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May 20, 2010

Mr. John Signor, President and CEO
Members of the Board of Directors
Capital Off-Track Betting Corporation
1629 State Street
Schenectady, NY 12305

Report Number S9-9-81

Dear Mr. Signor and Members of the Board of Directors:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished through our audits, which identify opportunities for improving corporation operations and Board of Directors' governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

In accordance with these goals, we conducted an audit of five regional Off-Track Betting Corporations throughout New York State.¹ We included the Capital Off-Track Betting Corporation in this audit. The objectives of our audit were to assess the financial condition of the Corporations and to determine if Off-Track Betting Corporation (OTB) officials have developed and/or implemented plans to achieve operational improvements and cost savings at their respective Corporations. The audit period was from January 1, 2004 to June 30, 2009.

Following is a report of our audit of the Capital OTB. This audit was conducted pursuant to the State Comptroller's authority as set forth in Article 5 of the Racing, Pari-Mutuel Wagering and Breeding Law.

This report of examination letter contains our audit results specific to the Capital Regional Off-Track Betting Corporation. We discussed the findings and recommendations with Corporation officials and considered their comments, which appear in Appendix A, in preparing this report. Corporation officials generally agreed with our findings and recommendations. At the

¹ There are six regional Off-Track Betting Corporations in the State. This audit does not include the New York City OTB.

completion of our audit of the five Corporations, we prepared a global report that summarizes the significant issues identified at the five Off-Track Betting Corporations audited.

Summary of Findings

Over the past five years, Capital OTB's financial condition has deteriorated due to a downturn in the economy as well as continual decreases in net handle (wagering) and a general decline in interest in horse racing, as well as increased competition from other entities in the gaming industry. Capital OTB has experienced a 10 percent (\$21.7 million) decline in net handle over the past five years, and through May 2009, its net handle is down \$6.6 million compared to the same time last year. As a result, operating revenues have dropped to \$22.7 million in 2008 compared to \$25.6 million in 2004, a 12 percent decline. These declines have significantly affected the revenue distributions to local governments, which have decreased 34 percent over the past four years.

Despite efforts taken by Capital OTB officials to decrease operating expenditures and increase net handle and revenues, if the recent trends continue the OTB may incur operating deficits in future years.

Background and Methodology

The Capital OTB was formed as a public benefit corporation on May 14, 1975. The OTB's geographic area is comprised of 21 counties and the City of Schenectady (City), but only 16 of these counties and the City participate in the off-track betting operations. The City of Schenectady, which had operated off-track pari-mutuel betting since 1971, was allowed to participate as a city. The governing body of the OTB is the Board of Directors (Board). The Board has 17 members, one from each of the participating counties and one for the City of Schenectady, who are appointed by their respective governing boards.

The OTB offers off-track pari-mutuel² wagering on horse racing with the objective of promoting the horse racing industry, providing revenues to State and local governments, and diminishing the role of illegal bookmakers. As of June 30, 2009, the OTB operated 40 branches, 36 EZ Bet locations,³ and two tele-theaters. The OTB also has a telephone account wagering operation and Internet wagering capabilities. In addition, the OTB owns and operates its own horse racing television station that allows patrons to wager through an account wagering system. The major cities located within the Capital OTB region are Albany, Schenectady, Troy, and Utica.

While an OTB collects significant amounts of money each year, it must distribute these funds to various sources designated in statute and contracts. An OTB may not retain its net revenues to help subsidize future operations.⁴ Net handle (wagers) represents the amount wagered by the Capital OTB's patrons throughout its branches, EZ Bet locations, tele-theater, and telephone and Internet venues. The winning patrons receive back a major percentage of the net handle on each

² Pari-mutuel refers to a betting pool in which winners divide the total amount wagered, after management expenses are deducted.

³ EZ Bet is a machine in an establishment where patrons can place bets through the machine.

⁴ Except for contributions to a capital acquisition fund, as explained later in this report

race. The OTB then must distribute some of the remaining net handle to the State's horse racing industry (which comprises various racetracks and horse breeding funds), New York State, and the City of Albany for a tele-theater operation. These payments, called "statutory distributions",⁵ are based on complex formulas contained in the State's Racing, Pari-Mutuel Wagering and Breeding Law (Racing Law). In addition, the OTB makes payments to certain racetracks pursuant to negotiated simulcast contracts, and incurs various other operating expenses.

Racing Law governs how an OTB distributes surcharge revenues and net revenues derived from the operations. Each regional off-track betting corporation or off-track betting operator conducting off-track betting must impose a surcharge of five percent on the portion of pari-mutuel wagering pools distributable to persons having placed bets at OTB facilities. The OTB distributes these surcharge revenues monthly to the participating local governments and to local governments where the tracks are located. In addition, an OTB distributes its net revenues from operations (i.e., operating revenues less operating expenses) after contributions to the capital acquisition fund⁶ are deducted, to the participating municipalities on a quarterly basis. For the year ended December 31, 2008, the Capital OTB distributed surcharge revenues and net revenues of approximately \$4.8 million dollars to local governments.

To complete our objective, we interviewed staff and examined the OTB's budget and/or operating plans, budget status reports, financial statements, New York State Racing and Wagering Board Annual and Simulcast reports and meeting minutes as well as any relevant policies and procedures and supporting documentation for the period January 1, 2004 through June 30, 2009.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

⁵ The Corporation's payments to various race tracks under its simulcast contracts are regularly included with its statutory distributions to the racing industry, even though these contract payments are not "statutory" in nature (i.e., not required by law).

⁶ The intent of the capital acquisition fund is to permit OTB corporations to reserve revenue for the payment of debt service and acquisition of capital assets without negatively affecting the respective corporation's cash flow required for operations.

