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# **THE GOVERNOR'S VIDEO LOTTERY FRANCHISE PROPOSAL**

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## The Governor's Video Lottery Franchise Proposal

Governor Pataki, as part of his proposals for New York Stat's 2005 fiscal year budget, has suggested the addition of "video lottery franchise gaming." His proposal is contained in Part R of Senate Bill No. S. 6060/ Assembly Bill No. A. 9560. This bill would add a new Section 1621 to the Tax Law. The prior provisions which have authorized lottery gaming at certain racetracks [hereinafter referred to as racinos] are contained in Section 1617-a of the Tax Law.

It should be noted that appropriation implementation language in the budget is often drafted hastily. Crucial decisions on the budget are frequently not made until late in January, leaving little time for those drafting the legislation to get all the details right. As a result, there is often a need for technical corrections to budget legislation. The video lottery franchise gaming part will likely need a number of technical corrections.

Section 1621 is divided into seven subdivisions. Subdivision (a) is the key component of the legislation. It establishes the concept of video lottery franchise gaming and provides for a maximum of eight separately licensed franchise venues. Any entity including an OTB corporation can bid for a franchise license from the Division of the Lottery. Local land use and zoning regulations will not apply to video lottery franchise locations.

Subdivision (a) also establishes the geographic boundaries for the video lottery franchises. In general, under paragraph (I) "except as otherwise authorized" franchise licenses cannot be granted within fifteen miles of any racino location. Paragraph (II) then says that only five locations are permitted in the City of New York and can only be in Brooklyn, Staten Island, and Manhattan below 59<sup>th</sup> Street. Paragraph (III) blocks franchise licenses in the counties of Rockland, Westchester and Putnam. This is followed by a proviso that the Lottery Division can waive any one or more of these geographic restrictions if any racino is not in operation or is not scheduled to operate by April 1, 2005.

There clearly are drafting concerns with the establishment of the geographic boundaries established by this subdivision. While paragraphs (II) and (III) appear chiefly concerned with establishing a franchise-free buffer zone around the prospective racino at Yonkers Raceway in Southern Westchester County, the proviso allowing a waiver of the buffer zone is not limited to Yonkers Raceway's inability to operate VLT's by April 1, 2005. Instead, it reads that if any racino locale in the entire state is not operating by April 1, 2005, then the Lottery Division can waive any of the boundary restrictions. Thus, if Vernon Downs in central New York (whose current principals have been denied licensure by the Racing and Wagering Board and whose stockholders are engaged in significant litigation) does not have an operating racino by April 1, 2005, the Lottery Division could install a lottery franchise in Westchester or some other county otherwise blocked from having a lottery franchise.

Additionally, paragraphs (I) and (II) do not mesh. Under paragraph (I), you can't have a lottery franchise within 15 miles of a racino unless "otherwise authorized." Does (II) "otherwise authorize" all locations in Brooklyn, Staten Island, and southern Manhattan? Aqueduct Racetrack is in Queens County, but it is within one mile or two from the Brooklyn border. Does paragraph (II) open up all of Brooklyn to lottery franchises? All of southern Manhattan is less than 15 miles from Aqueduct; yet it appears to be otherwise authorized to have lottery franchises. Some parts of Staten Island are within 15 miles of Aqueduct. Other parts of Staten Island are more than 15 miles from Aqueduct. Is all of Staten Island available for lottery franchises, or only those locations more than 15 miles away from Aqueduct? The statute is totally ambiguous, and there is the real possibility that while Yonkers was well taken care of in this bill, NYRA at Aqueduct was given almost no real geographical protection.

Subdivision (b) gives authority to the Division of the Lottery not only to promulgate rules governing the operation of the lottery but to establish the rules governing the criteria for awarding the lottery franchises. The delegation grants significant authority to the Lottery Division. The only express criteria established by the legislature are general in nature and find that criteria for the award of licenses include but are not limited to maximizing educational revenue, location and quality of the facility, the ability to institute the franchise on a timely basis, and the expertise of the applicant. Additionally while the hours of operation for racinos are largely established by the legislature in §1617-a.b., this section lets the Division of the Lottery determine the hours of operation for lottery franchisees.

