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Memorandum

R-131-3047

To: The Honorable William P. Coley, II
Ohio Senate

From: Alyssa Bethel, Attorney *AB*
Thomas Kilbane, Economist *TK*

Date: June 29, 2016

Subject: Advance-deposit wagering (ADW) in Ohio

You requested an overview of advance-deposit wagering (ADW) in Ohio. Specifically, you would like to know about its legality, prevalence, and potential long term impacts. The Ohio Revised Code does not define ADW. Generally, ADW refers to a form of wagering on the outcome of horse races in which the bettor must fund an account before being allowed to place bets. ADW is most often conducted via Internet or telephone. Because ADW is taking place in Ohio mostly via online systems, the majority of research in this memorandum is related to online ADW providers and systems.

Legality of ADW in Ohio

According to the State Racing Commission, telephone ADW is not prevalent in Ohio today. Still, its legality has been debated, and discussion of that debate may be helpful to you. The Commission, which has authority to prescribe the forms of permissible wagering and the procedures on wagering in Ohio,¹ has adopted rules governing telephone account wagering in Ohio, a form of ADW.² The rules authorize a horse racing permit holder to manage a telephone account wagering system through which a person who has established a deposit account with the permit holder may wager by telephone. The Ohio Attorney General issued an opinion in 1995 that held that the adoption of these rules *was not within the Commission's authority* and that the Commission should rescind the rules. The Attorney General reasoned that the Revised

¹ R.C. 3769.03.

² O.A.C. 3769-3-32 (thoroughbred and quarter horse racing) and 3769-13-32 (harness racing).

Code contemplates only wagering that takes place in person, and that the Commission went beyond that by adopting rules to allow telephone ADW because it does not take place in person at the race track.³ Further, simulcast wagering and wagering at satellite facilities are "narrow exceptions" the General Assembly has crafted to the location restrictions.⁴ So, this Opinion seems to conclude that ADW conducted via telephone is unlawful unless authorized by statute as an exception to the location restriction. The Commission has not rescinded its telephone ADW rules, and the General Assembly has not amended the Revised Code to expressly allow ADW, or to expressly allow the Commission to establish rules regarding ADW.

Seemingly in contrast with its 1995 Opinion, in 2000, the Attorney General's Office "acknowledged" that the use of an online ADW system fell within the provisions of the Commission's rules (all rules, not specifically the telephone ADW rules discussed above). Based on this acknowledgment, the Commission authorized Beulah Park in Ohio, which is no longer in operation,⁵ to develop an online ADW system. But, the Attorney General later requested that the Commission immediately terminate the operation of the online ADW system by Beulah Park until the Attorney General could issue a formal opinion. Ultimately, a court allowed Beulah Park to continue operation of its online ADW because it found Beulah Park was entitled to a notice and hearing under due process before operation of the ADW could be terminated.⁶ It appears the Attorney General has not issued a formal opinion regarding the legality of ADW in Ohio since its 1995 decision. I am also unable to locate a case that addresses this issue. Therefore, the legality of ADW systems in Ohio is uncertain.

Although telephone ADWs are currently uncommon in Ohio, and the legality of the Commission's rules is uncertain, we note that the Commission's rules for telephone ADWs require that each track deduct the same percentage on a telephone wager as is deducted on a wager made in person at the track.⁷

Prevalence of ADW in Ohio

Producing a detailed dollar estimate of ADW in Ohio is difficult for a number of reasons, as explained below. However, based on the information currently available to

³ 1995 Op. Att'y Gen. No. 1995-034.

⁴ *Id.* at page 10.

⁵ In 2013, the State Racing Commission approved the transfer of Beulah Park's license to Mahoning Valley Race Course near Youngstown, Ohio. <http://www.vindy.com/news/2013/may/30/hollywood-at-mahoning-valley-race-course/>.

⁶ *Heartland Jockey Club LTD. v. Ohio State Racing Commission*, Case No. 00CVF11-10256, Decision and Entry Ordering the Ohio State Racing Commission to Conduct a Hearing Regarding its November 16, 2000, Decision to Terminate Appellant's Internet Wagering System, Winticket.com.

⁷ O.A.C. 3769-3-32(L) and 3769-13-32(L).

us, ADW handle⁸ on Ohio races attributable to Ohio residents is likely over \$100 million per year and growing.

