

**Department of Legislative Services**  
Maryland General Assembly  
2011 Session

**FISCAL AND POLICY NOTE**

House Bill 1010  
Ways and Means

(Delegate Glenn, *et al.*)

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**Video Lottery Terminals - Expansion to Alcoholic Beverages Licensed Establishments**

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This proposed constitutional amendment authorizes the State Lottery Agency to award video lottery operation licenses throughout the State to holders of Class B, Class C, or Class D alcoholic beverages licenses. The amendment limits the number of newly authorized video lottery terminals (VLTs) to five per licensed location but does not limit the total number of VLTs that the State Lottery Agency can award. The State Lottery Agency is required to supervise, administer, and license VLTs awarded to these licensees. VLT revenue generated from these new licensees is to be distributed in the same manner as the proceeds from State lottery tickets.

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**Fiscal Summary**

**State Effect:** General fund revenues may increase beginning in FY 2013 and beyond due to VLT revenues being distributed in the same manner as proceeds from lottery tickets. Special fund revenues and expenditures from the existing VLT Program may decrease by a significant amount beginning in FY 2013. General fund expenditures increase in FY 2013 and beyond due to education and State Lottery Agency expenditures. While the total revenues generated by the bill cannot be reliably estimated, *for illustrative purposes only*, under one set of assumptions, net State revenues may increase by approximately \$49.0 million annually if 5,000 VLTs authorized by the bill are in operation.

**Local Effect:** Potential decrease in local impact grants distributed to certain counties from VLT revenues beginning in FY 2013. County expenditures are not affected.

**Small Business Effect:** Potential meaningful.

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## Analysis

**Current Law:** During the 2007 special session, the General Assembly adopted two pieces of legislation pertaining to VLT gambling – Chapter 4 (Senate Bill 3) and Chapter 5 (House Bill 4). Chapter 5 was a constitutional amendment approved by the voters at the November 2008 general election that authorized the expansion of gambling subject to specified restrictions. The constitutional amendment provided that (1) a maximum of five VLT facility licenses may be awarded within specified areas of the State; (2) no more than one facility license may be awarded in any county or Baltimore City; (3) a maximum of 15,000 VLTs may be authorized; and (4) VLT facilities must comply with any applicable planning and zoning laws of a local jurisdiction. Chapter 4, which was contingent on ratification of Chapter 5, established the operational and regulatory framework for the VLT program. Chapter 624 of 2010 made several changes to the VLT program implemented by Chapter 4.

Under Chapter 4, VLT facility operation licenses are awarded by the Video Lottery Facility Location Commission. The State Lottery Commission oversees VLT operations, and owns/leases VLTs and a central monitor and control system. Except for provisions related to the offering of food and beverages at facilities, the commission is required to ensure VLT licensees comply with the regulatory framework of the VLT program.

Chapter 4 allows for a maximum of 15,000 VLTs, distributed as follows: 4,750 VLTs in Anne Arundel County; 3,750 VLTs in Baltimore City; 2,500 VLTs in Worcester County; 2,500 VLTs in Cecil County; and 1,500 VLTs in Allegany County (Rocky Gap State Park).

### *VLT Program Implementation*

The Video Lottery Facility Location Commission has awarded video lottery operation licenses for VLT facility locations in Anne Arundel, Cecil, and Worcester counties. Penn Cecil in Cecil County opened in late September 2010 with 1,500 VLTs and Ocean Downs in Worcester County opened in January 2011 with 750 (increasing to 800 in the near future) VLTs. Power Plant Entertainment (PPE) Casino Resorts, LLC was awarded a license in December 2009 to operate a 4,750 VLT facility adjacent to Arundel Mills Mall in Anne Arundel County, contingent upon local zoning approval. County officials subsequently approved zoning legislation, but the legislation was petitioned to a local voter referendum at the November 2010 election. Anne Arundel County voters approved the legislation, allowing the VLT facility to go forward. PPE plans to open a 2,000 VLT temporary facility by the end of 2011 with a permanent facility scheduled to open by the end of 2012. The licenses for Baltimore City and Allegany County are yet to be awarded.

**Exhibit 1** shows the distribution of estimated VLT revenues through fiscal 2016, which assumes a Baltimore City facility begins operations in July 2013.

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**Exhibit 1**  
**Distribution of Estimated VLT Revenues in Maryland**  
**(\$ in Millions)**

	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>
Education Trust Fund (48.5%-51.0%)	\$64.1	\$192.3	\$286.6	\$471.3	\$512.3	\$549.4
Licensees (33%)	43.6	130.8	195.0	320.7	348.6	373.9
Local Impact Grants (5.5%)	7.3	21.8	32.5	53.4	58.1	62.3
Business Investment (1.5%)	2.0	5.9	8.9	14.6	15.8	17.0
Purse Dedication Account (7%) <sup>1</sup>	9.2	27.8	41.4	68.0	73.9	79.3
Racetrack Renewal (2.5%) <sup>2</sup>	3.3	9.9	14.8	24.3	26.4	28.3
Lottery Operations (2%)	2.6	7.9	11.8	19.4	21.1	22.7
<b>Total (100%)</b>	<b>132.1</b>	<b>396.5</b>	<b>590.9</b>	<b>971.8</b>	<b>1,056.4</b>	<b>1,132.9</b>

<sup>1</sup>Up to \$100 million annually.

