

State of Delaware

Video Lottery Advisory Council

November 5, 2012

Mr. Tom Cook
Secretary of Finance
State of Delaware
Carvel State Office Building
820 N. French Street
8th Floor
Wilmington, DE 19801

Dear Mr. Cook,



In accordance with Title 29, Chapter 29, Paragraph 4824 of the Delaware Code, attached is the 2012 Report of the Video Lottery Advisory Council (VLAC). This report contains legislative recommendations of the VLAC necessary to allow the Delaware gaming industry to remain competitive, given the increasing changes to the mid-Atlantic gaming environment. Members of the VLAC representing state office or the slot machine industry were not asked to vote on the recommendations included in the attached report, in respect of the sensitivity of their positions.

I, as well as the other Delaware video lottery agent representatives who serve on the VLAC, look forward to discussing the recommendations in the attached report.

Sincerely,



Edward J. Sutor
Chairman
Attachment

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**Video Lottery Advisory Council
2012 Report**

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What is the competitive outlook for Delaware gaming?

Delaware slot revenues have declined since the opening of the first Pennsylvania casino, Philadelphia Park, in December 2006. The 3rd quarter of 2012 marks the 19th consecutive quarter, over 57 months, of declining slot revenues.

- Additional Maryland casinos and additional competitive initiatives:
 - *Maryland Live at Arundel Mills, Maryland's third and largest casino, opened on June 6th, 2012 with 3,000 slot machines, and quickly increased to 4,750 slot machines in September 2012, making it one of the nation's largest casinos. As projected, due to location and size, Maryland's newest casino has had a more significant negative impact on Delaware's gaming revenues than any other single competitor to date. For the 3rd quarter of 2012, Delaware casino revenues were down 13% compared to the 3rd quarter of 2011. As drastic as this initial negative impact is, it is not an accurate representation of the detrimental effect of Maryland Live on the Delaware casino industry, given that we're comparing to a quarter that was negatively impacted by the closing of Delaware casinos due to Hurricane Irene in 2011.*
 - *Maryland has approved plans for 5 casino locations, and an upcoming referendum includes plans for a 6th site in Prince George's County (Metro D.C.), which is another significant demographic market for Delaware casinos. A major casino operator (Caesars Entertainment) currently has vested interest in operating the approved Baltimore County casino, and another (MGM) is pushing heavily to secure the Prince George's County site.*
 - *Also included in Maryland's upcoming referendum is a proposal for Maryland casinos to gain 24-hour/day gaming, a lower tax rate on slot revenues at certain locations, and the implementation of table game operations at a lower tax rate than Delaware. If the Maryland referendum for a lower tax rate is approved, Delaware casinos will have one of the highest tax rates in the nation.*
 - *The combination of the opening and thriving of Maryland Live, additional Maryland casinos in major markets operated by huge, multi-national casino organizations, and, if approved, the institution of competitive initiatives supported by the State of Maryland (additional hours, table game operations at a lower rate than Delaware, and a lower tax rate on slots) add up to a force under which Delaware's casino industry cannot compete given the current revenue share model.*
 - *The additional competition from Maryland was compounded at Delaware Park by the I-95 construction in general and the closing of Exit 4B in particular. The closing of the exit has made access to Delaware Park from the south extremely inconvenient for patrons, making it even less likely that Maryland customers, who now have in-state gaming options, will patronize Delaware Park.*

- Maturing Pennsylvania gaming facilities with table game operations at a highly competitive tax rate:
 - *The eleventh Pennsylvania casino, Valley Forge Casino near Philadelphia, opened on March 31st with a lower tax rate than Delaware casinos. Although it is not a massive facility, it has followed suit with its counterparts by negatively affecting Delaware casino revenues. Furthermore, the competitive advantage afforded to all eleven Pennsylvania casinos by the ability to offer table games at the very low comparative table game tax rate of 14% makes it even more difficult for Delaware casinos to compete. The lower Pennsylvania table game tax rate translates to a stronger and more competitive gaming industry for Pennsylvania.*

- Atlantic City:
 - *Despite having a significantly lower slot tax rate of 8% for the past three decades, Atlantic City has also felt the negative effects of additional Mid-Atlantic casino competition, which began with the opening of Philadelphia Park in December 2006. Only recently did they post their first quarterly increase in slot revenues (for the 3rd quarter 2012 compared to 2011). Although they are not experiencing the positive impact anticipated by the opening of the mega-casino, Revel, highly competitive marketing initiatives and lowered regulations have begun to have a positive effect on Atlantic City gaming revenues.*

- Table game operations in West Virginia:
 - *Since the commencement of West Virginia's table game operations in July 2010 at Penn National's Charles Town Casino, the casino has retained the position as leader in table game revenue for that state. Charles Town is the closest West Virginia casino to Delaware, and actively competes for customers in Delaware's Mid-Atlantic market, with an advantage given their lower effective table game tax rate than Delaware.*

What are the 2012 recommendations of the VLAC?