Left undecided by the courts or the statutes, Ohio tracks have each operated with ADW providers independently. Some have online wagering platforms of their own, usually a joint venture with a larger ADW company.⁹ Most tracks also have individual contracts with multiple out-of-state ADW providers. These ADW providers negotiate the rights to take wagers and provide live video for races at Ohio tracks. This ADW handle is accounted for in the pari-mutuel pool managed by the host tracks that determines post-race payout odds.

Many industry people we spoke with talk about ADW as if it is old news. ADW has had a presence in Ohio for over a decade.¹⁰ Various news articles throughout the past decade can be found online recapping contractual disputes between tracks, horsemen's groups, and ADW providers.¹¹ One of the early ADW providers was founded by a former owner of Beulah Park, in partnership with other Ohio tracks. The ADW provider struggled with Ohio's regulatory environment (see "**Legality of ADW in Ohio**," above), and was eventually sold to Churchill Downs, Inc., which runs one of the largest current ADW providers under the name Twin Spires, registered in Oregon.¹²

As the result of legislation in 1997,¹³ and subsequent support from the state's legislators and racing industry, Oregon has become the most popular state of domicile for the ADW providers. As of the 4th quarter of 2015, nine ADW providers (or hubs) domiciled in Oregon reported substantial handle to the Oregon Racing Commission, including industry giants, Twin Spires, TVG, and XpressBet. Many of the providers operate under multiple names and affiliates, including BetHarness.com, which is an "online wagering service of Northfield Park," and RacelineBet.com, which is a "subsidiary of Scioto Downs, Inc." Both are listed by the Oregon Racing Commission as affiliates of Twin Spires. Under Oregon law, these companies must have a "multi-

⁸ Handle is a racing industry term for the total amount wagered.

⁹ Some examples of Ohio tracks online wagering platforms include Betharness.com (Northfield Park), Racelinebet.com (Scioto Downs), and Xpressbet.com (Thistledown).

¹⁰ <http://www.businesswire.com/news/home/20051020005962/en/Youbet.com-Carry-Races-Beulah-Park-River-Downs>.

¹¹ http://usatoday30.usatoday.com/sports/horses/2009-01-08-2629110006_x.htm; <http://www.bloodhorse.com/horse-racing/articles/153188/racetracks-fire-back-in-adw-conflict>.

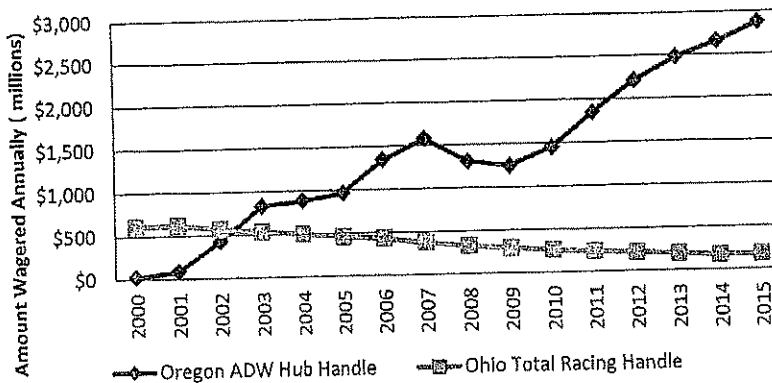
¹² https://www.churchilldownsincorporated.com/our_company/company_news/2008/07/22/churchill-downs_incorporated_acquires_american_bloodstock_rese.

¹³ House Bill 3009 of the Oregon 69th Legislative Assembly authorized the Oregon Racing Commission to license and regulate all phases of multi-jurisdictional simulcasting and interactive wagering totalizator hubs.

jurisdictional simulcasting and interactive wagering totalizator hub" license.¹⁴ The license requires an application fee of \$200 per day the hub will be scheduled to operate. For a provider that plans to operate every day year round, the fee is \$73,000. Additionally, the license holder will pay 0.25% of gross mutual wagering receipts to the Oregon Racing Commission.¹⁵

Since most providers claim jurisdiction in Oregon, hub handles as reported by the Oregon Racing Commission serve as a decent proxy for overall ADW growth nationwide. The chart below depicts total annual handle for ADW providers in Oregon, as well as Ohio's total racing handle (which does not include wagering done through ADW providers) during the same time period as reported by the Ohio Racing Commission.

Racing Handle Trends



Ohio's total racing handle peaked in 1998 and declined every subsequent year, until a small increase in 2015. It is generally accepted that total wagering in the U.S. racing industry has been in decline nationwide for some time now (due to many factors, including the rise of alternative gambling options), but tracking the decline is difficult since the mechanics, and reporting, of wagering in the industry have changed. Clearly, the ADW portion of nationwide industry handle has still managed to grow very quickly.