<sup>2</sup>Up to \$40 million annually for eight years, after which the monies accrue to the Education Trust Fund. Chapter 624 of 2010 altered provisions regarding the authorized VLT facility in Allegany County. Contingent upon the purchase of the Rocky Gap Lodge and Golf Resort by the licensee, the 2.5% of VLT proceeds from the Allegany County facility for the first five years of operations that would otherwise be distributed to the Racetrack Facility Renewal Account would instead be distributed to the Allegany County facility licensee.

Source: Department of Legislative Services, December 2010 Revenue Estimate

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*Video Lottery Operation Licensing and Licensees*

An individual or business entity may not own an interest in more than one video lottery facility. An initial license fee of at least \$3 million for every 500 VLTs is required, which accrues to the Education Trust Fund. The initial term of a video lottery operation license (of which up to five may be awarded through a competitive process) is 15 years; a licensee may subsequently reapply for an additional 10-year term.

License applicants must meet State minority business enterprise (MBE) requirements for construction/procurement contracts and to the extent possible meet county MBE requirements if they exceed the State requirement. These requirements terminate on July 1, 2011. License applicants must also invest \$25 million in construction and related costs for every 500 VLTs proposed in a bid. VLT licensees must begin operations in a permanent facility within 18 months after the license is issued, which may be extended for up to 12 months by the State Lottery Commission. VLT licensees must pay an annual fee of \$425 per VLT to a Problem Gambling Fund administered by the Department of

Health and Mental Hygiene (DHMH). DHMH is required to conduct a problem and pathological gambling prevalence study to measure the rate of problem and pathological gambling in the State.

#### *Other Provisions of Current Law*

VLTs must have an average payout percentage of at least 87%. Free food and alcoholic beverages are generally prohibited at VLT facilities. By regulation, the State Lottery Commission must establish a list of individuals who are mandatorily excluded from VLT facilities. VLT facilities must develop procedures that permit self-exclusion from facilities for individuals with gambling problems. Regulations are also required for the protection of consumers, including a prohibition on cashing of paychecks at VLT facilities.

#### *Local Gaming*

Each county is responsible for regulating gaming activities conducted by civic and charitable organizations. There is no statewide reporting of gaming activities by civic and charitable organizations. Gaming licensees may use the proceeds of gaming activities for the benefit of their own organizations, but do not need to share them with other organizations. However, nonprofit organizations on the Eastern Shore that operate slot machines must use half of the proceeds from slot machines to benefit a charity.

Facilities operating electronic bingo machines are located primarily in Allegany, Anne Arundel, and Calvert counties. Tip jar gaming, predominantly paper based, is conducted in several Western Maryland counties including Allegany, Garrett, and Washington.

A 2006 Abell Foundation report on underground video gambling found between \$6.4 to \$15.3 million in lost local admissions and amusement tax revenue for fiscal 2005, due to underreporting of income from nearly 3,500 amusement devices in bars and other businesses in Baltimore City and Baltimore County, many of which had not been licensed by the jurisdiction. A subsequent report by the foundation notes that the Comptroller's Office, in coordination with Baltimore City, located over 100 machine owners who had not been paying the tax. An unknown number of these "gray" machines are in operation throughout the State, primarily in Baltimore City and Baltimore County.

Legislation was enacted in 1987 and 2007 authorizing certain nonprofit organizations to operate slot machines in the following eight Eastern Shore counties: Caroline, Cecil, Dorchester, Kent, Queen Anne's, Somerset, Talbot, and Wicomico. The 1987 legislation required a nonprofit organization to be located in the county for at least five years prior to the application for a license and to be a fraternal, religious, or war veterans' organization.

Legislation enacted in 2007 expanded the list of eligible organizations that may be licensed to operate slot machines to include those that have been affiliated with a national fraternal organization for less than five years, but have been located within an eligible county for at least 50 years before applying for a license.

At least one-half of the proceeds generated from slot machines must go to charity. The remainder of the proceeds must go to the organization. An individual cannot benefit financially from the proceeds. The organization must keep accurate records of gross receipts and payouts from slot machines and must report annually under affidavit to the Comptroller's Office the disposition of these proceeds. The Comptroller's Office, however, does not have authority to audit these reports.

### *West Virginia VLTs*

Limited numbers of VLTs (Limited Video Lottery, or LVL) are available at licensed West Virginia bars, clubs, and fraternal organizations. Licensed retail premises may operate up to 5 VLTs whereas eligible fraternal societies and veteran's organizations may operate up to 10 VLTs. As of June 30, 2010, 7,940 of the 9,000 maximum VLTs authorized were operating at over 1,600 licensed locations throughout the state. In fiscal 2010, West Virginia's LVL gross income totaled \$397.3 million for an average win-per-day of \$137. Since fiscal 2002, LVL revenues have averaged \$316.4 million annually. South Dakota and Oregon also have state-run LVL programs.

