act.

A central computer system would be established to provide game services, including all video lottery terminals. The central computer system would host a single random number generator that would determine the outcome of each game on each terminal. This system would be operated by the Department of Revenue. With the benefit of already having experience with our existing Lottery games, we believe we can get this central computer system up and running quickly and efficiently. We expect start-up costs to be approximately \$20 million.

The estimated revenues generated by the proposal are based upon approximately 35,000 active video lottery terminals. That is, 8,800 licensed establishments averaging four terminals per location. The minimum payout would be 80 percent of amounts wagered, with prizes limited to less than \$600. It is anticipated that the net profit per machine, per day, would be \$86. Those profits would be distributed as follows: 50 percent to the Tuition Relief Fund; 25 percent to licensees; and the remaining 25 percent to cover the costs of administration by the Department of Revenue, the Liquor Control Board and the Pennsylvania State Police. I would note that we project administrative costs to be lower than 25 percent. Any remaining balance would be deposited into the General Fund.

Before closing, I would like to address one more point that is sure to arise, and that is, would this impact the Lottery. To that, I would like to make a few points. First, video

lottery would not introduce new gaming competition – unregulated, illegal gaming devices thrive today, yet the Lottery continues to grow. Second, this is the same argument that was made when the first casinos opened their doors in 2006 and was proven unfounded. For the second year in row, the Legislative Budget and Finance Committee could not identify any distinctive negative impact on the Lottery due to the casinos. Last, although the impact of video lottery on traditional lotteries varies from jurisdiction to jurisdiction, HB 1317 contains safeguards for protecting the Lottery Fund in the unlikely event video lottery negatively impacts Pennsylvania Lottery sales. The hold-harmless clause in the proposed legislation provides for a transfer to the Lottery Fund from the General Fund if Lottery determines sales were negatively impacted by video lottery terminals

In addition, this bill allows the Pennsylvania Lottery, at its discretion, to require video lottery licensees to also sell Lottery tickets. This has the potential to actually benefit our Lottery by expanding its market to new retail locations. I would note that a similar provision exists that requires Pennsylvania casinos to sell Lottery tickets, and it has proven to be a success.

The Pennsylvania Lottery is recognized as an industry leader -- ranking sixth in total annual sales and fifth in annual profits generated among the 43 U.S. lotteries -- and it continues to grow. Over the last six years, the Lottery has grown its business by more than \$1 billion dollars to fund programs that support Pennsylvania's seniors. It is our intention to continue this success, and we are satisfied that HB 1317 would not hinder that.

The sooner legislation is enacted and the sooner we may begin to get operations up and running, then the more quickly we can get emergency tuition relief into the hands of our young people during these difficult economic times. Again, I would like to thank the committee for allowing me the opportunity to speak here today and I would be happy to answer any questions that you may have.