How much of the ADW is being done on races at Ohio tracks is difficult to know. In theory, the tracks should be able to report this since those wagers are incorporated into the pari-mutuel pools, but detailed reporting was difficult to gather (see "Data acquisition," below). Official handle data that the State Racing Commission

¹⁴ Oregon Revised Statutes § 462.725.

¹⁵ Technically, taxes on the first \$60 million in receipts during an approved license period are paid at the rate of 0.125%, and 0.25% for every dollar thereafter. Oregon Administrative Rules § 462-220-0040.

collects from tracks and reports publicly is limited to wagering on live racing, wagering at the in-state Cedar Downs satellite facility, wagering on county fair harness racing, and wagering on simulcast action. This simulcast wagering consists of bets taken at Ohio tracks for races hosted at other facilities, video signal of which Ohio tracks have contracted to receive.¹⁶ These wagers are generally known in the industry as "simulcast import," and are governed by Ohio law explicitly. On the other hand, tracks also contract to provide video signal of their own races at out-of-state facilities (typically other tracks) in what is known as "simulcast export." The Revised Code allows for tracks and horsemen's groups to negotiate their own out-of-state simulcast export arrangements.¹⁷ ADW handle is usually classified by tracks to be under the umbrella of simulcast export. The Commission does not officially collect or publish simulcast export handle, however the tracks must keep these records, since it is used to determine pari-mutuel pool odds.

While not official, discussions we had with industry officials lead us to believe simulcast export handle makes up the majority of pari-mutuel pools. According to executives at Penn National Gaming (PNG),¹⁸ only around 10% of a given race's pari-mutuel pool is live racing wagers, while ADW makes up around 25% to 30%. The majority of the remaining portion comes from various other simulcast exporting (mostly to other interstate or international tracks). According to the same executives at PNG, simulcast export handle at the Mahoning Valley track was around \$600 million in 2015. This is in relation to only \$2.6 million of 2015 live racing handle at Mahoning Valley as published in the 2015 Ohio Racing Commission Annual Report.¹⁹ It is unclear how much of that \$600 million figure came from ADW handle, and also how to reconcile it with the information that around 10% of pari-mutuel pools are from live racing. However, it does seem to make clear that the amount of money being wagered on Ohio races via simulcast export, and therefore unreported by the Commission, is very large.

In regards to ADW, a key aspect is the geographical origination of the wager. Wagers placed on Ohio races through ADW providers from beyond Ohio's borders are less likely to have been placed at all before the advent of ADW. If anything, they likely displace wagers taken at out-of-state tracks that contract to receive simulcast signals from Ohio tracks. However, wagers taken through ADW providers on Ohio races and

¹⁶ Ohio tracks may receive simulcast signals from both in-state and out-of-state facilities. Intrastate simulcast arrangements are governed by Ohio law. R.C. 3769.089.

¹⁷ R.C. 3769.089(G) through (K).

¹⁸ PNG is an owner and operator of casinos and racetracks, but also operates its own ADW, eBet. PNG currently owns and operates the racinos in Dayton and Mahoning Valley, including management of their race handle.

¹⁹ Available at www.racing.ohio.gov/pdfs/AnnualReport.pdf.

that originate within Ohio's borders, in many cases are replacing Ohio live track wagering handle. Complicating the matter, only the ADW providers have record of where individual wagering accounts are registered. Even that does not always match the geographical origination of each bet.

A 2012 report²⁰ done by the State of New York Racing and Wagering Board surveyed ADW providers to assess the impact of New York state residents' use of their services. The results revealed that in 2010, New York residents wagered approximately \$2 with ADW providers for every \$5 they wagered with in-state providers (tracks or state sanctioned off-track betting facilities). Assuming a similar ratio occurred in Ohio in 2010, and applying the annual rate of growth of the Oregon hub handles to the ADW, and the rate of decline of total Ohio handle, we can estimate that ADW handle attributable to Ohio residents would have surpassed their wagers at in-state providers in 2014. In 2015, Ohio residents would be estimated to have wagered about \$6 with ADW providers for every \$5 they wagered at an in-state track or satellite facility. This estimate is similar to estimates given by executives at PNG, who estimated the current ratio of Ohio resident wagering at live track facilities versus ADW providers to be approximately \$1 to \$1.

