

INTERIM JOINT COMMITTEE ON LICENSING, OCCUPATIONS, AND ADMINISTRATIVE REGULATIONS

Minutes of the 4th Meeting of the 2018 Interim

October 12, 2018

Call to Order and Roll Call

The 4th meeting of the Interim Joint Committee on Licensing, Occupations, and Administrative Regulations was held on Friday, October 12, 2018, at 10:00 AM, in Room 129 of the Capitol Annex. Representative Adam Koenig, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator John Schickel, Co-Chair; Representative Adam Koenig, Co-Chair; Senators Joe Bowen, Tom Buford, Julian M. Carroll, Denise Harper Angel, Jimmy Higdon, Dan "Malano" Seum, and Damon Thayer; Representatives Tom Burch, Al Gentry, Dennis Keene, Chad McCoy, Jerry T. Miller, C. Wesley Morgan, Kimberly Poore Moser, David Osborne, Ruth Ann Palumbo, Phillip Pratt, Sal Santoro, Arnold Simpson, Diane St. Onge, Walker Thomas, and Susan Westrom.

Guests: Brendan Bussman, Director of Government Affairs, Global Market Advisors; Tom Delacenserie, President & CEO, Kentucky Lottery Corporation; Charles Cohen, Vice President, Sports Betting, IGT; John Osenenko, Vice President, Lottery Systems Business Development – Americas, Scientific Games; Brad Cummings, CEO, Equilottery Games; Mark Brenner, President, The Poker Alliance.

LRC Staff: Tom Hewlett, Bryce Amburgey, Jasmine Williams, Melissa McQueen, and Susan Cunningham.

Minutes

The minutes of the September 14, 2018, were approved without objection.

Global Market Advisors

Brendan Bussman, Director of Government Affairs, Global Market Advisors (GMA) said GMA is the largest gaming/hospitality consulting firm in the US market. In May, the Supreme Court ruled in *Murphy vs NCAA* that the Professional and Amateur Sports Protection Act (PASPA) is unconstitutional. The ruling removed federal restrictions on sports betting and left the regulation of sports betting to the states.

Sports betting is a high volume low margin business. The average sports book has a 40 to 50 percent operating cost. There is a federal tax of .25 percent of the total amount wagered (the total amount wagered is also referred to as the “handle”) and a state gaming tax, which is different from state to state. Rhode Island will go live in November working through its lottery with a tax rate of 51 percent. Nevada is at 6.75 percent. Delaware’s tax rate of 60 percent is a blended tax rate with 10 percent going to a horseman’s fund to help support the racing industry. Delaware is one of the states grandfathered in since previously there was a parlay run through the lottery. However, now there is single game wagering. New Jersey has an 8.5 to 13 percent rate. There is a higher tax rate for the on-line games than for brick and mortar due to the cost to maintain a building being higher than maintaining a web site. Mississippi has set its rate at 12 percent and West Virginia went live Labor Day at 10 percent.

The lower the tax rate, the better ability of the operator to compete with the illegal bookies and the market off-shore. Sports betting is happening today in states where it is legal and where it is not legal. A strong regulatory market is needed that will allow legal operators to operate, but will control the illegal operators.

Most of the major sports leagues have been advocating for an “integrity fee” which would be an additional 1 percent of handle. However, many feel that the sports leagues will see an increase in their profits due to revenues from increased TV fees, fan engagement and sponsorships. There is little support for the concept of an integrity fee.

Currently there are 30 states having active discussions regarding how to implement sports betting. This is sparking the interest of the European market. Some European sports wagering companies are moving to the United States. William Hill Plc, came to the US from Britain and purchased the majority of independent sports books in Nevada. Paddy Power Betfair Plc purchased Fanduel to be able to operate in the United States. Europe’s betting model is different than the United States.

Each state will look differently at how it will run sports betting. Some states will use casinos, lotteries and race tracks will also be considered as gaming outlets. There is also tribal impact. There are over 500 tribes looking at sports wagering. MGM just made an agreement with a tribal casino in California.

Pennsylvania just approved two licenses for sports betting. The Pennsylvania tax rate is at a 36 percent, of which 34 percent goes to the state and 2 percent stays with the local government where the license is held. The license fee is \$10 million. These figures were decided in order to fill a state budget deficit, not necessarily established based on market factors. There have only been two licenses sold and because the cost may be prohibitive all licenses available may not be sold. In West Virginia the lottery is the controlling interest and licenses are obtained through four casino facilities. West Virginia performed a study before passing legislation and writing administrative regulations.

