LEWIS ROCA ROTHGERBER

Lewis Roca Rothgerber LLP
3993 Howard Hughes Parkway
Suite 600
Las Vegas, NV 89169-5996

Anthony Cabot
Admitted in: Nevada and Arizona
Direct Dial: 702.949.8280| ACabot@LRRLaw.com
Direct Fax: 702.949.8367

Our File Number: 44974-00001

November 18, 2013

Via Electronic Mail

Adriana Fralick, Executive Secretary
Nevada Gaming Commission
1919 College Parkway
P.O. Box 8003
Carson City, NV 89702
Fax 775-687-8221
afralick@gcb.nv.gov

Re: **FOLLOW UP COMMENTS ON ISSUES RELATING TO THE OFFERING OF REBATES ON PARI-MUTUEL WAGERS**

To Whom it May Concern:

I represent the Nevada Pari-Mutuel Association ("NPMA"). The NPMA is a Nevada non-profit corporation comprising 83 race books licensed to conduct pari-mutuel wagering in Nevada and represents the interests of its members in regulatory and public affairs. This letter aids the Nevada Gaming Commission's ("Commission") study and review of rebates[1] on pari-mutuel wagers, as required by Section 3.5 of Senate Bill 425 of the 77th Legislative Session. Specifically, this letter supplements our August 8, 2013, letter by expanding on important aspects of the rebate issue and addressing key questions raised by the Commission.

Executive Summary

Nevada's race books represent a valuable patron amenity in the state's casino entertainment industry. As part of a larger endeavor to attract tourists to Nevada's casinos, the state's race books enhance the overall tourist experience, enticing visitors to stay longer and spend more money for both gaming as well as other increasingly important non-gaming services. Despite a decline in the national handle, our existing pari-mutuel business model allows books to remain profitable.

Rebates, however, will greatly reduce if not entirely eliminate the profits the average Nevada book can hope to achieve. Specifically, the cost structure race books operate under is largely dictated by the industry and cannot be adjusted by the books. As a result, Nevada books, while profitable, operate on a narrow margin. Even under the most optimistic projections, rebates will increase our books' track fees by 100% to bring them in line with the rates charged to other rebate providers. Coupled with the costs associated with issuing rebates, which are borne solely by the book, even a substantial increase in Nevada's handle would be offset by increased expenses attributable to higher track fees and rebates.

[1] A rebate is a cash reward paid on every wager a player makes, win or lose. The amount of the reward can vary based on several factors, including bet type.

Rebate houses, which are a direct result and inescapable consequence of rebates, are inimical to the health of the state's race book and gaming industry. Unlike Nevada's current books, which promote the state's vital flesh and blood tourist businesses and provide millions of dollars in wages to our state's residents, rebate houses sustain their business by stripping player amenities and customer service features. As a result, rebate houses are able to leverage low profit margins and attract more wagers—typically from computer bettors. Such bettors employ a method of wagering that disadvantages regular players and is having an adverse effect on the horse racing economy.

While race books are not a major profit center for casinos and operate on a thin margin, they invest back into the entertainment experience that draws tourists to the state. Rebates, however, would change the fundamental nature of the industry. In order to compete against race books that are not heavily invested in a brick and mortar casino-resort, such as rebate houses, the state's current books will be forced to lower their expenses by reducing employees and amenities in an effort to offer competitive rebates. This would lead to a race to the bottom that, at the end of the day, is detrimental to the state's tourism industry and results in a loss of jobs and wages in the State of Nevada. Accordingly, the state's casino resorts are universally opposed to rebates, not because they seek to stifle competition and change, but to avoid the inevitable cannibalization of a functioning and necessary race book industry.

Historical Overview of Nevada's Horse Racing Industry

While described in greater detail in my previously submitted letter, let me first start with a brief historical perspective on horse racing and rebates given its importance to understanding the issue. Horse race wagering in Nevada has always been a tightly regulated activity both for oversight and price regulation. This is because the industry depends on others for the product—Nevada has essentially no in-state horse racing[2]—and for the delivery of that product by wire and television into Nevada. Virtually every aspect of the industry is price controlled. Our books must adhere to the same commission schedule as the track. This is about 19.5% of each wager. A commission, also referred to as the takeout,[3] is the amount of each wager that the book retains as gross gaming win before all expenses, including track fees. The remainder of each bet is returned to the player as winnings. Each book must pay the same fee to the track, now typically about 4.01% on each wager. Each book also pays the same fees to the Las Vegas Dissemination Service, the provider of hub services. What little remains of the 19.5% after paying track fees, dissemination fees, employee costs, and other expenses is the book's gross profit.