Subdivision (c) gives the Lottery Division the right to establish a one-time license fee for each lottery franchise. Left unsaid is whether the fee will be the same for each licensee. Arguably, you might want to charge more for 2,500 VLT's in Times Square than you would for 500 VLT's along the Southern Tier of New York. Additionally, the money from the license fee is directed to the general lottery fund. All the other proceeds from lottery franchises are to go to a new fund set up to provide revenue for a sound basic education (SBE). Shouldn't the money from the new license fees also be directed to the SBE account?

Subdivision (d) requires that the payout from VLT's must average not less than 90% of sales. This is virtually identical to a provision in §1612 of the Tax Law and may not be necessary. Even if an amendment is necessary, it would make more sense to amend §1612 which contains the payout percentages for all of the games run by the Division of the Lottery.

Subdivision (e) establishes the SBE account and also establishes the groundwork for the vendor fee. The vendor fee is to be set by the Lottery Division with the vendor to receive a maximum commission of 20% of total machine revenue after payout. This contrasts with the racino vendor fee which is now up to 29% in §1612. Additionally, while the Lottery Division retains 10% of terminal revenue from racinos, subdivision (e) leaves the amount retained by the Lottery Division for "operation, administration and procurement" up to the discretion of the Lottery Division. Thought might be given to placing a ceiling

on the percentage of revenue that can be retained by the Lottery Division. In any event, lottery franchise gaming has the potential for returning considerably more revenue to the state for education than the 61% to be returned by racino gaming.

Subdivision (f) allows the Lottery Division to enter into an agreement with private entities and NYRA, which hold either racino or franchise license, that the state will give the facility the “exclusive right to operate such facility at its licensed location consistent with the geographical restrictions ... for a term of ten years.” This is a difficult subdivision to explain, and it reads very awkwardly. If the purpose is to insure racinos licensees that the geographical restrictions will not be altered, this is not the way to provide the protection. You could simply say that the state will not alter for ten years the geographical restrictions in subdivision (a) to adversely affect the interests of any racino entity licensed before April 1, 2005. Otherwise, it literally reads that these licensees have a ten year exclusive right to a license.

Part of the problem is that some of the potential licensees are not private entities or NYRA. Western OTB owns Batavia Downs which is scheduled to be a racino, and it is not a private entity. The Erie County Agricultural Society which owns Buffalo Raceway is a non-profit corporation which has certain public powers under §1409 of the Not-For-Profit Corporation Law. It arguably is not a private entity. Perhaps more significantly, the provision could be read as giving NYRA a 10 year exclusive right to VLT's at Aqueduct. Since NYRA's franchise currently expires in 2007, pursuant to Section 208 of the Racing, Pari-Mutuel Wagering and Breeding Law, this provision could be read as making it impossible for anyone who succeeded to NYRA's interest at Aqueduct to have the right to have VLT's at Aqueduct. Absent a right to have VLT's at Aqueduct, fewer outside parties would wish to bid to acquire the NYRA franchise, and the value of a NYRA franchise without VLT's would be greatly diminished. In short, this provision could be read as giving NYRA additional protections from competitors. This subdivision should be rewritten to avoid the assorted ambiguities that it has created.

Subdivision (g) allows the Lottery Division to amend (without resorting to another competitive bidding process) the competitively bid contracts it has established with VLT suppliers and its technology provider.

Part R also amends §1612 to provide that revenues from racino VLT's will now go the SBE account.

The \$64 question in government finance issue is often “Who won?” In this case, the winners are private hotel and casino firms which have the resources and the expertise to find the best sites for VLT franchises.

