

# FISCAL NOTE

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STATE OF ALASKA  
 1999 LEGISLATIVE SESSION

Revision Date/Time (Note if correction) April 21, 1999 Dept. Affected Revenue  
 Title Charitable Gaming and Gaming on State Ferries BRU Revenue Operations  
 Component Income and Excise Audit  
 Sponsor Senator Taylor  
 Requester (S) L&C Component Serial No. 113

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Personal Services		357.9	784.0	693.4	693.4	693.4
Travel		9.0	58.0	58.0	58.0	58.0
Contractual		1,481.9	1,821.9	1,821.9	1,821.9	1,821.9
Supplies		11.0	16.0	14.0	14.0	14.0
Equipment		60.5	27.5			
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>1,920.3</b>	<b>2,707.4</b>	<b>2,587.3</b>	<b>2,587.3</b>	<b>2,587.3</b>

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES (increase)	0.0	3,104-7050	8,278-18,801	9,313-21,151	10,348-23,502	10,865-24,678
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**FUND SOURCE** (Thousands of Dollars)

FUND SOURCE	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
1002 Federal Receipts						
1003 GF Match						
1004 GF	0.0	1,920.3	2,707.4	2,587.3	2,587.3	1,821.9
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
<b>TOTAL</b>	<b>0.0</b>	<b>1,920.3</b>	<b>2,707.4</b>	<b>2,587.3</b>	<b>2,587.3</b>	<b>2,587.3</b>

Estimate of current year (FY99) cost: 0.0

**POSITIONS**

POSITIONS	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Full-time		10	15			
Part-time		1	1			
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)  
 \*\* see attached analysis

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 Commissioner Department of Revenue  
 Agency

Phone 465-3682  
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 Date April 21, 1999

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**SECTIONAL ANALYSIS AND GENERAL OVERVIEW  
BY THE DEPARTMENT OF REVENUE OF SB 144 –VIDEO LOTTERIES**

Section 1 amends AS 05.15.060(a) to extend the regulation authority of the department to video lotteries, including the issuance, renewal and revocation of vendor registrations, the investigation of vendors, and the disposition of funds in the possession of vendors. Consistent with the addition of video lottery vendors under the bill to pull-tab vendors under current law, the bill makes numerous amendments in AS 05.15 to envelop and differentiate between the two types of vendors.

Section 2 amends AS 05.15.070 to extend the authority of the department to examine the books and records of a video lottery vendor, video lottery manufacturer, and video lottery distributor.

Section 3 amends AS 05.15.095(a) to extend the current law general provisions relating to the filing of applications and reports and payment of fees to licensed video lottery machine manufacturers and distributors and to registered video lottery and pull-tab vendors.

Section 4 amends AS 05.15.100 to provide that municipalities and qualified organizations must obtain a permit to conduct video lotteries through the use of video lottery machines by registered video lottery vendors.

Section 5 amends AS 05.15.105(a) to provide that persons convicted of certain crimes may not be involved in video lottery operations and that licenses may not be issued to vendors who employ such persons.

Section 6 amends AS 05.15.115(c) to provide that a permit holder may not contract with an operator to conduct video lotteries.

Section 7 amends AS 05.15.124 to extend the ability of municipalities to prohibit video lotteries in addition to pull-tab businesses.

Section 8 amends AS 05.15.128(a), pertaining to the revocation of an operator's license for the failure to report and pay certain minimum percentages, to exclude from coverage video lotteries consistent with Section 6 since operators may not engage in these activities.

Section 9 amends AS 05.15.150(a) to provide that net proceeds from gaming may not be used for political purposes or for payment to a lobbyist. However, the proceeds of raffles and lotteries may continue to be used for the designated political purposes specified in AS 05.15.150(a)(3)

Section 10 amends AS 05.15.160(d) to exclude video lotteries from the 90% expense limitation.

Section 11 amends AS 05.15.170, dealing with the suspension and revocation of permits, licenses, and registrations, to include video lottery vendors along with pull-tab vendors.

Section 12 amends AS 05.15.180(a), dealing with the limitations on the use of coin-operated machines and other gambling devices, to allow the use of such devices to the extent allowed under the video lottery provisions.

Section 13 amends AS 05.15.180(b) to add video lotteries as an activity that may be licensed even though not conducted in that form before January 1, 1959.

Section 14 amends AS 05.15.180(g) to remove video lotteries from the statutory prize limitations. Bingo continues to enjoy the same exemption from the prize limitation.

Sections 15, 16, 17 and 18 are housekeeping amendments to various provisions dealing only with pull-tabs.