Audit Results

Financial Condition Analysis

Net Handle – Capital OTB has experienced a 10 percent decline in net handle – approximately \$21.7 million – over the five-year period 2004 through 2008. Further, the OTB’s net handle through May 2009 was down \$6.6 million compared to the same period the prior year. The following table shows the change in net handle during the last five years:

Capital OTB Net Handle 2004-2008					
	2004	2005	2006	2007	2008
Net Handle	\$212,235,503	\$213,061,004	\$209,922,787	\$201,839,522	\$190,544,474
Dollar Value Change From Prior Year	N/A	\$825,501	(\$3,138,217)	(\$8,083,265)	(\$11,295,048)
Percent Change From Prior Year	N/A	0.39%	(1.47)%	(3.85)%	(5.60)%

The Capital OTB pays out a significant portion of the net handle to winning patrons and to local governments receiving the surcharge revenues. In 2008, the OTB paid approximately 76 percent, or \$145 million, of the net handle collected to winning patrons. It also paid some of the surcharge revenues collected to participating local governments (almost \$2.9 million) and local governments with tracks (almost \$1.2 million). The OTB kept the remaining surcharge revenues collected by funding its capital acquisition fund (about \$800,000) and retaining the rest in net revenues (about \$1.7 million) for further distribution.

Several factors have contributed to the decline in overall net handle at the OTB. These include a downturn in the economy, a general decline in interest in horse racing, as evidenced by declines in attendance and net handle at most racetracks in the State, as well as competition from other entities in the gaming industry such as casinos and government-sponsored lotteries. OTB officials have also attributed the decline in net handle to the increase in out-of-state and offshore advance deposit wagering sites.

Statutory Distribution – The OTB also must make statutory distributions before paying its operating expenses. These distributions represent a significant financial outlay for the OTB. The largest distributions are those made to the horse racing industry.⁷ During the five years ended December 31, 2008, these distributions totaled \$87.3 million and accounted for more than 83 percent of the OTB’s total \$105 million in statutory distributions. The distributions to the horse racing industry are made to the following entities:

- In-state racetracks based on statutory rates dependent on the type of wager and other contractual agreements

⁷ These payments are commissions to the tracks and payments for breeding and development funds.

- Out-of-state racetracks based on specific contractual agreements
- Certain designated horse breeding funds that were created to support and promote in-State activities related to horse breeding and racing.

The following table shows the statutory distributions paid during the five years ended December 31, 2008:

Statutory Distributions 2004-2008						
	2004	2005	2006	2007	2008	Total
Racing Industry⁸	\$17,954,537	\$17,315,066	\$18,089,108	\$17,360,161	\$16,587,364	\$87,306,236
New York State⁹	\$3,318,305	\$3,441,499	\$3,240,200	\$3,319,811	\$3,234,352	\$16,554,167
City of Albany¹⁰	\$338,391	\$349,972	\$325,134	\$304,435	\$0	\$1,317,932
TOTAL	\$21,611,233	\$21,106,537	\$21,654,442	\$20,984,407	\$19,821,716	\$105,178,335

Operating Revenues – Capital OTB operating revenues consist of the remaining net handle after winning bettors are paid, and monthly surcharge revenues and statutory distributions are allocated, and other miscellaneous incomes. These incomes include admission income, concession income, income derived from section 532 charges (a portion of the surcharge collected), interest income, other miscellaneous income and uncashed tickets.¹¹ Reflecting the declining net handle trend, the Capital OTB has experienced a 12 percent decline in operating revenues – approximately \$3 million – over the five-year period 2004 through 2008. In 2008, operating revenues were down 5 percent, or \$1.1 million, from the prior year.

Operating Expenditures – Overall, the OTB’s operating expenditures have decreased by approximately \$2.1 million, or 9 percent, over the five-year period 2004 through 2008. A significant portion of the OTB’s operating expenditures is employment-related (employee salaries and fringe benefits). While salaries and fringe benefits accounted for \$11 million (51 percent) of the OTB’s operating expenditures in 2008, both expenses have decreased significantly since 2007 due to cost cutting initiatives implemented by Capital OTB officials (see the section entitled “Operational Improvements” for more information). However, the decline in operating revenue has outpaced OTB’s cost cutting efforts, resulting in a significant decline in net revenues (i.e., operating revenues less operating expenditures) from operations. The following table illustrates these financial trends:

⁸ These payments are commissions to the tracks and payments for breeding and development funds.

⁹ Includes payments for pari-mutuel taxes and breakage, regulatory fees to the Racing and Wagering Board, and uncashed tickets

¹⁰ Pursuant to Section 1009(10) of the New York State Racing, Pari-Mutuel Wagering and Breeding Law, the Corporation has entered into a contractual agreement with the City of Albany whereby the City receives 1 percent of Tele-theater handle in lieu of any other local tax. In 2008, due to a new reporting format, the payment to the City of Albany was not reported separately; however, the amount was \$270,200.

¹¹ The OTB receives no income from uncashed tickets as the entire amount is remitted to New York State; however, it is reported in other income and then shown as a payment to New York State.

Capital OTB Financial Trends 2004-2008						
	2004	2005	2006	2007	2008	% Decline 2004-2008
Operating Revenues	\$25,640,958	\$25,371,027	\$24,983,353	\$23,779,109	\$22,665,670	12%
Operating Expenses	\$23,778,397	\$22,550,628	\$22,281,899	\$22,190,820	\$21,673,649	9%
Net Revenues from Operations	\$1,862,561	\$2,820,399	\$2,701,454	\$1,588,289	\$992,021	47%

Distribution to Local Governments – After paying its operating expenses, the Capital OTB distributes its net revenues to local governments quarterly, after deducting contributions to the capital acquisition fund. Local governments receive these net revenue distributions in addition to the monthly surcharge revenue distributions.