It is difficult to translate these estimates to an aggregate dollar figure of Ohio resident wagers with ADW providers because we do not know what portion of the state's handle (as reported by the Commission) is wagered by Ohio residents. However, given the information and data we have, it seems reasonable to estimate that it is over \$100 million annually. Of course, not all wagering done by Ohio residents through ADW providers would have been done at an in-state facility in the absence of the ADW provider.

Long term impacts of ADW in Ohio

For many reasons, ADW wagering has grown rapidly. Some of this growth is organic; the result of new and better technology that enhances the customer experience of wagering on racing, all from a computer or smartphone. As with many industries, the rise of computing technology and the pervasiveness of smartphones has played a large role in the growth. But another catalyst for ADW growth is the avoidance of regulatory costs. Similar to online shopping in the retail industry (e.g., Amazon), or transportation network companies in the taxi industry (e.g., Uber), ADW providers have used technology to transform their industry, while governments and regulators must later adapt their regulations to conform to the transformation. Free from many of the stipulations required of live track betting, ADW providers have been able to attract bettors with promises of larger winnings, and track participation with promises of

²⁰ 2012 Annual & Simulcast Report, New York State Racing and Wagering Board, available at <https://www.gaming.ny.gov/pdf/2012.RWB.AnnualReport.pdf>.

larger handle and, in some cases, a larger portion of the "takeout."²¹ Rebates offered to bettors by ADW providers were mentioned by multiple industry officials as a strong incentive for bettors to use the ADW services to place wagers instead of the traditional in-state betting options.

As with the examples in the shopping and transportation industries, the impact of ADW on the horse racing industry has been profound. Clearly, more wagering has been done on Ohio racing than would have taken place without the ADW providers. That is highly likely to be the case going forward as well. After considering the industry growth that ADW provides, long term impacts ultimately boil down to the disposition of revenue.

Currently under Ohio law,²² between 18% and 22% of live racing wagers are retained as takeout by the track (determined by type of bets), with the remainder being returned to the bettors as winnings. Taxes to be paid on the wagers are between 1% and 7% of handle (usually around 3% to 4%, depending on the total amount and type of wagers). The remaining portion of the takeout (about 16% of wagers) is split 50/50 between the host track and horsemen's groups. Portions of the taxes go to the following state funds: Medicaid Services – Long Term Care (Fund 5R20), Thoroughbred Development (Fund 5620), Standardbred Development (Fund 5630), Racing Commission Operating (Fund 5650), Ohio Fairs Fund (Fund 7083), and Horse Racing Tax (Fund 7082), which is used to fund agricultural societies in the counties that have wagering facilities. These funds lose revenue when wagers are placed with ADW providers (which do not pay state tax) instead of in-state facilities.

When a wager is placed with an out-of-state ADW provider, takeout percentage typically remains in a similar range, but the disposition of it is different. Some tracks command a "host fee" from the ADW providers in return for the rights to carry the signal and accept wagers for races run at their tracks. Host fees in the industry vary considerably between tracks, but typically run between 3% and 8% of ADW handle. According to multiple industry officials, Ohio tracks typically fall on the low end of that range, and at least one source told us that some tracks in Ohio with particularly low leverage do not command any host fee at all. A host fee can be split among the hosting track and the horsemen's groups. Horsemen's groups may also negotiate separately with the ADW providers for revenues from wagering handle to offset the losses from decreased wagering at in-state facilities. ADW providers then pay their other expenses, usually including fees and taxes in their state of domicile (typically Oregon or North Dakota) and retain the rest as earnings. ADW providers frequently use a portion of

²¹ Takeout is a horse racing industry term referring to the portion of the handle that is not returned to bettors in the form of winnings. Takeout typically is around 20% of wagers, and gets split among tracks, horsemen's groups, ADW providers (when applicable), and governing or regulatory bodies.

²² R.C. 3769.08, 3769.087, and 3769.26.

their takeout on rebates for bettors to attract business. This effectively lowers the takeout percentage of the handle and raises the percent returned to bettors as winnings.

| Direct Revenue Effects of Wagering with ADW Provider When It | | |
|--|------------------------|--------------------------------|
| Party | Displaces In-State Bet | Does not Displace In-State Bet |
| Host Track (in Ohio) | ↓ (varies by track) | ↑ (varies by track) |
| Horsemen's Groups | ↓ (varies by track) | ↑ (varies by track) |
| Racing Commission | ↓ | — |
| Other State Funds | ↓ | — |
| ADW Provider | ↑ | ↑ |
| ADW State of Domicile | ↑ | ↑ |
| Bettors | ↑ | N/A |