Due to the current state of the Delaware gaming industry, and the intensifying competitive landscape, the following recommendations include major structural changes to the current revenue sharing and license fee model. *It is noted that members of the VLAC representing state office or the slot machine vendors, in respect of the sensitivity of their position, were not asked to vote on the inclusion of the following recommendations.*

Legislative Recommendations

- Reinstatement of a tiered slot gaming tax structure.
 - *Justification: Given that the Delaware gaming industry has been faced with steadily declining slot revenues, with additional competitive pressure and no real sign of economic improvement in the near future, a high fixed rate model is no longer workable. A tiered structure, similar to the structure in place when slots began in Delaware, is necessary to allow the*

state to retain its larger share when business is good, but also to lessen the burden on the video lottery agents during downturns.

- Institute a tiered table game tax rate
 - *Justification: With a referendum on the Maryland ballot in November to add table game operations, and with Pennsylvania lowering their table game tax rate to 14% to increase competitiveness for their casinos, Delaware casinos are at a disadvantage in competing for table game market share with neighboring gaming states. Delaware table game revenue is being entirely consumed by gaming taxes, license fees, and payroll and operating expenses. Relief in the form of restructuring the current table game tax model to a tiered structure, similar to the proposed slot share model would allow Delaware video lottery agents to retain the 1,400+ jobs created by table game operations and extend better offers to our customers.*
 - *As indicated in the Table Game Committee minutes of the meeting on July 27, 2009, the State would “consider reviewing” the table game tax rate and annual license fee should Pennsylvania institute table game operations. At this point, not only has Pennsylvania instituted table game operations, they are operating at a tax rate less than half of the Delaware table game tax rate, giving them significant advantage in revenue retention and, as a consequence, a stronger competitive position.*
- Eliminate the remaining \$3 million annual table game license fee.
 - *Justification: Due to declining table game volume, high payroll and benefits costs, and high table game taxes and license fees, all three Delaware video lottery agents yield little to no table game profit and continue to lose table game market share to Pennsylvania.*
- Amend the internet gaming revenue share rate included in the recently enacted law to match the internet gaming industry’s model.
 - *Justification: Delaware’s internet gaming revenue sharing rates in the current law are identical to that of the existing video lottery revenue sharing model. Internet gaming consultants all agree that the current revenue sharing rates are unworkable using generally accepted internet gaming models.*
- Amend HB 333 to allow for excess capital, marketing, and debt service expenditures to be carried over into the next fiscal year.
 - *HB 333, the bill which introduced internet gambling legislation in June 2012, also includes a collective, minimum requirement for Delaware casinos to spend \$10.25 million each fiscal year in capital, debt service, and marketing, or be required to pay more in terms of annual license fees. Given the financial state of the Delaware casino industry, capital, marketing, and debt service spending that goes beyond the \$10.25 million mark should roll over into the next fiscal year as a credit.*

- Allow video lottery agents to deal (purchase or lease) directly with licensed slot machine vendors.
 - *Justification: New Jersey and Pennsylvania casinos currently have this ability, and the larger Maryland casinos may soon have a choice to deal directly or to deal through the state.*
 - *The requirement for the state to control the purchase or lease of slot machines dates back to the inception of video lottery gaming in Delaware, 16 years ago. Under this provision, the state negotiates with machine suppliers and, although not allowed to participate in negotiations, the video lottery agents are required to pay what the state agrees to. With the recent addition of table games, the state's control procedure was to license table game vendors, and then approve purchase orders of products from those table game vendors by the video lottery agents. This process allows the agents to have more information and control on cost for budgeting and operating purposes. The table game control process could be applied to slots; the Lottery would license slot machine vendors, and the video lottery agents would not be able to add a video lottery machine without prior Lottery approval of a purchase or lease order. The video lottery agents will retain the vendor's share of slot revenues to compensate for the video lottery agents' increase in capital requirements.*