Who lost? Clearly the racetracks and their horsemen. They appeared to have a monopoly on VLT's. Now they have a ton of competition – and competition from major corporations. Yonkers Raceway may have lost the least since it has been given a considerable buffer zone that is free of VLT franchises. Westchester County and its

adjacent counties have a population in excess of 2.5 million people, and it is likely that Yonkers will have far and away the best access to this lucrative market NYRA may have lost the most among all the racetracks since it does not appear to have any real protected area. Also losers are the casino firms and tribes hoping to strike it rich in the Catskills. While people may still go to the Catskills to wager on table games, the tribes' and their partners' prime access to the New York City metropolitan gambling market just vanished. They may now be faced with 5,000 machines at Yonkers, 4,500 machines at Aqueduct, possibly five additional VLT franchises in New York City, and the potential for additional VLT franchises in the metropolitan New York area. Who is going to schlep to Kutsher's to play a machine when they can play the same machine in Times Square or Coney Island? Obviously, the Atlantic City and Connecticut casinos lose many additional players as well.

The OTB's neither won nor lost. They were hopeful of obtaining exclusive access to the VLT franchises at their teletheaters. Now they have to compete with major casino outfits which clearly have deeper pockets and more expertise in casino operations than the OTB's possess. But at least they are still in the ball game, and some OTB's might be able to work with casino corporations to obtain a VLT franchise. The most likely operation is Capital OTB which has a special demonstration project in the northern Catskills in Greene County at the Friar Tuck Inn. While arguably in need of significant upgrading, the hotel could provide an outlet for a VLT franchise for Capital OTB. The OTB's which do not get a VLT franchise will be in particularly poor shape, however, since their casual fan base is now likely to choose to play one of possibly 30,000 VLT's (not including those slots at Indian casinos) in New York rather than make a wager on a horse race.

The language of proposed Part R follows:

#### PART R

33 Section 1. The tax law is amended by adding a new section 1621 to read  
34 as follows:

35 S 1621. VIDEO LOTTERY FRANCHISE GAMING. A. THE DIVISION IS HEREBY  
36 AUTHORIZED TO LICENSE, PURSUANT TO RULES AND REGULATIONS TO BE

PROMUL-

37 GATED BY THE DIVISION, THE OPERATION AND CONDUCT OF A LOTTERY TO BE  
38 KNOWN AS VIDEO LOTTERY FRANCHISE GAMING TO BE CONDUCTED AT UP TO

EIGHT

39 VENUES THROUGHOUT THE STATE, EACH REQUIRING A SEPARATE LICENSE.

40 LICENSES SHALL BE AWARDED BY THE DIVISION ON A COMPETITIVE BASIS AND

41 EACH PROPOSED VIDEO LOTTERY FRANCHISE LOCATION SHALL BE SUBJECT TO  
THE

42 APPROVAL OF THE DIVISION. ANY ENTITY, INCLUDING BUT NOT LIMITED TO OFF

43 TRACK BETTING CORPORATIONS, WHICH DEMONSTRATES TO THE SATISFACTION  
OF

44 THE DIVISION THAT IT POSSESSES THE QUALIFICATIONS AND EXPERTISE TO OPER-

45 ATE VIDEO LOTTERY FRANCHISE GAMING SHALL BE ELIGIBLE TO COMPETITIVELY

46 BID FOR ONE OR MORE AVAILABLE LICENSES. PROVIDED, HOWEVER, THAT THE

47 FOLLOWING GEOGRAPHIC RESTRICTIONS SHALL APPLY: (1) EXCEPT AS OTHERWISE

48 AUTHORIZED IN THIS SECTION, LICENSES MAY NOT BE GRANTED PURSUANT TO THIS  
49 SECTION FOR LOCATIONS WITHIN FIFTEEN MILES OF ANY FACILITY LICENSED  
50 PURSUANT TO SECTION SIXTEEN HUNDRED SEVENTEEN-A OF THIS ARTICLE; (II)  
51 THE OPERATION OF VIDEO LOTTERY FRANCHISE GAMING AS AUTHORIZED IN THIS  
52 SECTION IN THE CITY OF NEW YORK SHALL BE PERMITTED ONLY IN THE COUNTIES  
53 OF NEW YORK SOUTH OF 59TH STREET, KINGS AND RICHMOND AND AT NO MORE  
THAN  
54 FIVE LOCATIONS; AND (III) LICENSES MAY NOT BE GRANTED PURSUANT TO THIS