Because there is no professional team in West Virginia, the state did not include the one percent integrity fee.

GMA estimates a potential handle of up to \$138 billion depending on convenience and availability. From a revenue perspective that could mean \$10 million to \$104 million. Market considerations range from who operates the book, such as a casino, or a third-party operator, and include factors such as the convenience of mobile betting. Mobile betting is key to compete with the illegal books that are currently happening. Bookies use online apps or are going through an off-shore book. Mobile use is also more cost effective. Another consideration is offering “in play” wagering. These are bets that are made during a live game, such as what will the half-time score be, or other in-game statistics at markers along the way. Another consideration is allowing bets on college/amateur or e-sports. E-sport is an emerging technology. They are organized, multiplayer video game competitions, particularly between professional players. All of these factors affect the revenue.

A key consideration is making sure that equipment being used is thoroughly tested to keep integrity. Customers need to know that they are gaming in a secure environment. Look to existing jurisdictions. For example, Nevada has been gaming for 50 years. Kentucky is unique in everything it does. A feasibility study will show actual revenue potential. Kentucky has a great horse racing industry here. There is strong potential for brick and mortar casinos here and sports betting should be included in those facilities. Tax rates are important. Licensure should include strict regulations as well as going with known operators, someone who has experience with sports betting.

In response to a question from Representative Koenig, Mr. Bussman gave an example that, in Las Vegas if a person bets \$11 on the Bengals to cover, and the person wins, the person gets \$21 back. That is a fairly simple example and there may be other bets that are more advantageous for the house. The odds are more in favor of the house versus a straight up over/under or a cover off of anything else. As you look at the law of averages, the book usually takes about 10 percent, but that can vary and can end up being only about 5 percent at times. The variability can change from year to year based on events beyond the control of the Book. For example, Las Vegas now has a professional hockey sports franchise with the Vegas Golden Knights. They are new. The scenario was of an expansion team coming to the city with an assumption that it would have no chance to make the playoffs. They came close to winning it all, and if the Golden Knights had won the Stanley Cup this year, books would have lost \$8-10 million.

In response to a question from Senator Carroll, Mr. Bussman said it is important to go with known, experienced operators when dealing with licensees. Additionally, adding convenience to the player is essential to be able to be competitive with illegal markets that already exist and have the ability to engage more patrons. Operators today want to make sure they know their customer. Regarding unregulated sports betting, you need to have strict regulations with operators who have a rate that allows them to compete. The 36

percent in Pennsylvania does not allow them to compete with the bookie that you can find at the bar down the street. The bookies that reside outside borders are also a problem.

In response to a question from Representative St. Onge, Mr. Bussman said projected revenue depends on the structure. The difference in cost between the brick and mortar or mobile app depends on who controls the mobile app. The relationship that you have as a brick and mortar facility through your mobile app with those customers will do two things; first, it will enhance the ability to wager on the race or game without going to the facility. Second, you can see the effect of gaming dollars added to non-gaming dollars, such as for food and beverages. Facilities that build a sports book with a restaurant will see increased revenue as well as added tax revenue from jobs, food and beverage or room tax.

Kentucky Lottery Corporation

Tom Delacenserie, President and CEO of the Kentucky Lottery Commission (KLC), said that the Kentucky Lottery will be 30 years old in April. KLC has 3,000 brick and mortar locations selling lottery tickets and sells online and through mobile apps. KLC is prohibited by KRS 154A.063(2) from offering sports wagering. Delaware, Rhode Island, and West Virginia offer sports wagering through the lottery. Mississippi has a Gaming Commission that is within its lottery. Globally, lotteries regulate 70 percent of sports wagering.

Kentucky will have to decide where sport wagering will be available, what license fees will be, if licensing fees will be a one-time fee or annual, whether it will include collegiate sports, the tax rate, who will oversee and operate sports wagering, and whether the tax rate will be on gross or net gaming revenue. KLC has estimated that the revenue from these taxes could be \$6.7 million to \$26 million.

