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Senate of Pennsylvania

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November 18, 2016

Honorable Representative
PA House of Representatives
Main Capitol Building
Harrisburg, PA 17120

Dear Representative:

As many of you know firsthand, and as our newly elected colleagues surely observed from the campaign trail, gaming in the Commonwealth was a much discussed issue during our recently concluded legislative session. Numerous hearings were held to examine whether or not we should expand gambling opportunities in Pennsylvania. Various bills were introduced to add certain elements of gaming and to respond to such challenges as underage and compulsive gambling. And, most recently, we were forced to grapple with the ramifications of the Supreme Court's local share decision, invalidating key local funding provisions in the Race Horse Development and Gaming Act.

Given the complexity of these issues and the potential to harm "the goose that lays the golden eggs" (*i.e.*, the existing industry), our leaders were smart not to rush into new gaming legislation. Yet, with the local share problem unresolved and other initiatives under consideration, gaming promises to remain on the legislative agenda in the coming year.

Discussions on gaming began at the turn of the century and led, in the first instance, to the passage of the Race Horse Development and Gaming Act of 2004. As the vast majority of members were not in office at that time, I thought it might be helpful to give my perspective on what we did to create that historic act (supplemented by the Table Games

Act some years later) and what we should now pay attention to as the legislature begins to consider gaming related issues. I say this because the gaming industry that these acts created has become the most successful of its kind in the country, and we must be extremely careful before embarking on any changes that could jeopardize or stifle the huge benefits that continue to accrue to the Commonwealth some 7-12 years after their enactment. These major pieces of legislation required dialogue and compromise among all four caucuses and the administration. They were grounded in reality in terms of anticipated revenue, the reasonableness of regulation and the creation of viable business opportunities that could attract investment and increase employment.

The results of our efforts have been dramatic. No one could have imagined that Pennsylvania would build an entirely new industry that brought in almost 20,000 new jobs and billions of dollars of state revenue. Today the Commonwealth receives the highest amount of gaming tax of any jurisdiction in the nation. As the *Las Vegas Review-Journal* recently declared: "The gambling tax grand champion in the U.S.: Pennsylvania. It collected a whopping \$1.38 billion in tax revenue, nearly \$500 million more than what Nevada takes in." (Nov. 5, 2016). That success is something we have to maintain by keeping in mind the business model that our legislation created and by not eyeing the industry as a business that can be squeezed even further by additional taxation and other burdens.

For these reasons, I am convinced that the first thing we need to do is to promptly restore the local share funding that is vital to so many of our counties and communities across the Commonwealth. In the Senate, we passed a measure to do just that, addressing the direct issue created by the Pennsylvania Supreme Court's decision and restoring the financial status quo for our municipalities. Consistent with that approach, Parx and several other casinos, including Mohegan Sun Pocono, Hollywood Casino at Penn National Racecourse and Rivers Casino, have entered into agreements with their host communities to ensure that this funding will remain in place for 2017.

The House of Representatives chose a different approach to this issue, amending the local share bill with over 100 pages of new initiatives that would expand gaming in multiple ways and alter the structure of the industry. Each of these measures, and certainly all of them collectively, entail complex regulatory and business considerations and require careful examination.

Having remained at the forefront of legislative and regulatory developments in Pennsylvania and the ever-increasing gaming jurisdictions that surround our state, I respectfully urge you to consider the following concerns about the measures featured in the

amendment. The main theme in my approach is to protect and preserve our current industry and the enormous contributions it makes to the Commonwealth and our citizens:

Licensed Fantasy Sports – The potential licensure and regulation of fantasy sports is not an issue on the front burner of public concern. Fantasy sports has been primarily a recreational activity and hobby for friends and families across the Commonwealth. While certain large scale actors in this space have changed the tenor of this activity with their business models and mass marketing, fantasy sports, in its simplest form, will persist with or without state involvement. Further, as currently drafted, the projected revenue for the Commonwealth is insignificant.

The formal legalization of fantasy sports requires careful consideration as to whether and how the Commonwealth should license and regulate the activity. Certainly, one can argue whether or not fantasy sports are predominantly based on skill or chance. Of greater concern, should the General Assembly determine to regulate this activity, is the business model of the commercial operators. This model is predicated upon receiving, and can only succeed if it continues to receive, as many new participants as possible. Thanks to advanced computer algorithms, approximately 90% of the winnings from fantasy sports contests go to the approximate 1% of participants who are professionals, resulting in disaffected players and the constant need to replenish the model with new arrivals.