Rebates occur when a portion of the 19.5% is returned to the player. Large rebates are most associated with electronic clearing houses (known as rebate houses) with low overhead, because they do not have the employee and facility costs associated with a physical race book. If race wagers were simply a commodity, rebate houses would be the equivalent of Amazon.com while Nevada race books would be the neighborhood book store. Several states, including Oregon and South Dakota, have created environments to attract these rebate houses by offering an extremely low tax structure and very little regulatory cost or oversight. These states realize that the rebate houses have a choice of where they want to locate and still accept wagers from across the United States. The rebate houses will choose the state with the lowest taxes and operating costs to provide the highest rebates.

Rebates are controversial because large computer bettors will place their wagers with the off-track betting ("OTB") facility that gives the largest rebates. This naturally draws the players away from the track.

---

[2] The Elko County Fair does include seven days of horse racing.

[3] Takeout means "the amount retained and not returned to patrons by a pari-mutuel book from the total amount of off-track pari-mutuel wagers." NGC Reg. 26A.020(4).

As we are well aware, track attendance has plummeted. Moreover, because the rebate houses have low overhead, they can afford to pay higher track fees, which are imposed to make up for lost track revenues. Specifically, tracks charge ADW and rebate providers higher simulcast fees and impose source market fees. A source market fee requires the OTB to pay extra for players located in the same state or geographic location of the track. These higher fees further reduce the already limited revenues for race books and negate the benefits of the increased handle that might accompany rebates.

As evident throughout the Commission's pari-mutuel review process, the issue of rebates needs to be explored from many perspectives.

Nevada's Gaming Industry is Based on Tourism

Tourism is the foundation of the Nevada gaming industry. The NPMA and the operators understand that patrons come to Nevada to bet on sports and horses for the entertainment experience. Accordingly, Nevada's race books are unlike anything else in the United States. They are opulent, having plush seating, expensive video boards, individual monitors, food and beverage services, etc.

These race books are not offered as an independent business but as an amenity for the patron convenience. Nevada has not had a standalone race book in Nevada for over 20 years. Rather, race books have been part of the larger and more expensive process of attracting tourists to Nevada casinos. This experience makes them stay longer, spend more money in other parts of the casino including the increasingly important non-gaming areas such as restaurants, entertainment, and retail, and return more often.

As repeatedly reflected by industry representatives, "[w]e want flesh and blood people in the property…we are not looking for the low cost bettor that is looking for the low cost no matter what." In other words Nevada caters to tourists. So while horse racing is a very small part of the overall revenues of the casino, it is an important aspect of the tourist experience.

Giving rebates, however, does nothing to promote tourism. In fact, if we enter the rebate arena, the traditional race book in Nevada will be eliminated. As Jay Rood, Vice President of MGM Resorts Race and Sports Book, explained at the August 22 workshop:

> [W]e are not going to be able to entertain cocktails to our customers, we are not going to be able to entertain offering them food comps on top of the race business. We are not going to be able to entertain that because that profit margin is going to be so thin that those ancillary comps that just come as an afterthought almost at this point in our business model is going to erode what profit we will be able to run, and it is going to be strictly a back room of either servers, some people on the phone possibly accepting wagers, and you will not have a front end race book.

Thus, the crux of the Nevada race book industry—tourism—would disappear if rebates are offered, because the industry would no longer offer the unparalleled amenities that draw patrons. In fact, the industry would no longer offer any amenities. Rather, rebates would force the industry to switch to a lowest cost-highest rebate model. This changes the fundamental nature of our books and erodes our tourism industry. Viewing this debate as simply one to "fix" racing in Nevada ignores the role that race books play in the tourist industry.