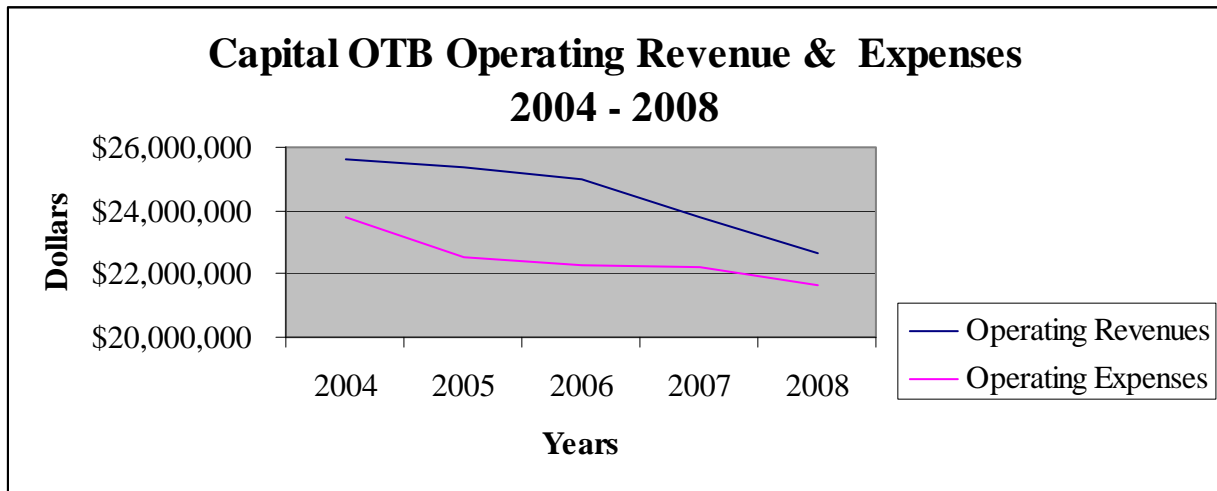
In summary, the Capital OTB has distributed surcharge revenues and net revenues to local governments totaling approximately \$31.2 million over the last five years. For the period audited, the OTB made the following distributions:

Capital OTB Total Distribution to Local Governments 2004-2008						
	2004	2005	2006	2007	2008	Total
Net Revenues for Distribution	\$1,449,761	\$2,407,599	\$2,288,654	\$1,278,689	\$697,971	\$8,122,674
Surcharge Revenues for Participating Local Governments	\$3,463,597	\$3,475,972	\$3,401,894	\$3,237,997	\$2,881,011	\$16,460,471
Surcharge Revenues to Local Governments with Tracks	\$1,420,731	\$1,358,562	\$1,336,623	\$1,333,080	\$1,195,082	\$6,644,078
TOTAL	\$6,334,089	\$7,242,133	\$7,027,171	\$5,849,766	\$4,774,064	\$31,227,223

Total distributions to local governments have decreased 34 percent or \$2.5 million since 2005. Significantly, the net revenues portion available for distribution have declined 44 and 45 percent in 2007 and 2008, respectively, and by 71 percent, or \$1.7 million, since 2005. Surcharge revenues declined more than 16 percent since 2004.

In summary while the OTB has been able to reduce operating expenditures, its operating revenues have declined at a greater rate. Thus, as shown above, its net revenues have declined significantly over the last four years. If net handle continues to decline, the local governments will see continued reductions in net revenue distributions, especially as additional operating

expenditure reductions become more difficult. If these trends continue, the OTB will eventually realize a net loss at year-end.



“Hold Harmless” Legislation

New York State’s “Hold Harmless” legislation, enacted in 2003, authorized the Off-Track Betting Corporations to accept wagers on nighttime thoroughbred racing. In return, the Corporations were required to pay the in-state regional harness tracks a percentage based upon the 2002 net handle. The payment represented the bets lost to in-state harness tracks once OTB bettors could wager on out-of-state thoroughbred racing. Nighttime racing is defined as having a post time after 7:30 PM. In addition, as part of this legislation, each OTB is required to make additional “Maintenance of Effort” payments to the harness tracks within its respective region.

In 2003, people believed that the net handle from these nighttime races would generate as much as \$400 million for the Corporations, and would outweigh the Hold Harmless clause based on a percentage of the 2002 net handle (one of the highest in OTB history). However, the net handle never materialized, and, in fact, it has declined significantly since 2003.

As a result, the OTB participated in a lawsuit brought by the regional OTBs against the New York State Racing and Wagering Board, which sought judicial review of the Board’s calculation methodology relative to the Hold Harmless and Maintenance of Effort payments. In December 2008, the court ruled against the Corporations, requiring them to make the payments. According to Capital OTB officials, they will be required to pay \$3.4 million or more in payments, which at the time of our audit, have not yet been made. However, Capital OTB officials have recorded a monthly liability for these payments and prepared a cash flow analysis. The Capital OTB has adequate cash flow to make the payments, and as of September 2009, it intends to make the payments once the Racing and Wagering Board approves its proposed payment schedules.

Budgeting and Expense Control

The Capital OTB utilizes a variety of methods to monitor and control expenditures. For example, the Comptroller prepares a budget report, showing budget-to-actual variances, which is reviewed by both the Comptroller and President monthly. The Board of Directors also receives a budget report prepared by the Comptroller at each Board meeting (six times a year). In addition, the Comptroller and Vice President of Operations review and approve payments weekly to ensure that only budgeted items are being purchased. The OTB's computerized financial system allows expenditure line items to go over budget without warning the user that the item exceeds the budgeted amount, placing greater importance on the Comptroller's monthly budget-to-actual review.

Our analysis indicated that the OTB has been generally successful in controlling its costs of operation and has developed realistic budget forecasts. Due to the difficulty of precisely predicting patron-betting tendencies, a careful analysis of historical trends provides the most accurate source of information for future net handle forecasts. Our analysis of OTB's budget-versus-actual performance for revenues and expenses over the five and a half year period January 1, 2004 through June 30, 2009 indicated that actual revenue and expense were both less than budgeted with slight variances ranging from less than one to approximately 8 percent.