An additional concern for any viable regulated fantasy sports market will be the inherent advantage and market share enjoyed by the two primary commercial operators, as well as the fact that press reports suggest these two operators may combine to form one company and thereby even further distort the market. Such market dynamics would only further decrease interest among potential licensees and, thereby, decrease potential revenue to be garnered by the Commonwealth.

Category 3 Amenities Relief – One of the keys to the incredible success of gaming in Pennsylvania, was the care, thought and study that was put into creating a well-balanced gaming market and licensure structure. These efforts included market and revenue studies conducted for the Senate by leading experts in the field of gaming market analysis. An integral part of the advice provided to the General Assembly, which was incorporated into the Gaming Act, was the classification of casino licenses and the conditions attendant to each category. Category 1 casinos were assured a license, but bore the condition of having to operate a racetrack. Category 2 casinos were free of any obligation to conduct horse racing, but were required to compete for their license and were restricted as to where they could be located. Category 3 casinos enjoyed the benefit of substantially reduced license fees, but were designed to be an additional amenity to the patrons of the existing well-established hotel resort and were *never* intended to be mini-Category 2 casinos.

With the full knowledge of the conditions applicable to each category of casino, entities applied for particular casino licenses and, if they were successful, paid the related licensure fees, which, in the case of each Category 1 and 2 casinos, were as much as \$74,750,000 million. On that basis, Category 1 and 2 casinos also poured billions of dollars into their facilities.

Now, one of the categories of licensure, the Category 3 casino, desires relief from the conditions that were specifically designed for that category of casino – and of which the licensees were fully aware when they chose to seek and secure their licenses. Such a change would fundamentally alter the framework upon which our Gaming Act was based and upon which all of the licensees based their business and investment decisions. In the event that such a change is considered, it is inevitable that there will be pressure from the Category 1 licensees to gain some relief from the conditions attached to their licenses as well.

Moreover, to the extent this change is positioned as a revenue generating measure for the Commonwealth, it is a weak one. The change, as proposed in the House amendment, produces a mere, one-off \$2 million for the state.

Interactive Gaming – As we are all acutely aware, the expansion of gaming to allow for interactive, or Internet, gaming is a very complicated matter that requires significant research into and careful consideration of the financial implications and assumptions of the various options and proposals on the subject. You may be asking, having had so many hearings already, how could any additional research or study be necessary? The answers to this question are simple: (1) the stakes are too high to get it wrong; and (2) the assumptions and projections offered to date are deeply flawed.

In terms of what is at stake, we simply must protect and preserve the tremendous success we have already achieved. That success was not acquired easily. It was built; by the thoughtful, sound and reasonable approach employed and actions taken by the General Assembly and former administrations and by the investment, know-how, risk and first class operations of our private partners. Our bricks-and-mortar casinos have made Pennsylvania the leader in gaming tax revenue generation. We must protect them – and all of the investment they represent and all of the thousands of our constituents they employ.

Beyond financial concerns, though, we can place a very human face on what is at stake; it is our citizens and their good health. Interactive gaming, with its mobile applications and pervasive accessibility, poses a unique threat to the challenges of underage and compulsive gambling. We have heard of the difficulties our existing casinos face in policing underage

gaming, with legislation introduced to enhance the criminal penalties for such conduct in the hopes of creating a greater deterrent for our youth. In addition, just last year, we rightly voted down proposals to introduce slot machines into every corner bar on every main street in Pennsylvania, at least in part due to concerns of these issues. Interactive gaming presents similar challenges on these issues.

The other problem that has bedeviled our consideration of this issue is that we have, frankly, been given data and financial assumptions that are, simply, unreliable. We have been told that interactive gaming will produce over \$100 million in revenue to the Commonwealth. Yet, those in the industry have testified that – under the very best case scenario – interactive gaming could produce some \$40 million in revenue in year 3 of its implementation.

The outlandish revenue projections we have been fed have also been exposed by the real life experience in New Jersey. In its first full year of Internet gaming, New Jersey received a mere \$18 million in tax revenue. While revenue has increased modestly over the subsequent months, even at these higher levels (and without accounting for the impact of promotional play), the real world experience in New Jersey shows the projections given to us for Pennsylvania to be 3-4x overstated.