Rebates Will Change the Fundamental Nature of the Industry

In contrast to Nevada's unique race books that function as an additional amenity that promotes the state's vital flesh and blood tourism industry, rebates serve a fundamentally different purpose and class of patrons. Specifically, rebates entice and benefit those engaging in Computerized Robotic Wagering ("CRW"), which involves the use software and sophisticated algorithms to analyze pools and odds, to find mispriced bets, and place multiple, direct bets into the tote system immediately prior to a race.

Moreover, unlike a majority of the state's casino patrons, CRW players do not care about the customer experience. In fact, CRW players do not even need a physical book. They just want a place to bet that provides the best rebates so they can lower their margins. During a recent conference, Rob Terry, Vice President of Racing and Gaming Services, a rebate house that accepts CRW players, told horsemen that the company's customers lost 6% in 2011 before factoring in rebates. Essentially, CRW players and companies are looking to come out ahead by receiving rebates that exceed their losses. A dichotomy of interests therefore exist between Nevada's flesh and blood patrons, who are drawn to our casinos' luxurious race book facilities and largely account for the state's $325 million dollar handle, and CRW players, who are attracted to the highest rebate provider.

Accordingly, for Nevada race books to compete in the rebate arena, they must transform themselves from books in a niche industry that cater to tourists to ones that compete against rebate houses for CRW play.[4] Better rebates for CRW, however, equal increased costs for Nevada race books. Therefore, to attract CRW players with competitive rebates, our operators will inevitably have to eliminate amenities that define the typical Nevada book and serve to attract tourists to the property. This is not merely speculation but is evidenced by operators whose former luxuries were sacrificed to compete in the rebate industry.

As noted by Mr. Rood:

> [A] lot of tracks back in the day had nice restaurants in them, and not many of them do that anymore. And it is simply because everyone is trying to operate on the thinnest margin possible….

Whether we intend to, the allowance of rebates will dramatically change the nature of Nevada's race book industry and will eliminate the customer experience for in-person patrons in most casinos.

To understand the fate of Nevada's race books, our books have to be compared to what will occur if rebates are permitted. To offer the best rebates, the competing books will be required to cut costs to the bare minimum—eliminating the luxuries of the typical Nevada race book. As described by Mr. Art Manteris, Vice President of Race and Sports Operations at Station Casinos, the rebate houses our race books will be forced to compete against are comprised of:

> [A]n office, phone lines, and a computer server, and that is all. They don't have . . . some of the most expensive real estate in the country on the Las Vegas Strip. They don't have the big, lavish, elaborate race books that we have in Nevada.

Inevitably, all that will remain is a shell; a back office with servers and phone lines. This is not a question of race books versus race books-lite, it is race books versus race books-zero.

---

[4] CRW players often participate via teams to maximize their wagering volume. In turn, they leverage this volume to negotiate and wager with the operator who is willing to provide the greatest rebate. Consequently, many OTB operators have obliged by giving high-volume CRW teams what amounts to be significant rebates. Specifically, since these CRW teams operate as their own Advance Deposit Wagering outfits, the rebate comes in the form of a lower "host fee" for taking the tracks signal.

Perhaps with the exception of certain major races like the Triple Crown or Breeders Cup, tourists do not come to Nevada because we have horse racing. They come to Nevada because we offer a total casino-resort experience with race books as an added amenity. Virtually all Americans can place a wager on their computer with the rebate houses in Oregon or South Dakota. The casino-resorts are the ones responsible for creating the massive marketing campaigns that drive the tourism to Nevada. The casino-resorts are the ones responsible for creating the critical amenities that make Nevada a tourist destination. The race books are an important part of the casino industry's tourist experience.

Ultimately, the question that has to be answered is what is better for Nevada—many books that employ numerous people and cater to our current patrons (tourists) or large rebate houses that focus on CRW play? If we want to replace tellers with servers, alienate our current patrons, and jeopardize Nevada's niche race book market, then the move towards rebates is the road we should go down. As the Nevada State Gaming Control Board's Audit Division recognized:

> [T]he issue of whether or not the Commission should authorize rebates for off-track pari-mutuel wagering is a business decision which properly belongs to the industry.