Legislative and Administrative Recommendation

- Recommend an independent gaming regulation consultant be engaged to perform a comprehensive review of Delaware's regulatory gaming structure for the purpose of identifying regulatory modifications, including employee licensing, to improve cost effectiveness for the State and video lottery agents.
 - *Justification: In response to the Governor's call for all State regulations to be reviewed for cost savings and efficiency. Many Delaware video lottery and table game regulations currently in place were modeled after decades old New Jersey regulations. Atlantic City casinos recently went through a joint, major de-regulation process in partnership with the State of New Jersey to improve operational efficiency for Atlantic City's casino operators. With the significant advancements in technology, many regulations in place are currently unnecessary.*

What is the VLAC?

The Video Lottery Advisory Council (VLAC) (aka the Advisory Council on Video Lottery Planning) was formed under House Bill #269 on June 19, 2003 to serve in a planning and advisory capacity to the Secretary of Finance.

What is the purpose of the VLAC?

Per Title 29, Chapter 48 of the Delaware Code:

The purpose of the VLAC is to consider matters relating to the growth and competitive vitality of the video lottery industry in the State, including but not limited to the following:

- (1) The status of video lottery game development issues in the State;
- (2) The status of known game problem resolution;

- (3) Personnel issues and concerns affecting the industry;
- (4) The effectiveness of current operational procedures and recommendations for new operational procedures or regulations;
- (5) The competitive vitality of the video lottery industry in the state, and recommendations for marketing and technological improvements;
- (6) Issues and concerns relating to the repair and maintenance of video lottery machines and related equipment, including preventive maintenance programs;
- (7) Video lottery agent or manufacturer specific projects that will impact the operation of the video lottery; and
- (8) Issues and concerns of the State Lottery Office relating to the video lottery operations and the status of internal control approvals.

The VLAC shall submit a report on its activities to the Secretary of Finance by November 5 of each year, together with recommendations for legislative and/or administrative changes it deems desirable. (Emphasis added.)

What is the Mission Statement of the VLAC?

“To provide a forum for video lottery officials, agents, and vendors to routinely address and resolve issues related to maintaining and improving the utmost in program integrity and operational efficiency. The VLAC shall render an annual report to the State on the results of its efforts and include recommendations to improve the program’s viability and to maximize the program’s growth in an increasingly competitive regional market.”

Who serves on the VLAC?

Per Title 29, Chapter 48 of the Delaware Code:

Membership on the VLAC shall include:

- (1) The Director of the State Lottery Office. (Vernon Kirk 302-744-1600)
- (2) One member from each licensed video lottery agent, to be designated by the respective agent. (Edward J. Sutor – Dover Downs Hotel & Casino 302-857-3206, Patti Key – Harrington Raceway 302-398-5913, Andrew Gentile – Delaware Park 302-994-2521 ext. 7206)
- (3) Two members representing all of the licensed manufacturers of the video lottery machines to be designated by the Director of the State Lottery Office, and/or the licensed manufacturer of the central computer systems to be designated by the Director of the State Lottery Office. (Brennen Lawrence – Scientific Games 770-664-3827, Tim Shortall – IGT 609-484-6301, Robert Neugebauer – Spielo 302-376-1100)

The Governor shall designate one member to serve as Chairperson of the Council, who shall serve in that capacity for two years and shall be eligible for reappointment. (Edward J. Sutor – President & CEO for Dover Downs Hotel & Casino – Term 2006 - 2007, reappointed 2008 – 2009, 2010-2011, and 2012).

How often does the VLAC meet?

Per Title 29, Chapter 48 of the Delaware Code:

The VLAC usually meets quarterly, and a meeting can be called by the Director, the Chairperson, or a majority of the members.

When & where did the VLAC meet in 2012?

VLAC meetings during 2012 were as follows:

<u>Date</u>	<u>Time</u>	<u>Place</u>
April 17, 2012	1:00 p.m.	Dover Downs Hotel & Casino
July 10, 2012	1:00 p.m.	Dover Downs Hotel & Casino
September 18, 2012	1:00 p.m.	Dover Downs Hotel & Casino
November 1, 2012	1:00 p.m.	Conference Call <i>(Rescheduled October 30th meeting due to Hurricane Sandy)</i>

All of the VLAC meetings were open public meetings and advanced public notice of each meeting was provided. Minutes of the VLAC meetings are available on the State of Delaware website.