Sports Betting in Kentucky

Charles Cohen, Vice President, Sports Betting for International Game Tech (IGT), said that what happens in a sports book is slightly more sophisticated than making a bet with a bookie. Sports betting itself is an extremely complex activity. Business sports betting involves investing hundreds of millions of dollars in technology, in people, and in infrastructure. A platform is built using thousands of bits of information. Very few companies in the world are capable of making this type of IT platform. On the other side, the data is received and the system settles all the wagers in seconds with 100 percent accuracy. Accountability is assured by legitimate operators to the bettors.

IGT has considered options for sports betting in Kentucky based on what other states have done and on its worldwide experience. There is a single supplier route. This is a monopoly of sports wagering, in this case through the lottery. This provides efficient oversight to regulate. However, the down side is that the economic potential is limited because there is no competition and the distribution comes from the existing lottery distribution. There could be a full open sports book with a regulatory body that would issue

a license to anyone who applies. This could be limited to going through casinos which creates a free market. This also allows for mobile operators. However, this is costly and more complicated to regulate, although it has the maximum economic potential to the state because it will grow the business. The "Trusted Participants" model is a compromise between the first two. In this model there will be a limited number of licenses. Suppliers and partners will come from a trusted source. The economic potential is only slightly smaller, but there is more regulatory oversight and control. Using the trusted participants model in Kentucky could be based on using race tracks or the lottery.

The bonus is having digital access for bettors. There is no evidence that introducing mobile betting cannibalizes the land based business. It makes players more likely to continue playing. There is, however, a need to balance accessibility for the player with social responsibility. The illegal bookie has no incentive to care about his customer, as long as he gets paid. The more open competition there is, the better it is to offer a safe service, particularly for people with gambling problems.

The integrity fees the sports leagues are seeking are just a money grab and integrity is served by having a good regulatory system.

Lottery Sports Wagering

John Osenenko, Vice President of Business Development for Scientific Games, said his company is a leading provider of retailer-based, and internet-based sports wagering around the globe. They have been partnered with the Kentucky Lottery, supplying instant produces and other services. Scientific Games has been in the business for 20 plus years and is a worldwide leader of sports solutions.

Considering the lottery to manage sports betting is not paving new ground. Sixty-five countries have legalized sports betting with 70 percent of the betting going through organizations that are managed by a lottery. In Kentucky there are retailers widely positioned across the state. They have fully regulated, age controlled environments. There is a history of support for good causes. The World Lottery Association supports transparency, integrity, consumer protection, and information flow. The KLC has achieved a level three in terms of responsible gaming.

Delaware's lottery is good model for lottery-based sports wagering. The rollout of the product, in 2009, started with three racetracks with a limited form of betting, on only one sport. The betting was only parlay wagering where the bettor must group bets together. In 2013 Delaware brought lottery retailers into the mix. As of June this year betting is open to all sports. Betting will primarily be in football, basketball and baseball. This allows for betting on a single event. The average ticket wager at a Delaware retailer is about \$10, at a casino it is about \$50. The more sophisticated bettor is using the casino/racetrack, the casual sports bettor will use the retailer.

In response to a question from Senator Carroll, Mr. Delacenserie said there may be lottery retailers who would not want to have a separate machine to make sports bets. Also, the retailer may not want to have a separate machine on counter space. People like vending machines, however. The lottery currently leases the machines and provides them to the retailers.

In response to a question from Representative Gentry, Mr. Delacenserie said that spending on the lottery is a discretionary dollar to begin with, so any other type of competition potentially takes away from that dollar. Sports betting probably would take money away from the lottery. The KLC will work hard to keep those dollars. To the lottery's advantage, there are online products as well as mobile apps which are important to the younger consumer.

Senator Thayer stated that the Kentucky Horse Racing Commission is also a regulatory body that could regulate sports betting in Kentucky.

In response to a question from Representative McCoy, Mr. Cohen said the kiosk is a large part of the in play wagering. In Europe the different countries have different gambling cultures. Setting up the regulatory environment correctly for your situation and business will benefit.

In response to a question from Representative Palumbo, Mr. Osenenko said the charge to lease a machine depends on the market. There are generally two types of markets, a sell market and a participation market. The US is a participation market, so Scientific Games does not charge the lottery upfront. They are participating in the sales of the business. When a dollar is spent in Kentucky on the lottery, Scientific Games gets a small portion to pay for the investment in the technology. In a sale market the machines are valued from \$10,000 to \$25,000. The total cost in a participation market depends on the size of the jurisdiction and how much the vendor participates in the market.