### *State Lottery*

Licensed lottery agents receive regular commissions equal to 5.5% of the agent's gross receipts from ticket sales. In fiscal 2010 through 2012 this commission is equal to 5.0%. In addition, an agent may receive a cashing fee not to exceed 3% of prizes paid. The Lottery Commission may also authorize the payment of special bonuses or incentives to licensed agents and their employees, not to exceed 0.5% of the gross receipts from ticket sales for the year for which the bonuses or incentives are awarded. Net proceeds after commissions are deposited into the State Lottery Fund. Except for specified revenue that is distributed to the Maryland Stadium Authority, net proceeds are deposited into the general fund.

**State Revenues:** This proposed constitutional amendment authorizes the State Lottery Agency to award video lottery operation licenses throughout the State to holders of Class B, Class C, or Class D alcoholic beverages licenses. The amendment limits the number of newly authorized video lottery terminals (VLTs) to five per licensed location but does not limit the total number of VLTs that the State Lottery Agency can award. In fiscal 2009 and 2010, there were about 5,000 Class B, C, and D alcoholic beverages

licenses issued in Maryland. Accordingly, a maximum of 25,000 VLTs could potentially be awarded by the State Lottery Agency.

The actual revenue increase, which cannot be reliably estimated at this time, depends on the actual number of VLTs installed at eligible locations, the average revenue generated by each VLT, and the impact these VLTs would have on lottery sales and revenues generated by facilities currently authorized to operate VLTs.

However, *for illustrative purposes only*, based on a preliminary analysis of data on West Virginia LVL revenues, it is estimated that if 5,000 VLTs are awarded, after payouts to winning players, but **before** any other distributions are made, net VLT revenues generated may increase by \$120 million at full implementation. This amount reflects the net of increased revenues from VLTs authorized by the bill *minus* revenue losses resulting at the facilities currently authorized to operate VLTs as well as State lottery revenue losses. **Exhibit 2** shows the distribution of the increased net revenues resulting from the bill at full implementation.

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**Exhibit 2**  
**VLT Net Revenue Increase**  
**Full Implementation**  
**(\$ in Millions)**

<b>Total Annual Revenues</b>	<b>\$120.0</b>
Agent Commissions	70.7
<b>General Fund</b>	<b>49.3</b>

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This estimate assumes that licensees are paid a 5% commission of the gross play of VLTs, plus any applicable cashing fees, and that the VLTs have a win percentage of 91.5%, the West Virginia LVL win percentage. To the extent licensees pay a higher winning percentage, general fund revenues will be significantly less.

*Effect on Existing State Revenues*

The estimated revenue generated from VLTs authorized by the bill take into account a reduction in lottery sales and VLT gambling under the existing VLT program. However, the amount of this reduction cannot be reliably estimated. The State Lottery Agency advises that lottery sales from 829 Class B, C, or D alcoholic beverages licensees total \$216.9 million on an annual basis.

### *Current VLT Revenue*

State special fund revenues will decrease under the existing VLT program, depending on the degree to which eligible locations are licensed to operate and implement VLTs. These machines will serve as a substitute for gambling at existing VLT facilities in the State. The amount of decrease cannot be reliably estimated.

### *Problem Gambling Fund*

Under current law a person authorized to operate VLTs is required to pay a fee of \$425 per VLT, which is credited to the Problem Gambling Fund administered by DHMH. The fund must be used to establish a 24-hour hotline, provide counseling for problem gamblers, and establish problem gambling prevention programs and other support services. If the State Lottery Agency authorizes 5,000 VLTs under the bill, an additional \$2.1 million annually will be paid to the fund.

### **State Expenditures:**

#### *State Lottery*

Current law requires the State Lottery Commission to purchase or lease VLTs. This will entail significant annual State Lottery Agency expenditures, to the extent that awardees do not directly cover these costs.

#### *VLT Program*

State special fund expenditures will decrease under the existing VLT program, depending on the degree to which eligible locations are licensed to operate VLTs.

**Local Expenditures:** If approved by the General Assembly, this constitutional amendment will be submitted to the voters at the 2012 general election. Legislative Services anticipates that the budgets of local boards of elections contain funding for notifying qualified voters about proposed constitutional amendments for the 2012 general election in newspapers or on specimen ballots.

**Small Business Effect:** Small businesses that are awarded VLTs under the bill may benefit from a net increase in business revenues. A business awarded the maximum number of VLTs may increase gross revenues (before payment of operating expenses and taxes) on average by about \$40,000 annually.

## **Additional Information**

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** Comptroller's Office, Maryland State Lottery Agency,  
Department of Legislative Services

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Analysis by: Robert J. Rehrmann

Direct Inquiries to:  
(410) 946-5510  
(301) 970-5510