Section 19 adds a new article 2A on Video Lotteries. Pursuant to AS 05.15.300, the department may issue a video lottery endorsement to a permit holder. The permit holder may contract with a video lottery vendor or conduct its own activities if it has a club license. A video lottery vendor is a venture with a business license under AS 43.70 and a beverage dispensary license under AS 04.11.090 or a package store license under AS 04.11.150 that conducts video lotteries on behalf of a permit holder.

An endorsement is issued for each gaming location. The permit holder must register a vendor and pay a fee of \$100 for each gaming location and \$100 for each video lottery machine at each location. A video lottery machine is an electronic video game of chance that simulates poker, keno, or blackjack using video display and microprocessors.

The video lottery endorsement must be posted at each location. The department must issue a permit for each machine and the permit must be posted on each machine. The department must be notified if a location changes. The failure to inform the department of changes, or to return permits after a change, is ground for suspension or revocation of a gaming permit.

Permit holders must execute written contracts with vendors. The department may inspect a contract and the department may declare the contract void and suspend or revoke the vendor registration and the permit if the contract would violate the gaming laws or regulations. The contracts are required to contain provisions to allocate the costs of buying or leasing the video lottery machines. A permit holder may not contract with more than five video lottery vendors and a vendor may not have more than 10 machines at any location.

The department must approve the breed of all video lottery machines. A permit holder may buy a machine from a distributor, or enter into a lease or lease-purchase agreement that must be approved by the department.

Vendor contracts must provide that net machine income is distributed 30% to the permit holder, 30% to the vendor, 15% to the state, and 25% to either the municipality or the state if the machine is located in the unorganized borough. Net machine income is the money inserted into a machine less cash credits paid back. The timing of the distributions is to be established by the department in regulation.

The game odds must be posted near each machine. The posting and the manner in which the odds are calculated is determined by the department. The machines may not be played by persons under age 21 or outside the legal hours of operation. The vendors must monitor the machines by a physical presence, video cameras, or mirrors, as well as by personal inspections.

Neither the permit holder nor the vendor may advertise the availability of the machines on the premises. If a municipality is "dry" but gaming is authorized, the department may issue an endorsement to a permit holder to conduct gaming in the manner permit holders with club licenses are authorized to conduct gaming but only if access is restricted to persons age 21 or over.

Pursuant to AS 05.15.310, a video lottery machine must meet specified conditions to be approved. The machine:

1. games must be authorized by the department
2. must have no means of manipulation to affect the odds.
3. must accept cash and be designed to require a resetting if tampered with.
4. must have a non-resettable meter that maintains a permanent record of receipts, winnings, and credits.
5. must pay off winners by printing a ticket voucher containing various information.
6. must have software to maintain an electronic record of receipts, winnings, credits, and payback percentages.
7. must be linked to a central communications system although it need not be on-line or in constant communication. The department must approve the communication system and it cannot limit participation to only one manufacturer on either a cost basis to enable it to communicate or based upon the inability of a machine to communicate with the central communications system. This provision should be made clear regarding the nature of the linkage and whether there is a central communication requirement.
8. must not allow more than \$2 to be played on a game or award free games or credits in excess of \$125 per credit value of \$.25 played. This results in a maximum prize of \$1,000 on a \$2 bet.
9. total payoff must be 80% of the value of a \$.25 credit. This is unclear. It may be interpreted to mean that 80% of all credits wagered as reported by the machine, as

opposed to money paid in, must be paid out or credited to players. The basic formulas are assumed to be as follows:

- a) cash (credits) in + credits won – credits played – credits paid = 0
- b) cash (credits) in – credits paid = credits in + credits won – credits played
- c) cash (credits) in – credits paid = net machine income

Therefore, the effective cash payoff rate will be less than 80% as a player continues to play with the credits won.

Pursuant to AS 05.15.320, a manufacturer, seller, or distributor of video lottery machines and related equipment must be licensed by the department. The manufacturer's license is \$5,000. The department must examine prototypes of machines intended to be manufactured, sold or distributed in the state or may contract with another person or state to perform the examination. The manufacturer is to pay the costs of the examinations. A manufacturer may distribute machines only to licensed video lottery machine distributors. A manufacturer must report to the department each machine sold or distributed by the last business day of the month following the month of the sale or distribution.

Pursuant to AS 05.15.330, a video lottery machine distributor license is required to distribute a machine. The license fee is \$5,000. The machines may only be distributed from a location in the state. A distributor must report to the department each machine distributed by the last business day of the month following the month of the distribution. A distributor may not sell a machine to a video lottery vendor.

Pursuant to AS 05.15.340, the endorsement of a permit holder or the registration of a vendor is to be revoked if the specified percentages are not paid at the time required by the department.