S. 6060

52

A. 9560

1 SECTION FOR LOCATIONS WITHIN THE COUNTIES OF WESTCHESTER, ROCKLAND  
AND  
2 PUTNAM; PROVIDED, HOWEVER, THAT ANY ONE OR MORE OF SUCH GEOGRAPHIC  
3 RESTRICTIONS MAY BE WAIVED BY THE DIVISION IF ANY RACETRACK AUTHORIZED  
4 TO CONDUCT VIDEO LOTTERY GAMING PURSUANT TO SECTION SIXTEEN  
HUNDRED  
5 SEVENTEEN-A OF THIS ARTICLE HAS NOT BEGUN OR IS NOT SCHEDULED TO BEGIN  
6 OPERATING VIDEO LOTTERY GAMING ON OR BEFORE APRIL FIRST, TWO THOUSAND  
7 FIVE. NOTWITHSTANDING ANY INCONSISTENT PROVISION OF LAW, VIDEO LOTTERY  
8 FRANCHISE GAMING AT EACH APPROVED LOCATION PURSUANT TO THIS SECTION  
9 SHALL BE DEEMED AN APPROVED ACTIVITY AT SUCH LOCATION UNDER THE  
RELEVANT  
10 CITY, COUNTY, TOWN, OR VILLAGE LAND USE OR ZONING ORDINANCES, RULES OR  
11 REGULATIONS. NO ENTITY OPERATING VIDEO LOTTERY FRANCHISE GAMING  
PURSUANT  
12 TO THIS SECTION MAY HOUSE SUCH GAMING ACTIVITY IN A STRUCTURE DEEMED  
OR  
13 APPROVED BY THE DIVISION AS "TEMPORARY" FOR LONGER THAN EIGHTEEN  
MONTHS.  
14 B. THE DIVISION SHALL PROMULGATE RULES AND REGULATIONS GOVERNING ALL  
15 ASPECTS OF THE OPERATION AND CONDUCT OF VIDEO LOTTERY FRANCHISE  
GAMING,  
16 INCLUDING BUT NOT LIMITED TO, THE CRITERIA FOR AWARDING SUCH LICENSES,  
17 ESTABLISHING LICENSE FEES, APPROVING LOCATIONS, SETTING AGENT FEES AND  
18 ESTABLISHING HOURS OF OPERATION, SUBJECT TO THE REQUIREMENTS OF THIS  
19 SECTION. CRITERIA FOR AWARDING LICENSES SHALL INCLUDE, BUT NOT BE  
20 LIMITED TO, MAXIMIZING FINANCIAL SUPPORT FOR EDUCATION, TIMELY  
IMPLEMEN-  
21 TATION OF VIDEO LOTTERY FRANCHISE GAMING, LOCATION AND QUALITY OF THE  
22 FACILITY AND EXPERTISE OF THE APPLICANT. SUCH RULES AND REGULATIONS  
MAY  
23 BE ADOPTED ON AN EMERGENCY BASIS PURSUANT TO SECTION TWO HUNDRED  
TWO OF  
24 THE STATE ADMINISTRATIVE PROCEDURE ACT.  
25 C. IN CONSIDERATION OF ITS LICENSURE AND PARTICIPATION IN VIDEO  
26 LOTTERY FRANCHISE GAMING, EACH LICENSEE SHALL PAY A ONE-TIME LICENSE  
FEE  
27 TO BE ESTABLISHED BY THE DIVISION FOR EACH LICENSE ISSUED, TO BE PAID  
28 INTO THE STATE TREASURY, TO THE CREDIT OF THE STATE LOTTERY FUND  
CREATED  
29 BY SECTION NINETY-TWO-C OF THE STATE FINANCE LAW.  
30 D. THE SPECIFICATIONS FOR VIDEO LOTTERY FRANCHISE GAMING SHALL BE  
31 DESIGNED IN SUCH A MANNER AS TO PAY PRIZES THAT AVERAGE NO LESS THAN  
32 NINETY PERCENT OF SALES.