Operational Improvements

Revenue Enhancement and Cost Savings Steps Implemented by Management – Capital OTB management has taken steps to reduce operating costs. The OTB conducted a thorough review of branch operations to determine if unprofitable branches should be closed or if operational adjustments could be made to turn them into profitable sites. As a result, since 2007, 12 branches have been modified. Some were converted to "self-service" locations, while hours were reduced at others. Implementing a self-service format has made many of these branches profitable again. The Capital OTB also no longer shows nighttime thoroughbred racing on Mondays, which is historically a day when attendance and wagering is low. This modification allows the OTB to avoid a Hold Harmless payment due when it accepts wagers on nighttime thoroughbred racing.

The Capital OTB also has done a full analysis of personal service-related costs and implemented some changes. Specifically, the OTB restructured its executive personnel, resulting in the elimination of one Executive Vice President position. It also reduced overall staffing by 45 employees since January 2007, when the Capital OTB employed 329 people (down to 284 in July 2009). In addition, the OTB switched from self-financing employee health care costs to a Health Maintenance Organization.

The Capital OTB has also taken steps to increase revenue. Management believes cash rewards are essential to contend with the competition from out-of-state (i.e., Internet) wagering entities. As such, Capital OTB was the first OTB in New York to offer cash rewards in 2006. The OTB has also been offering a 50/50 promotion¹² during the Saratoga racing season to help bring in new customers, and began offering video streaming on its website to make its account wagering

¹² This promotion provides new patron account holders with a \$50 deposit into their account after they wager \$50.

product even more competitive. Finally, the OTB has automated its telephone betting operations to allow for touch-tone, voice-activated, and operator-assisted wagering. The system monitors queue volume and time, operator call time, number of answered calls, and number of dropped calls. It further routes VIP accounts to more experienced operators, provides comprehensive reporting and tracking options, and records all transactions for audit and inquiry/complaint resolutions. The OTB changed over to its automated phone system in July 2004. Due to this change, OTB records show it has reduced the number of full-time equivalent employees in the telephone room by seven, saving \$270,000 annually.

Further Improvements Needed – By more rapidly introducing its newer betting mechanisms, the Capital OTB may be able to improve its operating results. Currently, the OTB accepts wagers at branch offices, over the telephone, at EZ Bet locations, over the Internet and at two tele-theaters. As shown in the table below, some of these newer mechanisms have lower costs to operate than the more traditional methods. For example, benefits of the EZ Bet mechanism include OTB not having to staff the EZ Bet location and not paying rent for the building; instead OTB pays just a commission based on net handle to the owner of the establishment.

Source of Wagers in 2008				
	Percent of Wagers Placed	Net Handle (\$ Million)	Operational Costs (\$ Million)	Operational Costs (Percent of Net Handle)
Branch Sites	56%	\$106.7	\$10.7	10%
Tele- Theaters	16%	\$30.2	\$1.9	6%
Telephone	16%	\$30.9	\$1.7	6%
EZ Bet Locations	7%	\$13.8	\$0.80	6%
Internet	5%	\$8.9	\$0.15	2%
TOTAL	100%	\$190.5	\$15.3	

In addition, the OTB may have additional opportunities to modify branch sites and achieve cost savings. We analyzed OTB records for 2008 and identified wide variations in operating expenses as a percentage of net handle between branches. The branches had operating expenses that ranged from 4 percent to 38 percent of net handle. It also had two locations where expenditures were greater than revenues both of which have been closed. Although OTB management has taken action to close or replace five underperforming branches and made modifications to others, additional opportunities may exist. However, OTB management has cited difficulty in the past several months obtaining approval to open new branches or EZ Bet locations due to a provision in Racing Law that enables regional harness tracks to deny such a request if the proposed location is within a pre-determined radius of the track.

Recommendations

1. OTB management should continue its efforts to increase revenue through innovative marketing ideas (e.g., Cash Rewards) and the use of technology (e.g., EZ Bet, Internet) to attract new customers and retain existing customers.

2. OTB management should continue to focus on increasing its revenues from the more cost-effective telephone betting, Internet betting and EZ Bet operations.
3. OTB management should continue to analyze branch operations and consider addressing underperforming branches with options such as converting them to EZ Bet locations or closing them altogether and should continue to explore other opportunities to reduce operating expenses.
4. OTB management should perform a comprehensive assessment of all Corporation operating areas to identify further cost saving opportunities.
5. OTB management should collaborate with the remaining New York State Off-Track Betting Corporations to identify cost saving and revenue enhancement opportunities, and identify cost efficiencies where appropriate by collectively working together.

Good management practices dictate that the Board of Directors has the responsibility to initiate corrective action. As such, the Board of Directors should prepare a plan of action that addresses the recommendations in this report and forward the plan to our office. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the OTB's administrative offices. If you have any further questions, please contact the Statewide and Regional Projects Unit at (607) 721-8306.

Sincerely,

Steven J. Hancox
Deputy Comptroller
Office of the State Comptroller
Division of Local Government and
School Accountability

APPENDIX A

RESPONSE FROM OTB OFFICIALS

The response from Capital OTB officials can be found on the following pages.



Capital District Regional Off-Track Betting Corporation

1629 State Street, Schenectady, New York 12304
(518) 344-5225

November 25, 2009

Office of the State Comptroller
State Office Building, Room 1702
44 Hawley Street
Binghamton, NY 13901-4417

To Whom It May Concern:

This letter will serve as the formal response to the Office of State Comptroller Audit Report (Report) of Capital District Regional Off-Track Betting Corporation dated October 23, 2009. First, I would like to compliment the staff and auditors from the New York State Office of State Comptroller's office (OSC) for conducting a thorough and objective review of Off-Track Betting operations between the years of 2004 and June 2009. The staff from OSC took the time to understand the industry, the underlying issues impacting the industry and provided some helpful recommendations to Capital OTB that will help the corporation become more efficient going forward.

