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BILL ANALYSIS

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House Bill 4610 (Substitute H-3 as discharged)  
Sponsor: Representative Jack D. Minore  
House Committee: Agriculture and Resource Management  
Senate Committee: Gaming and Casino Oversight

### **CONTENT**

The bill would amend the Lottery Act to do the following:

- Allow the Lottery Bureau to implement and operate video lottery games at licensed race meetings.
- Allow a licensee to install up to 500 video lottery terminals (VLTs), and apply for permission to install more.
- Provide for the allocation of funds from video lottery games to the School Aid Fund (SAF), a proposed "Agricultural Enhancement Fund", the City of Detroit, as commissions to race meeting licensees, an Agricultural Enhancement Purse Pool, and breeders' awards.
- Create the "Agricultural Enhancement Fund" within the State Treasury, from which the Michigan Department of Agriculture would have to spend money, upon appropriation, for the purposes of enhancing the development of agriculture in Michigan.
- Make it a felony, punishable by up to 10 years' imprisonment and/or a minimum fine of \$10,000, to manipulate the payoff or outcome of video lottery games.

The bill is tie-barred to House Bill 4609, which would amend the Horse Racing Law to allow off-track betting (OTB) at licensed casinos and race meetings, allow wagering by telephone or other electronic means, and allocate portions of licensees' commissions from OTB and account wagering to an Agricultural Enhancement Purse Pool and breeders' awards. The bill also is tie-barred to House Bill 4611, which would amend the Code of Criminal Procedure to include manipulating the outcome or payoff of video lottery games in the sentencing guidelines as a Class D felony against the public trust.

MCL 432.3 et al.

Legislative Analyst: Julie Koval

### **FISCAL IMPACT**

The bill is tie-barred to House Bill 4609 and House Bill 4611. If these other two bills are not also enacted, House Bill 4610 (H-3) would have no fiscal impact. Combined, the bills would increase revenues both to the State School Aid Fund and to local units. The degree to which revenues would increase depends on a variety of unknown factors, such as how much video lottery terminals (VLTs) would reduce existing gaming under the lottery, American Indian casinos, the Detroit casinos, and other forms of gaming currently allowed; as well as how many machines would be operating, the prize payouts, and the amount of new gaming activity they would generate.

#### Video Lottery Terminals

Data from other states were examined to estimate the impact of these bills. However, none of the states that currently have VLTs matches Michigan's gaming landscape particularly well: Five of the states do not have casinos operated by Indian tribes or commercial

interests; two of them offer VLTs only in bars or liquor-licensed establishments; none has more than four racetracks (while Michigan has seven); and few states have casinos near or in major urban areas. As a result, compared with Michigan, the VLTs in none of the other states have as much competition as would exist in Michigan. Among states that permit VLTs in racetracks only, the racetracks average approximately 1,200 machines per track, although each state's average varies widely. Generally, the more competition for gaming dollars (a higher number of racetracks and/or casinos, a wider proliferation of locations where VLTs can be placed, and/or more machines per track) and/or the more machines per capita, the lower the average daily win is per machine.

Using the averages for other states' experiences with VLTs and making adjustments to reflect the Michigan economy, a range for the amount of revenue that would be generated can be estimated given assumptions about how many machines would operate in this State. Video lottery terminals could be placed only at racetracks, of which there are seven currently operating in Michigan. House Bill 4610 (H-3) would limit each location to 500 machines unless the State Lottery Bureau authorized additional machines. The bill would not limit the number of additional machines the Bureau could authorize. Table 1 presents estimates under two scenarios, given a midpoint assumption regarding VLT popularity: 1) tracks would be limited to 500 machines (low), and 2) tracks would receive increases to allow an average of 2,000 machines per track (high).

In the first full year of operation, the analysis assumes for the year's average that only 90% of the estimated total number of machines are in place and operational. Partial-year estimates could be developed by assuming a given date the VLTs begin operating. Assuming there are no legal challenges to the legislation and based on the experiences of other states, implementation of VLTs could take at least six to 18 months. As a result, given potential dates for which the bill would be enacted, it is unlikely the bill would result in a partial-year revenue during FY 2003-04.

Table 1  
Estimated Impact of Video Lottery Terminals  
First and Second Full Years of Operation  
(dollar amounts in millions)

	1st Full Year of Operation		2nd Full Year of Operation	
	Low	High	Low	High
VLTs Per Track	450	1,800	500	2,000
Total Number of VLTs	3,150	12,600	3,500	14,000
Revenue Distribution				
General Fund	\$0.0	\$29.0	\$0.0	\$33.7
School Aid Fund	\$4.2	\$44.9	\$4.5	\$46.4
Michigan Strategic Fund*	(\$14.6)	(\$14.6)	(\$15.7)	(\$15.7)
City of Detroit	\$12.5	\$10.8	\$13.3	\$9.8
Local Units	(\$0.4)	(\$1.4)	(\$0.4)	(\$1.5)
Commissions to Tracks	\$58.2	\$201.1	\$61.7	\$212.1
Agricultural Interests	\$42.2	\$127.7	\$44.8	\$133.8
Total Net Revenue	\$102.3	\$397.5	\$108.2	\$418.7
*Note: Assumes VLTs are determined to trigger clause in Gaming Compacts regarding 8% payments to the State.				

Under these assumptions, in the initial year of operation, the bill would be expected to increase School Aid Fund (SAF) revenue by \$4.2 million to \$44.9 million, and City of Detroit revenue by \$10.8 million to \$12.5 million. Private agricultural interests would receive, through purse pools, grants and breeders' awards, between \$42.2 million and \$127.7 million, while tracks would receive between \$58.2 million and \$201.1 million in commissions.