33 E. NOTWITHSTANDING SECTION ONE HUNDRED TWENTY-ONE OF THE STATE  
FINANCE  
34 LAW, ON OR BEFORE THE TWENTIETH DAY OF EACH MONTH, THE DIVISION SHALL  
35 PAY INTO THE STATE TREASURY, TO THE CREDIT OF A SEPARATE AND DISTINCT  
36 ACCOUNT TO BE KNOWN AS THE SOUND BASIC EDUCATION ACCOUNT WITHIN  
THE  
37 STATE LOTTERY FUND CREATED BY SECTION NINETY-TWO-C OF THE STATE  
FINANCE  
38 LAW, THE BALANCE OF THE TOTAL REVENUE AFTER PAYOUT FOR PRIZES, LESS AN  
39 AMOUNT ESTABLISHED BY SUCH RULES AND REGULATIONS TO BE RETAINED BY  
THE  
40 DIVISION FOR OPERATION, ADMINISTRATION AND PROCUREMENT PURPOSES; AND  
41 LESS A LOTTERY AGENT FEE TO BE PAID TO EACH LICENSEE AT A RATE, TO BE  
42 ESTABLISHED BY SUCH RULES AND REGULATIONS, NOT TO EXCEED TWENTY  
PERCENT  
43 OF TOTAL REVENUE WAGERED AFTER PAYOUT OF PRIZES AT SUCH AGENT  
FACILITY  
44 WHICH WILL PROVIDE THE MAXIMUM LOTTERY SUPPORT FOR EDUCATION WHILE  
ALSO  
45 ENSURING THE EFFECTIVE IMPLEMENTATION OF THIS SECTION THROUGH  
REASONABLE  
46 REIMBURSEMENTS AND COMPENSATION TO THE LICENSEES FOR PARTICIPATION  
IN  
47 VIDEO LOTTERY FRANCHISE GAMING.  
48 F. THE DIRECTOR SHALL BE AUTHORIZED TO ENTER INTO CONTRACTS AS AN  
49 AGENT OF THE STATE WITH PRIVATE ENTITIES AND NON-PROFIT RACING ASSOCI-  
50 ATIONS LICENSED PURSUANT TO THIS SECTION AND SECTION SIXTEEN HUNDRED  
51 SEVENTEEN-A OF THIS ARTICLE TO ENCOURAGE THE TIMELY PARTICIPATION IN  
52 VIDEO LOTTERY GAMING. SUCH CONTRACTS MAY INCLUDE A COMMITMENT BY  
THE  
53 STATE THAT EACH VIDEO LOTTERY GAMING FACILITY SHALL HAVE THE  
EXCLUSIVE  
54 RIGHT TO OPERATE SUCH FACILITY AT ITS LICENSED LOCATION CONSISTENT WITH  
55 THE GEOGRAPHICAL RESTRICTIONS CONTAINED IN SUBDIVISION A OF THIS SECTION  
56 FOR A TERM OF TEN YEARS. NOTWITHSTANDING ANY OTHER PROVISION OF LAW  
TO