AS 05.15.350 provides that the state's percentage is to be deposited in the general fund. The legislature may appropriate the money to provide for education.

AS 05.15.360 provides that the department is to contract out the state's role under video lottery charitable gaming.

Section 20 amends AS 05.15.620(c), the local prohibition on charitable gaming, to include video lotteries.

Section 21 amends AS 05.15.620 by adding a new subsection that allows municipal voters to determine if video lotteries will be prohibited in the municipality.

Section 22 amends AS 05.15.680 to extend the penalty provisions to video lotteries.

Section 23 amends AS 05.15.680 by adding a new subsection making it a class A misdemeanor for a person with criminal negligence to allow a person under age 21 to use

a machine and for the person under age 21 to use a machine. It is also a class A misdemeanor if a person manipulates or tampers with a machine.

Section 24 amends AS 05.15.690(36) to exclude labor and political organizations from the definition of a qualified organization.

Section 25 amends AS 05.15.690(44) to define pull-tab vendors.

Section 26 amends AS 05.15.690 by adding 3 new paragraphs to define additional terms under the video lottery provisions. "Net machine income" means the money inserted into a machine less cash credits paid back. "Video lottery machine" means an electronic video game of chance that simulates poker, keno, or blackjack using video display and microprocessors. "Video lottery vendor" means a venture with a business license under AS 43.70 and a beverage dispensary license under AS 04.11.090 or a package store license under AS 04.11.150 that conducts video lotteries on behalf of a permit holder. A hotel or similar business that caters to the public as a substantial part of its business is a video lottery vendor only if conducts the video lotteries in a room in which there is regularly maintained a fixed counter or service bar where alcoholic beverages are sold or served to the public for consumption.

Section 27 amends AS 11.66.280(2) to exclude, from the definition of gambling, the operation of video lottery machines aboard the Alaska marine highway system.

Section 28 amends AS 11.66.280(3) to exclude, from the definition of a gambling device, a video lottery machine.

Section 29 amends AS 11.66.280(4) to exclude, from the definition of a gambling enterprise, vessels of the Alaska marine highway system that are lawfully conducting video lottery machine operations.

Section 30 amends AS 19.65 to add new sections governing the conduct of video lotteries aboard the Alaska marine highway system. AS 19.65.035 provides that the department may license an Alaska marine highway system vessel to operate video lottery machines in an area of the vessel that persons under age 21 are prohibited from entering. The license is valid in state waters only unless authorized by the jurisdiction in which the vessel is located. DOTPF shall operate the gaming or contract it out. The department is to adopt regulations to implement this provision.

AS 19.65.040 prohibits an employee of the Alaska marine highway system from allowing persons under age 21 to use a video lottery machine. It is also unlawful for a person under age 21 to use a machine or for any person to manipulate or tamper with a machine. A violation is a class A misdemeanor.

AS 19.65.045 provides that the revenues from video lottery machines on the Alaska marine highway system are to be deposited in the general fund and may be appropriated by the legislature for the Alaska marine highway system.

AS 19.65.050 provides that the definition of a video lottery machine is tied to the definition under AS 05.15.690.

Section 31 repeals and reenacts AS 05.15.115(c) to reach the same result as in Section 6.

Section 32 repeals and reenacts AS 05.15.180(b) to reach the same result as in Section 13.

Section 33 repeals the definition of labor organization and political organization in AS 05.15.690(25) and AS 05.15.690(34).

Section 34 allows the department to begin the regulation process in order to enable regulations to be effective on January 1, 2001.

Section 35 provides that the Act is effective on January 1, 2001, except for Section 34.

Section 36 provides that Section 34 has an immediate effective date.

### **Overall Analysis**

The department believes that the proposed legislation raises a number of policy issues that should be addressed. Some of these issues are set out below.

1. This activity can be expected to replace some of the pull-tab vendor activities that currently take place in bars. The vendors pay charities a minimum of 70% of the ideal net of pull-tab games. The video games under this legislation would pay only 30% to the permittees, and permit the costs of the operation to be deducted from that percentage.
2. Video gaming will almost certainly draw patrons to bars. This could be viewed as promoting increased alcohol consumption by enticing individuals into bars with video machines.
3. The department is concerned with the failure to restrict the permit holders to IRC 501(c)(3) charitable organizations. The department has seen abuses with allowing trade and other associations to obtain charitable gaming permits. The legislation would be improved if the permittees were limited to true charities. The legislation does not allow labor and political organizations to qualify for a gaming permit under the bill. Trade associations should be similarly excluded.
4. There are currently many more permittees in the state than there are vendors and operators who will run games for those permittees. As a result, they do not have much

bargaining power with respect to those who run games. This legislation may continue to foster the difference between the "have" and the "have not" qualified organizations. Again, the bill would be strengthened if limited to 501(c)(3) permittees.