We accept the findings in the audit and support the issues that were raised in the Report, and the recommendations made by OSC for Capital OTB to become more efficient and more profitable.

We also appreciate the fact that OSC has acknowledged the aggressive efforts the corporation and its Board of Directors have taken over the years to reduce spending by becoming more efficient and increase revenues by enhancing its technological approach to wagering especially by implemented the corporations' Internet wagering platform.

As noted in the Audit Report and we will detailed below in this response there are several issues that are having a negative impact on the racing industry in New York State and, more specifically, the OTB corporations. The issues are outlined below (numbered 1 though 5) and discuss in some detail how they are impacting the OTB. A State action or recommendation on how these issues should be resolved, changes in state a law that are needed are included, where appropriate. These changes would make the OTBs more profitable and therefore result in more money for local taxpayers. These issues are undermining the financial health of the OTB corporations and the monies we produce for the taxpayers.

(1) Out-of-State Internet Sites -- In Capital OTB's view this is one of the most important issues effecting the racing industry in New York State.

Years ago the OTB corporations and the tracks were the primary wagering sites for New York State residents that wanted to place a wager on horseracing. The OTBs and tracks produced more than \$2 billion dollars in handle annually. And the profits from those wagers benefited the State, local governments and the racing industry in New York State.

Over the last 10 years, out-of-state and offshore Internet wagering sites have appeared and are aggressively going after New York State customers. To further complicate this issue the State Racing and Wagering Board which held a similar position to the OTBs and tracks that these out of state sites could not legally take wagers from New York residents changed its position in 2008 which has opened the flood gates allowing these sites to poach bettors from New York racing entities.

The regulatory agency set up to protect New York racing made a policy decision that could be the demise of New York racing and the loss of millions of dollars to State and local taxpayers.

In the view of the OTB corporations, these out of state/offshore Internet wagering sites are illegally taking wagers from New York State residents. It is the estimate of the OTBs, tracks and the Chairman of the recently created Task Force on the Future of OTBs in New York State that between \$250 million dollars and \$500 million dollars in wagers are being processed through these "illegal" sites. The loss of revenue from these sites ranges in the tens of millions of dollars which would go to State and local governments and the racing industry. But instead these profits are being taken back to the state or country in which the Internet wagering site originates with no benefit to New York taxpayers.

State Action Required: *If the State is serious about helping the racing industry in New York State and helping to lower property taxes at the local level, then the State should either prohibit or regulate these out of state and out of country Internet wagering sites mandating that they pay the same Statutory costs that New York entities are required to pay – if they want to do business in New York State. These sites should be subject to the same rules and regulations as those entities licensed in New York State. This action would add tens of millions of dollars in revenues to tracks and OTB corporations therefore benefiting the racing industry and state and local taxpayers.*

The OTB's collectively view the decision of the Racing Board to allow these out of state entities to operate unregulated in New York State as illegal and have provided, in writing (see attached), their position to both the Racing Board and the Task Force on the Future of OTBs in New York State. The Task Force has requested a legal opinion from the Attorney General but their request has been denied. It is the position of Capital OTB that these out of state entities are operating illegally in New York State and we would request that the Comptroller's Office request a formal opinion from the Attorney General on the issue to determine if, in fact, these entities are operating illegally in the State. If these out of state entities are found to be operating illegally then they should be prevented from operating in the State until such time as they are regulated, licensed and subjected to abiding by the same rules and regulations that licensed entities are required to follow. (See attached letter to the State Racing and Wagering Board on the legal aspects of this out of state activity).

(2) Hold Harmless Payments – Over the years the OTBs have been looked upon as nothing more than a revenue source for the racing industry. The OTBs have been squeezed to the point where over 80 percent of the statutory payments are going to racetracks and less money is going to the taxpayers.

The most glaring example of that is the statutory change that requires OTBs to pay regional harness tracks millions of dollars annually in hold harmless payments. These payments were made as the harness tracks were transforming themselves from local tracks to multi-million dollar and even billion dollars wagering Video Lottery Terminals (VLTs) facilities.

These payments are being required of the OTBs (i.e., the taxpayers) at the same time the harness tracks have turned themselves into casinos where they have received state approval to operate Video Lottery Terminals (VLTs). In essence, the hold harmless law is mandating that local taxpayers subsidize casinos to the tune of millions of dollars annually. To put this into perspective let's look at the figures from Capital OTB's regional harness track, Saratoga Harness.

According to the State reports, Saratoga harness has generated:

- Nearly \$7 billion dollars in wagers via their VLT facility from 2004 to 2008.
- In 2008 alone, VLT wagers were the highest ever totaling \$1.6 billion dollars.
- With respect to revenues, Saratoga Harness realized \$171 million dollars in Racetrack Commissions from 2004 to 2008.
- In 2008, Saratoga Harness pocketed more than \$42 million dollars in Racetrack Commissions.

Despite the extraordinary success of Saratoga Harness' VLT operation, Capital OTB – whose monies go to help fund local budgets – is required to pay the harness track approximately \$3 million dollars annually, while generating only about \$600,000 in revenue on their harness product. These payments amount to corporate welfare where taxpayers are subsidizing one of the most successful gambling venues in the State – all while local property taxes escalate, families are losing their homes because they can't afford to pay the high property taxes.