S. 6060

53

A. 9560

1 THE CONTRARY, AN AGREEMENT BY A VIDEO LOTTERY GAMING FACILITY  
OPERATOR  
2 TO BUILD AND OPERATE A LICENSED VIDEO LOTTERY GAMING FACILITY SHALL BE  
3 DEEMED GOOD AND VALID CONSIDERATION FOR A COMMITMENT BY THE STATE  
FOR  
4 SUCH EXCLUSIVE RIGHT TO OPERATE SUCH FACILITY.  
5 G. NOTWITHSTANDING ANY LAW TO THE CONTRARY, THE DIVISION SHALL BE  
6 AUTHORIZED TO AMEND, UPON NEGOTIATED AGREEMENT, COMPETITIVELY BID  
7 CONTRACTS IN FORCE AND VALID ON THE EFFECTIVE DATE OF THIS SECTION IN  
8 CONNECTION WITH VIDEO LOTTERY GAMING AUTHORIZED PURSUANT TO  
SECTION  
9 SIXTEEN HUNDRED SEVENTEEN-A OF THIS ARTICLE TO ALLOW THOSE  
CONTRACTORS  
10 TO PROVIDE GOODS AND SERVICES IN FURTHERANCE OF THIS SECTION, AND TO  
11 EXTEND THE TERMS OF SUCH CONTRACTS.  
12 S 2. Subdivision b of section 1612 of the tax law, as amended by  
13 section 3 of part W of chapter 63 of the laws of 2003, is amended to

14 read as follows:

15 b. Notwithstanding section one hundred twenty-one of the state finance  
16 law, on or before the twentieth day of each month, the division shall:

17 (I) pay into the state treasury, to the credit of the state lottery fund  
18 created by section ninety-two-c of the state finance law, not less than  
19 forty-five percent of the total amount for which tickets have been sold  
20 for games defined in paragraph four of subdivision a of this section  
21 during the preceding month, not less than thirty-five percent of the  
22 total amount for which tickets have been sold for games defined in para-  
23 graph three of subdivision a of this section during the preceding month,  
24 not less than twenty percent of the total amount for which tickets have  
25 been sold for games defined in paragraph two of subdivision a of this  
26 section during the preceding month, provided however that for games with  
27 a prize payout of seventy-five percent of the total amount for which  
28 tickets have been sold, the division shall pay not less than ten percent  
29 of sales into the state treasury and not less than twenty-five percent  
30 of the total amount for which tickets have been sold for games defined  
31 in paragraph one of subdivision a of this section during the preceding  
32 month; and (II) PAY INTO THE STATE TREASURY, TO THE CREDIT OF A SEPARATE  
33 ACCOUNT OF THE STATE LOTTERY FUND TO BE KNOWN AS THE SOUND BASIC

EDUCA-

34 TION ACCOUNT, WHICH SHALL BE KEPT SEPARATE AND APART FROM ALL OTHER  
35 STATE LOTTERY FUNDS, the balance of the total revenue after payout for  
36 prizes for games {known as "video lottery gaming,"} AUTHORIZED PURSUANT  
37 TO SECTION SIXTEEN HUNDRED SEVENTEEN-A OF THIS ARTICLE, less ten percent  
38 of the total revenue wagered after payout for prizes to be retained by  
39 the division for operation, administration, and procurement purposes;  
40 and less a vendor's fee to be paid to the track operator at a rate of  
41 twenty-nine percent of the total revenue wagered at the vendor track  
42 after payout for prizes pursuant to this chapter, which amount shall be  
43 paid to the operator of the racetrack for serving as a lottery agent  
44 under this pilot program. In establishing the lottery agent fee, the  
45 division shall ensure the maximum lottery support for education while  
46 also ensuring the effective implementation of section sixteen hundred  
47 seventeen-a of this article through the provision of reasonable  
48 reimbursements and compensation to vendor tracks for participation in  
49 such pilot program. Within twenty days after any award of lottery  
50 prizes, the division shall pay into the state treasury, to the credit of  
51 the state lottery fund, the balance of all moneys received from the sale  
52 of all tickets for the lottery in which such prizes were awarded remain-  
53 ing after provision for the payment of prizes as herein provided. Any  
54 revenues derived from the sale of advertising on lottery tickets shall  
55 be deposited in the state lottery fund.

S. 6060

54

A. 9560

1 S 3. This act shall take effect immediately, provided, however, that  
2 the amendments to subdivision b of section 1612 of the tax law made by  
3 section two of this act shall not affect the expiration of such subdivi-

4 sion and shall be deemed to expire therewith.