5. The legislation provides that the permittee and the vendor will allocate costs between them. Given the uneven bargaining power, it is predictable that the charities will bear most of the costs. Other charitable gaming activities (such as pull tabs and bingo) are limited in the amount of permitted costs. There is no cost limitation for video gaming.

6. Pull-tab prizes are limited to \$500. This legislation allows a prize of \$1000 on a \$2 wager.

7. While the vendors appear to be the prime beneficiaries of the revenue generated, the state is responsible for the cost of the central computer and its operation. This is the system that interfaces with the individual machines. The state is also charged with the cost of administering the system. It is unclear if the state or permit holder is responsible for the telecommunication costs, which will be a substantial part of the cost of running the system.

9. The significant cost of the video gaming machines – from \$7,500 to \$10,000 – may foreclose smaller charities from being able to participate in video lotteries, and may favor trade organizations and the like over the IRC 501(c)(3) charities.

10. The legislation would require that the department review and approve contracts between permit holders and vendors, but sets no standards or rules for what those contracts can or should contain. Without standards, the department will not have grounds to disapprove a contract. Given the limited bargaining power of most permittees, we would expect that these contracts will favor vendors, with permittees bearing most of the costs. The vendor may charge space rental for the machines, a portion of employee salaries, and make an allocation of general overhead expenses of the establishment to the permit holder. The vendor may also provide that the permit holder is liable for the telecommunication expenses between the machines and the central computer. The bill does not preclude this result, and the department is without authority to void a contract that is not in violation of the bill.

11. It is not clear, in the bill, whether the restrictions that generally apply to the use of net proceeds will apply to the use of net machine income. For example, it's not clear whether the permittees may use the income to purchase other gaming machines. Current law precludes that type of use by requiring that the "net proceeds" of the gaming activity be used for charitable and other uses in the state. Net proceeds are defined to start with the gross receipts from the activity less the expenses and prizes of the activity. The receipt of only a percentage of net machine income therefore does not fit neatly within "net proceeds". The bill should make it clear if there is to be a limitation on how net machine income may be used.

12. The bill appears to permit video lottery proceeds to be used by a permittee to support political candidates or parties. The law currently prohibits the use of net proceeds for these purposes, except for proceeds from lotteries or raffles. If video lotteries are "lotteries" then political use of proceeds would be permitted.

13. It is possible that authorization to provide blackjack, keno and other games on video machines would require the state to permit these games outside the video context, in Indian casino operations. This legal question should be answered before legislation is passed.

14. A computer video gaming system, to the extent that it replaces current gaming operations, would be more accountable than the manual pull-tab gaming already in place. But the legislation does nothing to address the current abuses that we have seen in, especially, MBP-run operations. We question whether the advantage of superior accountability outweighs the other concerns raised by the bill.

#### OPERATING EXPENDITURES

The Department of Revenue does anticipate additional costs for administering the provisions of this bill. In our cost estimates we assume that all costs (including telecommunications costs) for purchasing and running the video lottery terminals will be borne by the permittees and vendors. The State will then assume all costs for administering the program and leasing and maintaining a central computing system. The purpose of the central computing system will be to monitor all video terminal transactions, produce all necessary reports and account for funds transferred to the Department electronically.

Although the state could purchase a central computer (estimates range from \$4.0 to \$5.5 million) and the maintenance contract (estimated at \$250,000 annually), we show the cost of leasing a central computer system. These estimates were provided to us by International Gaming Technologies. Additionally, a staff will be needed to perform inspections, to do background checks, to answer questions from permittees, vendors, contractors and the public, and to run the central computer facility. We have turned to South Dakota for information on their staffing requirements because they have a central computing facility (Montana does not have a central computing facility), they do not own, lease or maintain the video terminals (Oregon owns or leases and maintains video terminals) and they allow a maximum of 10 machines per vendor (Oregon allows for 5 and Montana 20).

Staff estimates are as follows:

Central Computing Facility and Help Desk  
Analyst Programmer III (supervisor) - 1  
Operators - 3.5

Investigations

Investigator I - 3  
Investigator III - 2  
Investigator IV - 1

Administration, Accounting Licensing and Collections:

Revenue Auditor III - 1  
Administrative Clerk - 1  
Accounting Technician - 3

**REVENUE**

Alaska's unique mix of games, geography, unique features of the bill and lack of experience with video gaming make revenue estimation particularly difficult. Additionally, because telecommunications and other costs will be higher in Alaska there is more risk in the purchase and maintenance of video terminals. The distribution of revenue and costs is also different in SB 144 than in any of the six states we contacted. For revenue estimation purposes we have only included Oregon, South Dakota and Montana. We chose these states for the following three reasons: geography, population density and experience with video gaming.