Accordingly, with the sole exception of Cantor Gaming, the operators and casino-resorts that use race books as a tool to drive tourism are universally against offering rebates. In contrast, and not surprisingly, the proponents of rebates are primarily those who benefit from additional churn but are unaffected by the profitability of each individual wager. This includes both the LVDC, which is compensated based on handle regardless of expenses, and the tracks and horsemen, who benefit from higher track fees that apply to rebate providers. These latter proponents have no skin in the game. They are not responsible for creating the attraction that is Nevada or contributing to the marketing efforts that draw tourists. They simply want a bigger portion of the tourist dollar that they do nothing to create.

Rebate proponents want to create an environment where rebates force books to give back some of their profits. However, tracks and content providers surrender none of their share but reap an immediate benefit with an increase in handle. Specifically, if a rebate successfully induces an additional wager, they profit by collecting their share of the additional handle. If the bettor takes their rebate and walks, without ever placing an additional wager, the book loses while the track or content provider is no worse off.

As explained by Mr. Russell in his description of the California Thoroughbred Association:

> [These entities] are paid on a percentage of the handle. They don't frankly care where the wager comes from. They don't particularly care whether a book makes a profit or doesn't make a profit. They are paid on the top line. All they care about is how many wagers are made. And that is the same for the other tracks, and that is the same for LVDC.

Rebate houses build their business by leveraging low profit margins to attract more wagers—typically from computer bettors. Rebates were never an additional tool to develop the business, they were the tool around which the business was built. In other words, low profit margins are not a threat to their business model, low profit margins are their business model.

The industry's opposition is not based on moral objections to rebates or the CRW players they tend to favor but stems from the fact that rebates are economically impractical; if rebates would generate additional profits, many operators would have a different view. Coupled with our books' inability to realistically compete with rebate houses, the increase in track fees, and enforcement concerns, rebates simply do not make sense in Nevada. The benefits that proponents may recognize from rebates would come at the detriment of the casino industry, which has invested millions in bringing tourists to the state and will be forced to subsidize the gains reaped by tracks, content providers, and any emerging low-overhead, high-volume operators.

Rebates Will Increase the Rates Nevada Race Books Pay

As discussed in the August 8th letter, Nevada race books must rely on others for the product and for the delivery of that product by wire and television into Nevada. This requires our industry to enter into numerous price controlled contracts. For instance, we have contracts for placing our wagers into tracks' pools (called track fees), contracts for communications and telecasting of the races, and contracts for hub services (called hub fees).

The Commission has therefore appointed an eleven person committee, representing eleven licensed pari-mutuel books, that has the exclusive right to negotiate these agreements with the tracks and with the systems operator. When the committee agrees to a rate with either a track or the systems operator, the rate must be "**fair** and **equitable**" for all books in the state. The track fees are the same for every book. If the books pay a daily fee to the track as opposed to a percentage fee, books pay a percentage based on their percentage of the handle on that track. So, if the daily fee is $500 and a book has 10% of the total handle on that track, then that book pays $50. If it has 1%, it pays $5.

These fees are paid out from a race book's takeout. The money left over from the takeout after paying the track fees, hub fees, gaming taxes, and all operating expenses is the net revenue of the book. What little revenue left is a book's small profit margin.

Accordingly, prior to the Commission workshops, the NPMA asked the major racetracks whether allowing rebates would increase track fees. Assuming that out-of-state tracks will even continue to provide television signals of the races, the NPMA was advised the host fee/track fee for rebate wagers would increase. Mark Russell, President of the NPMA, addressed this issue at the October 24th public workshop by recapping conversations between the NPMA's Executive Director, Patty Jones, race tracks, and content providers where the NPMA was advised that Nevada books will pay the same rates rebate houses pay if they offer rebates. As Joe Asher, CEO of William Hill, highlighted in his October 24th testimony, tracks such as Keeneland are basically hoping that Nevada books offer rebates so that they can raise their rates. So allowing rebates will unavoidably lead to increased fees.

This disadvantages race books because a book is going to have to pay the higher rate through contracting, whether it offers rebates to one player or everyone who walks through the door. The tracks and the content distributors are not going to differentiate. They are not going to create a sliding scale where they ask race books to tell them how many rebate players the book has and then adjust the rate accordingly. While a best case scenario would include a rebate rate and a non-rebate rate, in all likelihood there will only be one higher rate available. Moreover, with few limited exceptions, rate increase roll backs are unlikely. As observed by Mr. Art Manteris, "[track rates] don't go back. They go one way."