State Action Required:

The State should repeal the hold harmless provisions under sections 1017(1), 1017(2)(a) and 1017(2)(b) of the Racing, Pari-Mutuel Wagering and Breeding Law. In 2003 the Legislature opted to allow out-of-state nighttime thoroughbred racing to be simulcast during what had been the historically protected time zone of the evening when live harness racing had traditionally been conducted. In return for this option, the OTB accepting wagers on out-of-state nighttime thoroughbred races would "hold harmless" their regional harness track by ensuring that they received at least the base year (determined by the Legislature to be 2002) level of revenues. This was to protect them from the potential encroachment and loss of revenue by the introduction of this new out-of-state nighttime thoroughbred product. The presumption was that substantial revenue could be generated by the OTBs through this new product. Unfortunately this was not the case. These statutory provisions may have at one time been necessary to protect the harness industry but with the advent of the legalization of Video Lottery Terminals and their placement at racetracks exclusively a competitive disadvantage was created by the Legislature favoring the race tracks.

(3) Regional Harness Track Consent Issues -- State Racing Law Section 1008 gives regional harness tracks authority to approve or deny the placement of branches and EZ Bet locations within a certain radius of the track. Over the past several months, Saratoga Harness (our regional harness track) has denied the potential placement of eight EZ Bet locations at Capital OTB.

Over the past five years, Capital OTB has aggressively cut spending and taken actions to make its operations more efficient. One of the major actions taken by Capital OTB was to close unprofitable branches and replace them with low-cost, taxpayer friendly, and customer friendly EZ Bet locations (sports bars, bowling alleys, golf courses etc.). The fact that the regional harness tracks have the authority to prevent a public benefit corporation (taxpayers

benefiting corporation) from becoming more efficient and therefore providing additional revenues to help lower local property taxes is shameful and needs to be changed.

State Action Required:

Section 1008 Law (consent to cite new pari-mutuel wagering location/branch)

Under Racing, Pari-Mutuel Wagering and Breeding Law section 1003(2)(g) (which makes reference to section 1008(2)(c)(ii) should be repealed. The law states -- *For any simulcasting facility located within an area of a circle whose radius is forty miles, the center of which shall be measured from a regional track, and as provided in section [fig 1] one thousand thirteen of this chapter, the board shall not approve such application unless such regional track, as described in subparagraph (i), has given its written authorization, provided however, that between thirty-one and forty miles such approval shall not be unreasonably withheld. Such approval shall not be required if the simulcasting facility is located without the forty mile radius or if the sending track is a thoroughbred track in the Catskill region conducting a mixed meeting. Such written authorization shall not be required nor shall the provisions of section five hundred twenty-three of this chapter apply to those races that such regional track may elect to receive as a simulcast race during its regularly scheduled race meeting).*

The law dictates where an OTB can cite a new wagering location based on its distance from the nearest regional harness track. Under the law, the track can effectively prevent an OTB from opening a new location if that location is within 30 miles from the track without giving reason. Under the law, if the new OTB location is between 31 and 40 miles from the track such "approval shall not be unreasonably withheld." This law effectively limits where OTB branches can be located and allows the tracks to dictate OTB business operations. This provision of law should be repealed.

(4) Racinos/Casinos Competition – The advent of VLTs at harness tracks has had a negative impact on business and handle at the OTB corporations. The harness tracks are generating billions of dollars in wagers through their VLT operations. Capital OTB believes that good public policy would be to allow the six New York State Off-Track Betting Corporations to operate VLTs which would add hundreds of millions of dollars in recurring revenues to the State and local governments helping fix the budget deficit and help local government lower property taxes.

State Action Required: *Providing State approval for the Off-Track Betting Corporations to operate a single Video Lottery Terminal facility in each region would bring immediate financial stability to the corporations statewide and bring needed revenues to State and local governments, helping lower taxes and fund critical State programs like education.*

(5) Downturn in the Economy – The downturn in the economy has had a negative impact on New York State racing as well as racing across the country. In fact, major racetracks have reduced their number of race dates due to weak economic factors which have in turn hurt OTB business and the revenues we send to local governments. Unemployment is currently at more than 10 percent nationally and handle/wagers at most major tracks around the country, including the New York Racing Association, have seen double digit declines in their business.

The following looks at some of the direct quotes from the report that Capital OTB agrees with and, in turn, will elaborate or provide updated information on some of the issues noted.

Audit Report page 2: "...OTBs financial condition has deteriorated due to a downturn in the economy as well as continual decreases in net handle (wagering) and a general decline in interest in horseracing, as well as increased competition from other entities in the gaming industry".

- *Capital OTB: Capital OTB management agrees with this assessment but has included other factors in this formal response that we believe have impacted business at the OTBs.*

Audit Report, page 4: "The largest distributions are those made to the horse racing industry. During the five years ended December 31, 2008, these distributions totaled \$87.3 million and accounted for more than 83 percent of the OTB's total \$105 million in statutory distributions."

- *Capital OTB: One example is Hold Harmless Payments to Harness Tracks with VLTs. OTBs in general have seen its payment structure – due to legislative changes – shift from money going to the taxpayers to now going to owners of privately owned racinos. .*

Audit Report, page 5: "Overall, the OTB's operating expenditures have decreased by approximately \$2.1 million dollars or 9 percent, over the five year period 2004 through 2008."

- *Capital OTB: Update: Expenses continue to decline at Capital OTB. From September 2004 to September 2009, expenses have declined a total of \$3.2 million dollars or 16.7 percent. In 2009 alone, operating expenses have been reduced a million dollars bringing total savings for the taxpayers to \$3.2 million dollars over the past five years.*

Audit Report, page 8: Budget and Expense Control: The Audit Report states, "Our analysis indicated that the OTB has been generally successful in controlling its costs of operation and has developed realistic budget forecasts."

Capital OTB: This is indicative of Capital OTB Board of Directors oversight of the corporation. The Capital OTB Board has implemented various committees such as Finance, Audit and Policy and Management Committees to ensure information is being shared, discussed and reviewed prior to any budgets being approved.