The table above identifies revenue gainers and losers when a dollar is wagered on an Ohio race through an ADW provider under two different scenarios: when the wager is made with the ADW provider instead of an in-state facility, and when the wager is made with the ADW provider, but would never have been made otherwise. It is difficult to measure which of these categories an actual wager with an ADW provider falls into; however, it is generally accepted that the second category outnumbers the first. Ohio tracks and horsemen's groups will often contract with ADW providers and accept reduced revenue from the first category in order to capitalize on new revenue streams from the second. However, ADW providers do not often voluntarily divulge wager origination by geography, making the magnitude of the losses in the first category even more difficult to measure.

Officials at Ohio's Northfield Park track told us that at one time, TVG, one of the ADW industry leaders, would send extra compensation to the track for wagers made through their service that originated within a certain radius of Northfield Park. This type of payment is usually referred to as a "source market fee" in the industry. Apparently, this was not part of a contractual agreement, but done by TVG to foster goodwill with the track, applicable horsemen's groups, and perhaps to stave off additional regulation. According to the official, the payments eventually ceased without explanation. In addition to ownership of the tracks at Dayton and Mahoning Valley, PNG runs its own ADW provider. Executives there told us they plan to roll out a new ADW service for races at its Ohio tracks later in 2016. To address the geographic origination issue, they plan to use geo-fencing technology to detect wagers placed through the ADW service from the track, and treat revenue from those wagers as live

racing handle, including complying with Ohio state racing taxes. Despite the additional tax burden, the incentives to bypass the on-track betting procedures are much lower when the track and ADW provider have common ownership.

Effect on Commission

While detailed revenue effects of ADW on many parties are hard to determine, it is certain that the Commission has lost revenue as a result of the trend. Ohio tracks and horsemen's groups have been able to recoup some of their losses through negotiation of contracts with the ADW providers, but the Commission does not have that option. The Commission's annual tax revenue from race wagering peaked in 1979 at over \$28 million, but has declined since then to just over \$5.7 million in 2015, including declines in every year since 2001. However, a theoretical extra \$100 million in Ohio handle recouped from ADW providers (a 58% increase on 2015 reported handle) would not affect the Commission's budget by as much as it may seem for two main reasons.

First, the Revised Code stipulates the disposition of horse racing tax revenue so that after distributions to the Long Term Care Fund and the Ohio Fairs Fund (among others), the remaining portion of tax revenue to the Commission from \$100 million in wagering would be only approximately \$2 million. Of that \$2 million, only around \$0.75 million would go to the Racing Commission Operating Fund, with the rest being distributed back to the industry through Standardbred and Thoroughbred Development Funds.

Second, despite long term declining tax revenue from racing, overall Commission total revenue rose sharply in 2013 and subsequent years as the result of new revenue sources from the Gross Casino Revenue Tax and Video Lottery Terminal revenue. Total revenue in 2015 was \$26.3 million, up from \$8.9 million in 2012 (as published in the Commission's 2015 Annual Report), and the state's latest operating budget projections put it over \$40 million annually for FY's 2016 and 2017. Relative to the revenue boom the Racing Commission has experienced from video lottery terminals and the casino tax, losses from the shift in wagering to ADW providers have been overshadowed. The Commission's mission is in part to ensure the integrity of horse racing and racing-related wagering in Ohio. The loss of revenue associated with the expansion of ADW is highly unlikely to impair the Commission's mission for the foreseeable future.

Data acquisition

Research for this memorandum required communication with the Commission, Ohio tracks, and out-of-state ADW providers, among others. All parties approached this topic with caution, leading to varying levels of cooperation. Ohio racetrack responses to inquiries about ADW generally ranged from cautious, to nonexistent. The contractual details of arrangements made between the tracks, horsemen's groups, and ADW providers were difficult to uncover given the private interests involved. Some of

the parties involved seem to be satisfied with the current system of ADW and are hesitant to contribute to any potential changes. Further, a more detailed fiscal analysis of this topic, especially if asked to evaluate a specific policy proposal, would require better collaboration with the tracks, ADW providers, and possibly the Commission. Given the reception to our initial inquiries, we opted to defer additional probing until, and unless, we receive further request from your office to do so.

We hope this information is helpful to you. Please contact Alyssa Bethel at (614) 466-2927 or Thomas Kilbane at (614) 728-3218 if you have additional questions concerning this matter.