Beyond overstated revenues, we face the very real risk the Commonwealth will actually *lose* revenue as a result of the introduction of Internet gaming (at the significantly lower tax rate proposed) and its potential to siphon gaming dollars away from our bricks-and-mortar casinos. Likewise, for the same reason, our host counties and municipalities could see a material drop in their local share funding. The Pennsylvania Economic Development and Tourism fund, which helps communities across the state, and support for Pennsylvania's horse racing industry could also suffer. Neither the Commonwealth nor our communities nor our constituents should assume such a risk.

Considering all of this, you may ask, why is this happening? Because the primary advocates for interactive gaming are out-of-state interests and operators, looking to partner with smaller Pennsylvania casinos in order to gain access to and mine the major population centers in our Commonwealth. These entities did not pay \$74 million in casino license fees, they have not invested billions of dollars into Pennsylvania, and they do not employ thousands of our citizens – nor will they if Internet gaming is enacted. Yet, they will be doing everything they can to cannibalize our gaming market and to lure away the patrons of our bricks-and-mortar casinos. And, they will be doing so while paying a fraction of the tax revenue to the Commonwealth that it would otherwise receive if the players went to a Pennsylvania casino.

For all of these reasons, we should tread very slowly into this minefield. Any consideration of interactive gaming:

- ✓ must be based upon real data;
- ✓ must be operated only by our bricks-and-mortar casinos;
- ✓ must protect the Commonwealth's interests by imposing a tax rate on Internet gaming that does not make it more attractive to gamble online than to do so by visiting an actual casino; and
- ✓ must protect our industry employees and keep Pennsylvania open to the hundreds of millions of dollars of future investment from our licensees by maintaining the primary market areas that currently exist around our bricks-and-mortar casinos.

Airport Gaming – Finally, the proposed amendment included the concept of expanding gaming to the secured areas of airports through a limited program involving gaming on tablets. Given its many unique aspects, particularly the restricted area in which gaming may take place, airport gaming may represent an opportunity for gaming expansion that will generate new, incremental revenue for the Commonwealth without harming our existing industry. Once again, however, we must approach this expansion in a thoughtful, realistic, and business savvy way, in order to make whatever opportunity we create a viable and economically successful one for both the Commonwealth and its operator partners.

In conclusion, I urge all of us to remember that government's first, and often most important, rule is to do no harm. We all recognize the Commonwealth's financial predicament and need for additional revenue. But, our recent experience has shown that talk of gaming expansion can quickly devolve into funny-money projections and irrational proposals that lack any sense of business reality. Two recent examples of this would be the presumptions that significant revenue streams would be generated from the expansion of small games of chance and the creation of casino liquor licenses.

From my discussions within the industry, it is clear to me that one of the best ways to generate additional revenue from gaming is to simply let our experienced operators 'get on with it' by giving them a period of unthreatened stability, that is free of sudden tax and regulatory hikes and new competitive forces. Within that environment, they will continue to invest heavily in their facilities, from which, as prudent businessmen, they will expect a return. If they are successful in the deployment of that capital, the biggest beneficiary will be the Commonwealth of Pennsylvania, which takes the lion share of gross gaming revenue.

In addition, before we take any action, we must have thoroughly considered what consequences, intended or unintended, may flow from that action. A number of our existing casinos have either recently completed or announced plans to make hundreds of millions of dollars in improvements to their facilities. All of this investment in Pennsylvania and the jobs it creates are at risk – and could be lost – if expansion proceeds in ways that harm the industry.

We should protect the revenues, investment and jobs we already have and can grow through reasonable measures to support our present industry. To do so, we need to have real discussions with our existing casinos to ensure that any proposals or new measures are viable and likely to grow and enhance the success of Pennsylvania gaming.

Thank you for considering this correspondence. I look forward to working with you in the coming session to address these important matters for our Commonwealth.

Sincerely,

A handwritten signature in black ink, appearing to read "Robt M Tomlinson". The signature is fluid and cursive, with the first name "Robt" and last name "Tomlinson" clearly legible.

Robert M. Tomlinson
State Senator, 6th District

RMT/tmb