Audit Report, page 8: "Capital OTB management has taken steps to reduce operating costs."

Capital OTB:

- *Changes 12 unprofitable branches from multi-staffed facilities to self service branches. turning unprofitable branches into more profitable branches.*
- *Eliminated the Executive Vice President Position.*
- *Reduced OTB employees from 329 to 284.*
- *Corporate salaries at lowest level in more than 20 years.*
- *Created the EZ Bet concept, which is a low-cost, fan-friendly wagering site such as sports bars and bowling alleys.*

Audit Report, page 9: "Capital OTB has also taken steps to increase revenue."

- *Capital OTB: The corporation implemented a number of marketing endeavors and other technological advancements to make its account wagering product more profitable. First, the corporation implemented an Internet wagering platform that has increased handle by more than 100 percent year over year. Wagers made through the site so far in*

2009 totals \$16.4 million dollars, compared to \$8.3 million dollars in 2008 – a nearly 100 percent increase.

- *Capita OTB also implemented a new, fan-friendly mobile wagering branch – the Capital OTB Betmobile. This mobile unit allows the corporation to go out and bring the excitement of racing to fans across the Capital Region. The mobile unit which has a simulated horse race on the sides is a perfect marketing tool for the corporation to get its Capital OTB brand out into the public eye.*
- *Further, Capital OTB has enhanced its web site making it more customer-friendly and by offering more racing information for our patrons. Total hits to the site in 2009 were 660,000, compared to 289,000 in 2008. Unique visitors to the Capital OTB web site in 2009 topped more than 100,000, compared to less than 40,000 in 2008. The addition of “live video streaming” of races on the Internet, along with offering cash rewards has made the Capital OTB Internet wagering site competitive in the account wagering market – currently account wagering is the only growth area in the racing industry.*
- *Capital OTB and the other five OTBs have participated in a number of statewide marketing events that have allowed the corporations to pool their resources and provide top notch, customer-friendly promotions for OTB racing fans. Several promotions, including a statewide handicapping contest, were held collectively by the six OTBs. We expect to conduct many more statewide OTB contests that will build customer loyalty and bring new customers to the OTB corporations.*
- *Capital OTB also installed a voice recognition system as part of its phone-a-bet operations, as well as a new account wagering live operator monitoring system whereby live operators are monitored for efficiency and production. These new changes have allowed the corporation to improve its efficiency by lowering the “dropped call rate” – this is the number of phone calls that are made and do not get through to make a bet. The Corporation has lowered this rate from eight (8) percent several years ago to below two (2) percent in 2009.*

Audit Report, page 9: "However, OTB management has cited difficulty in the past several months obtaining approval to open new branches or EZ Bet locations due to a provision in the Racing Law that enables regional harness tracks to deny such a request if the proposed location is within a pre-determined radius of the track."

- *Capital OTB: See Regional Harness Track Consent Issue. By denying Capital OTB the ability to place EZ Bet sites, a private racino is preventing a public benefit corporation the ability to become more efficient and to provide additional revenues for local taxpayers.*

The recommendations noted on page 10 of the Audit Report provide OTB management with an outline of actions it should continue to take and take to make the OTB operations more profitable and efficient. Capital OTB appreciates OSC's recognition of Capital's positive actions, as the first three recommendations in the Report are prefaced by "OTB management should continue". We concur with all five OSC recommendations and believe they are objective and positive and will assist Capital OTB management as it continues to pursue its legislative intent to be a source of revenue to state and local governments.

Conclusion:

In the response to the OSC Audit Report, Capital OTB has outlined a number of issues that are having a detrimental effect on OTB business in the Capital Region and across the State. Capital OTB has outlined a number of legislative changes that would help bring financial stability to the corporation so that it could continue to provide critical revenues for local and state government. The OTBs were created to for three purposes: Generate revenue for government; support the horseracing industry in New York State and eliminate illegal bookmaking in the State of New York. The OTBs in New York state have met or surpassed all of its charges as outlined in statute. Since the inception of OTBs in New York, the six corporations have generated more than \$7 billion dollars for the taxpayers and racing industry.

The problem is that over the years – by changes in state law – more and more of the money generated by the OTBs is going to the tracks and less and less money is going to the taxpayers. The OSC audit has identified some of the issues that are undermining OTB success – out-of-state/offshore Internet wagering sites; excessive statutory payments to the racing industry especially harness tracks; regional harness track consent issues that prevent OTB from becoming more efficient; and other legislative changes that would benefit the OTBs.

Lastly, the OTB corporations in New York are committed to operating in a way that is efficient and effective on behalf of the taxpayers we represent. The OSC recommendation of the OTBs working together in a cooperative fashion is fully supported by Capital OTB, as long as the current county control structure is maintained. OTBs can work together on a single Internet platform, a single phone-a-bet center, marketing efforts and a single tote for all OTBs. These are things that the OTBs discuss on a regular basis and efforts are being made to make these cooperative changes happen.

Capital OTB thanks OSC for its professionalism during the audit and looks forward to working with the Comptroller's office on these and other issues of importance to help the OTBs become more profitable and therefore better benefit the taxpayers the corporation represents.

Yours truly,



John F. Signor

President & Chief Executive Officer



New York City Off-Track Betting Corporation
1501 Broadway
New York, N.Y. 10036-5572

March 6, 2008

VIA FACSIMILE (518) 347-1250
ORIGINAL VIA OVERNIGHT MAIL

Daniel D. Hogan
Chairman
New York State Racing and Wagering Board
1 Broadway Center, Suite 600
Schenectady, New York 12305-2553

Dear Chairman Hogan:

Nearly two months have passed since the Racing and Wagering Board earlier this year authorized, upon application by the New York Racing Association, Inc., one or more advance deposit wagering operators ("ADWs"), that were licensed in jurisdictions other than New York but unlicensed in New York, to accept account wagers by telephone and/or through the internet, including from New Yorkers, on races run at New York State race tracks in connection with the export of the New York tracks' (principally NYRA) simulcast signals for purposes of pari-mutuel wagering on those races.