Although video lottery gaming will reduce the demand for pull-tabs and possibly bingo, we do not have enough information to estimate this difference. The only State listed in La Fleur's World Gambling Abstract that has both video gaming and pull-tabs is Oregon. However, even as far back as 1992 when video gaming was first introduced pull-tabs sales in Oregon were small relative to pull-tab sales in Alaska (approximately 9%). Additionally, although pull-tab sales dropped by almost one-half within three years of the introduction of video lottery terminals, other factors such as the introduction of Keno, wider distribution of scratch-it cards and lack of emphasis on pull-tabs by the Oregon State Lottery contributed to the decline in pull-tab sales.

On the attached revenue spreadsheet you will find a low and a high revenue scenario. We use the population over 21 years old because this is the population of potential gamers. We then adjusted revenue estimates to reflect timing and market maturation issues. Because the effective date of this bill is January 1, 2001, we reduced FY 01 collections by one-half. Additionally, it will take time before the video lottery market matures enough so that vendors, contractors and permittees provide the necessary investment to match the demand for these machines. We use South Dakota as our model of how the video lottery market will mature. South Dakota was chosen because purchase, maintenance and

telecommunications costs associated with the video terminals is borne by the vendors and contractors. Consequently, we use a 60% adjustment factor in the first 6 months, an 80% adjustment factor in the first full year and a 90% adjustment factor in the second full year. After the fourth year we have the market leveling off and growing at 5% annually (see attached spreadsheet).

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**Assumptions:**

Alaska Population Over 21 years Old: 389,745  
 Low Scenario: Per Capita (over 21years old) Net Machine Income: \$177  
 High Scenario: Per Capita (over 21 years old) Net Machine Income: \$402  
 Adjustments for effective date (January 2001) and market development:  
 Adjustment for first full-year market development (FY 02): 0.3  
 Adjustment for second full-year market development (FY 03): 0.8  
 Percentage to Permittee 0.9  
 Percentage to Vendor 30%  
 Percentage to State 30%  
 Percentage to Municipalities 15%  
 Growth factor after FY 04 25%  
 1.05

	FY 00	FY 01*	FY 02	FY 03	FY 04	FY 05
<b>Source:</b>						
Oregon			389,745			
Montana			\$177			
South Dakota			\$402			
South Dakota			0.3			
South Dakota			0.8			
South Dakota			0.9			
30%			30%			
30%			15%			
15%			25%			
25%			1.05			
1.05						
<b>Low Scenario</b>						
Net Machine Income to Permittee		\$6,208,638	\$16,556,368	\$18,625,914	\$20,695,460	\$21,730,232
Net Machine Income to Vendor		\$6,208,638	\$16,556,368	\$18,625,914	\$20,695,460	\$21,730,232
Net Machine income to Municipalities		\$5,173,865	\$13,796,973	\$15,521,595	\$17,246,216	\$18,108,527
<b>Net Machine Income to State</b>		<b>\$3,104,319</b>	<b>\$8,278,184</b>	<b>\$9,312,957</b>	<b>\$10,347,730</b>	<b>\$10,865,116</b>
<b>Total Net Machine Income</b>	\$0	\$20,695,460	\$55,187,892	\$62,086,379	\$68,984,865	\$72,434,108
<b>High Scenario</b>						
Net Machine Income to Permittee		\$14,100,974	\$37,602,598	\$42,302,922	\$47,003,247	\$49,353,409
Net Machine Income to Vendor		\$14,100,974	\$37,602,598	\$42,302,922	\$47,003,247	\$49,353,409
Net Machine Income to Municipalities		\$11,750,812	\$31,335,498	\$35,252,435	\$39,169,373	\$41,127,841
<b>Net Machine Income to State</b>		<b>\$7,050,487</b>	<b>\$18,801,299</b>	<b>\$21,151,461</b>	<b>\$23,501,624</b>	<b>\$24,676,705</b>
<b>Total Net Machine Income</b>	\$0	\$47,003,247	\$125,341,992	\$141,009,741	\$156,677,490	\$164,511,365

\* Bill has an effective date of January 1, 2001 (6 months left in the fiscal year).  
 Sources: La Fleur's 1994 and 1996 World Gambling Abstract, Telephone conversations with government officials in SD, OR and MT; U.S. Bureau of Census and U.S Bureau of Economic Analysis.