In the second full year of operation, the bill would be expected to increase SAF revenue by \$4.5 million to \$46.4 million, and City of Detroit revenue by \$9.8 million to \$13.3 million. Private agricultural interests would receive between \$44.8 million and \$133.8 million, while tracks would receive between \$61.7 million and \$212.1 million in commissions.

#### School Aid Fund "Hold Harmless" Provisions

House Bill 4610 (H-3) contains provisions to earmark additional money to the School Aid Fund should a specific subset of State lottery games and/or revenue from the State casino gaming tax decline from the FY 2003-04 level ("hold harmless" provisions). Any contribution to the SAF from VLTs would not be considered when computing the hold harmless amounts. Because of the formulas for distributing money and the manner in which the hold harmless payments would be computed, there would be a number of circumstances in which no hold harmless money would be distributed or it would be insufficient to hold the SAF fully harmless. There also would be circumstances in which the provisions would hold the SAF harmless for events unrelated to the addition of VLTs to racetracks.

First, because revenues to measure the hold harmless provisions are measured against FY 2003-04 final revenues, any loss to lottery and casino revenues experienced in FY 2003-04 would not create hold harmless payments; thus, the bill would not "hold harmless" against those losses. Second, the revenue to hold the SAF harmless would come from the residual created after the first \$90 million received by the State Treasurer was distributed. In years when the State Treasurer did not receive \$90 million, no money would be available for hold harmless payments to the SAF even though the SAF would have already experienced reductions from lost lottery and casino revenue. Third, out of the residual from the \$90 million, the Agricultural Enhancement Fund and the SAF each would receive 15% before any money would be available to make hold harmless payments. In the example above during the second full year of operations and at an average of 2,000 VLTs per track, \$109.6 million of residual would be available, of which \$16.4 million would be distributed to the SAF and the Agricultural Enhancement Fund each, leaving a balance of \$76.7 million. However, under this situation the SAF is forecasted to lose \$43.0 million in revenue from the lottery and the Detroit casinos--more than half of the amount available to hold the SAF harmless. With fewer machines and/or more popular VLTs, the loss to the School Aid could exceed the amount available to hold the SAF harmless.

Despite the possible shortfalls in hold harmless payments, the bills also would trigger hold harmless payments when no loss was attributable to the operation of VLTs in the State or when the SAF might not have even taken a loss. Traditionally, when the lottery has introduced new games, a portion of the activity on the new games has been derived from decreased activity on other games. Because the bill would fix the games examined to create hold harmless payments, new games introduced by the lottery would reduce payments and trigger hold harmless payments. Similarly, SAF payments from the lottery vary from year-to-year and may decline for economic reasons unrelated to VLTs or even competition from casinos. School Aid Fund payments from the lottery have declined in every fiscal year since FY 1999-2000 and are estimated to decline in FY 2003-04 even without the introduction of VLTs. Lottery deposits to the SAF also declined four times in the 10 years prior to FY 1999-2000: in FY 1989-90, FY 1990-91, FY 1992-93, and FY 1995-96.

#### Account Wagering and Off-Track Betting

The amount of revenue generated from off-track betting (OTB) and account wagering under House Bill 4609 (H-2) would depend largely upon the amount of new gaming activity generated. Both options would essentially make it easier to place bets on races because bettors no longer would have to travel to an actual racetrack to place bets. Off-track

betting parlors would have to be located 25 or more miles from any other OTB parlor or racetrack, although the bill provides an exception for this limitation, suggesting that much of the activity that would take place at OTB parlors could involve individuals who would not otherwise travel to the racetrack to place bets. On the other hand, account wagering tends to provide incentives for individuals not to travel to either racetracks or OTB parlors because bettors would be allowed to place bets through the telephone, internet, and/or other communication media.

Using other states' experiences with OTB and account wagering, the effect on wagering can be estimated. The State School Aid and GF/GP Funds do not receive revenue from gaming activities at racetracks and would not receive revenue from OTB parlors or account wagering. The Agriculture Equine Industry Development Fund would receive 3.5% of the wagers, less prizes paid. Depending on the popularity of OTB parlors and account wagering, the bill would be expected to increase State revenue to the Agriculture Equine Industry Development Fund by between \$1.2 million and \$1.7 million in FY 2004-05 assuming an October 1, 2004, implementation date. Currently, the Fund receives about \$11.0 million from simulcast wagering at Michigan's seven licensed racetracks. This tax revenue is appropriated for administrative expenses, purse supplements, and owners/breeders' awards. Any new revenue would be available for the same purposes.

### Penalties

The penalty provisions in House Bills 4610 (H-3) and 4611 (H-1) would have an indeterminate fiscal impact on State and local government.

There are no data to indicate how many offenders would be convicted of the proposed Class D crime of manipulating the outcome or payoff of a video lottery game. Offenders would receive a sentencing guidelines minimum sentence ranging from 0-6 months to 43-76 months. The fiscal impact for each offender would depend upon the sentence and the incarceration option chosen by the court. Local units would incur the costs, which vary by county, of incarceration in a local facility. For those placed on probation, the State would incur the cost of felony probation at an average annual cost of \$1,750, while the annual cost for those incarcerated in a State facility averages \$27,000.

Public libraries would benefit from any additional penal fine revenue raised due to the proposed changes.

This estimate is preliminary and will be revised as new information becomes available.

Date Completed: 4-28-04

Fiscal Analyst: David Zin

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.