When the New York State OTB Corporations learned that the Board had in fact affirmatively authorized such activity, we promptly called to the Board's attention that the authorization represented a 180° about-face from the position that the Board consistently had adopted in the past when acting upon similar requests for approval of export of a New York track's simulcast signal for wagering purposes. We also offered our assessment that the activity, which the Board had expressly sanctioned, constitutes a clear and manifest violation of Article 1, Section 9, Clause 1 of the New York State Constitution prohibiting all gambling other than, among other exceptions, "pari-mutuel betting on horse races as may be prescribed by the legislature and from which the state shall derive a reasonable revenue for the support of government" Since then, there have been several informal communications between the Board and its staff, on the one hand, and representatives of the New York State OTB Corporations, on the other, concerning this "new" policy and its conformity with New York law. As a result of these informal discussions, we understood that you, as Chairman, and others on the

Board's staff, would evaluate the legal and policy concerns raised by the OTBs, and re-examine the Board's action, both as a matter of compliance with existing provisions of New York law and/or as a matter of policy given the prospect of significant negative impact from the Board's decision upon the OTB Corporations. It now appears that the Board believes that its prior decision was valid and should stand. We must respectfully disagree inasmuch as the activity upon which the Board has placed its imprimatur has neither been authorized by the legislature nor does it generate any revenue for the support of government, let alone the constitutionally required "reasonable" revenue.

The foregoing notwithstanding, there is a high likelihood that sometime within the coming weeks the matter of the formal grant of a franchise to conduct thoroughbred racing and pari-mutuel wagering at Aqueduct, Belmont Park and Saratoga Racecourse will be presented. Once that occurs, we anticipate that the Racing and Wagering Board will be petitioned by the then franchise holder, presumptively the "new" NYRA, to ratify, confirm and extend temporally the previously issued authorization for ADW operators unlicensed in New York to continue to receive the New York franchisee's thoroughbred simulcast signals and accept wagering thereon to the same extent as was authorized in January. This, of course, would squarely present the issue of continuing express permission from the Board for those ADWs to accept wagering from persons located within New York on races run both in New York and at race tracks located outside the state.

We therefore hereby formally request that the Board provide reasonable advance notice of the time and place of the public meeting of the Board at which this matter will be considered in connection with formal award of the franchise to conduct thoroughbred racing at the three previously identified tracks, and that we be given an opportunity to attend the meeting and present our position to the full Board before any ruling is issued.

Undoubtedly the Board appreciates and understands the significant competitive impact upon the OTBs from out-of-state ADW providers being affirmatively permitted to take account wagers from New Yorkers, as well as that the Board's earlier decision in January represented a complete sea change in the position that consistently had been expressed by the Board over a period of almost a decade, but despite being such a radical departure from past practice the reversal of policy took place without any prior notice to, or opportunity to be heard by, the OTBs. Therefore, the Board would not have been fully informed as to the supporting basis for our position that the New York State Constitution precludes permitting out-of-state ADWs to take wagers from within this state.

We presume that the Board does not wish intentionally to take action that would violate the New York State Constitution or another provision of New York law. Certainly this letter is not the proper vehicle to present a full discussion of the legal issues; however, we think it would be valuable for the Board to consider the following legal authorities in its evaluation of the matters referred to in this letter inasmuch as it has been suggested that the Board may be under the mistaken belief that the ADWs' activities that occur outside of New York State are not subject to the exercise of regulatory jurisdiction by the Board or other authority in New York:

1. Article 1, Section 9 of the New York State Constitution;
2. Sections 231 and 1012 of the Racing, Pari-Mutuel Wagering and Breeding Law;
3. Section 225.00(12) of the Penal Law;
4. Sections 20.30(2), 20.60(1) and 20.60(3) of the Criminal Procedure Law;
5. The decision of the New York Court of Appeals in People v. Carvajal, 812 N.Y.S. 2d 395 (2005);
6. The decision of the United States Court of Appeals for the Second Circuit in United States v. Cohen, 260 F.3d 68 (2001);
7. The decision of the Supreme Court, New York County in People ex rel. Vacco v. World Interactive Gaming Corp., 714 N.Y.S. 2d 844 (1999);
and
8. The decision of the United States Court of Appeals for the Second Circuit in the United States v. Gotti, 459 F.3d 296 (2006).

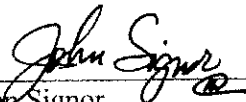
The Board's attention to the matters described in this letter is appreciated.

Respectfully submitted,


CATSKILL REGIONAL OFF-TRACK
BETTING CORPORATION

By: 
Donald Groth
President

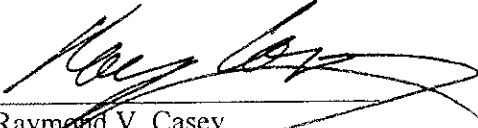
CAPITAL DISTRICT REGIONAL OFF-
TRACK BETTING CORPORATION

By: 
John Signor
President

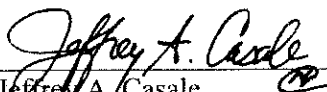
NASSAU REGIONAL OFF-TRACK
BETTING CORPORATION

By: 
Dino Amoroso
President

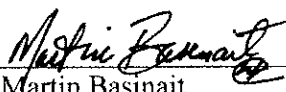
NEW YORK CITY OFF-TRACK
BETTING CORPORATION

By: 
Raymond V. Casey
President

SUFFOLK REGIONAL OFF-TRACK
BETTING CORPORATION

By: 
Jeffrey A. Casale
President

WESTERN REGIONAL OFF-TRACK
BETTING CORPORATION

By: 
Martin Basinait
President