Even if a multiple rate structure were possible, it would be irrelevant. As Mr. Salerno pointed out during the October 24th Commission workshop, allowing rebates will lead to a price war. All things being equal, any Nevada race book that offers rebates, during a trial period or otherwise, will have a competitive advantage over other Nevada race books that do not. To compete, other books will begin offering rebates and, before long, rebates will be offered by all Nevada race books. Consequently, all Nevada books would bear the cost of rebates, which will cause the industry's cost structure to significantly increase. As noted below, race books are not major profit centers for casinos and exist only as amenities to patrons as part of the larger tourist experience. Books will be forced to lower overhead, lower expenses, and have fewer employees to lower costs. The result will be a race to the bottom, and at the end of the day it will hurt customers as they will receive fewer services and amenities than they currently get under the existing model. Books with smaller handles simply cannot absorb the added costs stemming from offering rebates given their already slim profits and will have to close. The end result is the closure of many books and a casino experience that is less tourist friendly.

Moreover, a race book that is not heavily invested in a brick and mortar casino-resort could engage in predatory pricing by using unregulated rebates to price others out of the industry. Because race books cannot increase their margins as fees are price controlled and revenue percentages are fixed,[5] offering lucrative rebates will eliminate competition. We do not simply think this may happen, but rather past experience has shown predatory pricing will happen. The last time that rebates were allowed, a small low cost book at the Boardwalk casino had the lowest overhead and gave the largest rebates. As Vic Salerno noted:

> What happened in . . . the Boardwalk . . . they started giving the most until it became illegal. The only person that really benefitted was one gentleman who was working the Boardwalk, and he went down to the Caribbean island, took all his customers, the big customers with him that we are talking about, and he is still in business today. So that's what happened.

While it is unlikely given the economic disadvantages rebates place on Nevada books, even in a best case scenario, only a low cost provider, i.e, someone without the expense of a full resort but only a handful of servers, may be able to survive by undercutting the market. In doing so, the provider would first capture market share, even at a loss, thereby driving out competition and eventually obtaining enough volume to make a profit on a high volume low margin basis. Of course, gone will be the majority of the 83 race books that serve as valuable amenities to the tourist industry. For purposes of comparison, if it were shown that Nevada based Internet casinos could raise revenue but would put 75% of the casinos in Nevada out of business, would that be in the best interests of the state? This is exactly that situation on a smaller scale.

Any Nevada book that wants to compete as a rebate house has a simple solution: obtain a license in a lower cost state like Oregon or South Dakota. This way, they would have the full benefit of providing rebates without disturbing the Nevada market. If they have not done so, their whole argument regarding wanting to compete in that environment is misleading.

Analyzing Cost Structure

The Nevada gaming industry does not make a lot of money off of its books. In fact, the average win per book is small. The average book won over $1.2 million in 2005 and last year that number tumbled to under $700,000. To understand the economic impact of rebates, you have to start with the cost structure that our race books operate under, which is largely dictated by the industry and cannot be modified by our books.

By way of example, the average Nevada book’s handle was about $3,200,000 for the fiscal year ended June 30, 2013. Our books must adhere to the same commission schedule as the track, which equals about 19.5% of the gross revenue. This leaves the average book with a modest takeout of $624,000. The

---

[5] NGC Reg. 26A.150 Deduction of commission on wagers. The total percentage of off-track pari-mutuel wagers that is to be deducted as a commission on wagers must be:

> 1. For interstate common pari-mutuel pools, the same percentage as deducted by the track, unless a different percentage is otherwise approved by the commission; and
> 2. For intrastate common pari-mutuel pools, a percentage not to exceed 25 percent.

book is also required to pay a set fee to the track, which averages 4.01%. This leaves the book with $496,000. After providing comps of 4%, the book is left with $368,000, which is further reduced by, among other things, the following costs: Employment - race book manager, writers, and others; Systems Operator Fees; Fixed Wire Fees; and Equipment Charges - terminals, printers, large screen televisions, electronic boards, and wallboards. This demonstrates that Nevada race books are not a segment of the industry flush with cash or a healthy bottom line. After deducting all expenses from the $368,000, you are left with the rational question of why the average race book even exists? The answer is because it is an important amenity to the tourist experience.