In response to a question from Representative Miller, Mr. Cohen said the state will never be the "house." The risk is based on cash flow and is born by the operators. Mr. Osenenko added that, cannibalization is not a consideration because the markets as well as the customers are different in sports betting and the lottery. Mr. Delacenserie commented that Keno will grow after June when there will be more vending machines in bars and taverns.

Representative Koenig thanked Mr. Delacenserie for his frank testimony as well as that of the two experts that accompanied him. He then said he would like to see the state follow the Nevada gaming model with one group, a Gaming Control Board, within that board there would be different types of regulation to standardize the state's gaming.

Equilottery Games

Brad Cummings, Founder and CEO of Equilottery Games, said he began with the idea of lottery games based on the results of live horse racing. That idea has grown to the game called Win Place Show, due to launch in March of 2019, through KLC. Equilottery sees sports betting as a game of chance that could be the next big growth area in the lottery. Lottery players are sports fans. The Win Place Show market research in Kentucky shows that this game will bring in more new players than other lottery games that have been tested.

Equilottery envisions four categories in the future; draw games, instant play scratch-off tickets, Keno, and virtual sports and live sports. A Win Place Show player will purchase a \$2 ticket at retail or, once it is available, on lottery. The ticket will feature three horse numbers and names along with corresponding race track information. The random number generator quickly picks horses. Because the ticket is quickly picked it is not a game of skill. Each ticket has a QR code to download a mobile app to watch races. Racetracks will be paid a broadcast rights fee. Stores have been recruited in Louisville, Lexington, and Northern Kentucky to test the game. The mobile app is available in the Apple Store and Google Play in demo mode.

There are other live sports games. Baseball Bucks, Golfing for Gold, and Car Cash are built on the same platform as Win Place Show. However, these tickets are \$5 tickets because the events occur over a longer time span. For example, a golf tournament might take three days to complete. These are also random number generator quick pick tickets. A percentage of the money goes to the league or content provider for licensing, but also for cross promotions. Again, there is a QR code on the ticket so the player can download the app to watch the game. The payout depends on the number of matches per ticket.

The benefits to Kentucky are a cutting edge innovation company founded in Kentucky making our state a leader in national gaming trends. The Win Place Show product specifically offers new avenues to promote and uplift Kentucky's equine industry.

Representative Koenig said this could be seen as a Kentucky Proud Product.

The Poker Alliance

Mark Brenner, President of Poker Alliance, said his organization's mission is to promote a safe, well-regulated environment for adults to enjoy the sport of poker. There is already an extremely robust gaming environment in the state of Kentucky. Thousands are playing online games that are unlicensed, with zero consumer protection. Two online venues recently shut down and took money with no accountability to anyone. There are dozens of websites that claim to provide legal online games in Kentucky.

In 2006, a number of major poker sites stopped doing business in the United States due to federal legislation. This left players with money in their accounts but unable to access their money under the Wire Act. Subsequently, the Department of Justice made it

possible for players to withdraw their money. There are still people betting on unregulated sites, but now the state has authorization to take action to benefit players.

Regulated poker is a reality. Companies continue to focus on compliance, auditing, the prevention of money laundering, and multi-step identification processes to ensure that players are of legal age. When legalized, all operators will be required to have geo-locations. Also, Kentucky currently allows residents to wager over the internet on horse races, including websites owned by Churchill Downs. The Kentucky Lottery also offers games online. Poker Alliance is asking for the same protections to those who would like to play poker online in a safe environment. They view the state of New Jersey as an excellent example of how regulation works well for both the consumer and the state. Internet poker, along with internet casinos and sports gaming, referred to as iGaming, has been a big success in that state. David Rebeck, Director of Enforcement for New Jersey Gaming said “from a regulatory standpoint, our system is working, there have been no major infractions or any systemic regulatory failures that would make anyone doubt the integrity of our operations.”

In response to a question from Representative Koenig, Mr. Brenner said New Jersey reported revenue in August of around \$18.9 million. There is a memo of understanding that will allow players from different states to play against each other, creating more robust online tournaments. This also allows each of the states to collect taxes on those games. When asked if poker is a game of skill or chance he said it is a game of skill that requires great mathematical ability to calculate odds. There is no doubt that poker is a game of tremendous skill.

There being no further business, the meeting was adjourned at 11:57 AM.