Although operating on a narrow margin, our books are able to invest back into the casino's entertainment experience that draws tourists to the state. Rebates, however, will greatly reduce if not entirely eliminate the profits the average book can hope to achieve. While we have no reason to believe that rebates would significantly improve handle, let us assume that rebates would enable the average book to double their handle to $6,400,000. At the established commission schedule of 19.5%, the book's takeout is $1,248,000. However, as previously addressed, allowing rebates will result in an immediate increase in track fees, which even at the most optimistic estimations, are expected to equal or exceed 8%. This further reduces the book's after tax revenues to $736,000. After deducting a rebate allowance of 8.5%, the books revenue plummets to $192,000, which is further reduced by the aforementioned overhead expenses. Thus, even with a highly unrealistic increase in revenue, the average books can expect a 48% decrease in their gross margin as a result of unavoidable costs associated with rebates.

Moreover, any significant increase in handle based on giving rebates is predicated on the assumption that Nevada race books can somehow compete against the rebate houses. The rebate houses, however, operate under an entirely different cost structure and for an entirely different purpose than our race books. Specifically, the major rebate houses that proponents use to exemplify the alleged benefits of rebates, such as those located in Oregon, North Dakota, South Dakota, St. Kitts, or Curacao, are not subject to disseminator fees or regulatory compliance costs, nor are they operating facilities for flesh and blood patrons.

As identified by Art Manteris, rebate houses:

> [D]on't have . . . the most expensive real estate in the country on the Las Vegas Strip. They don't have the big, lavish, elaborate race books that we have in Nevada. They are very cost effective, and of course, they can offer rebates to a far greater magnitude than we could ever approach here in Nevada.

Further hindering the ability of Nevada race books to compete with rebate houses is the state's current tax regime, which is five times that of Oregon and does not permit the deduction of rebates from gross gaming revenue. Effectively, this taxes funds never received by the book. If it is in the best interests of Nevada to go into competition with Oregon and others in the rebate wars, it must be predicated on change in the law that allows rebates to be deductible. I asked the legislature to make this change in the last session if it were to consider rebates, it declined.

While the Nevada legislature could amend the tax structure in 2015 to accommodate a deduction for rebates, our books will nevertheless remain disadvantaged due to the state's tax rate. Specifically, absent additional legislation to lower the race wagering tax to .25%, a rate competitive to that imposed on rebate house operators in other jurisdictions, Nevada race books will continue to face an inherent economic disadvantage that eliminates any realistic ability to compete with rebate houses. For instance, the "tax" for those licensed in Oregon is only .25% of the handle. In contrast, assuming Nevada race books hold 19.5%

of the wagers made, our "tax" is around 1.31% of the handle—or about five times that of Oregon. Moreover, unlike out of state operators, all Nevada books are subject to the LVDC fee and compliance costs associated with Nevada's gaming regulations. Accordingly, regardless of whether the tax rate is amended, ***our books could never compete under the existing cost structure*****.**

As such, a substantial increase in Nevada's handle would be offset by increased expenses attributable to the increase in track fees and rebates. As demonstrated in our August 8th letter, even if the existing Nevada handle (about $325 million) was to expand to $800 million, which is almost two and a half times the current handle, the increased expenses resulting from higher track fees and issuing rebates simultaneously negate any increase in revenue for the race books.

Moreover, the belief that such a radical expansion of the Nevada handle could even occur is highly unlikely given the state of the horse racing industry. According to industry numbers prepared by the Jockey Club, the national handle has plummeted 28.3% from $15.18 billion to $10.88 billion over the last decade.[6] There simply are not enough players in the marketplace to sufficiently increase our handle to make the offering of rebates profitable.

In short, even if a sufficient player pool did exist, such a drastic expansion in handle will not happen under current Nevada law because, as detailed throughout, the electronic high volume rebate houses will undercut our books' best efforts as a result of lower taxes, the deductibility of rebates, and the absence of dissemination fees, regulatory compliance costs, and overhead associated with flesh and blood establishments. Our books could not compete on price against rebate houses authorized in other states.

Rebates Are Not the Solution

The notion that somehow rebates are the solution to the race industry's problems has proven incorrect. If rebates can drive handle by a multiple of even two, then one needs to explain why the United States handle has decreased by 28% since the widespread introduction of rebates about 10 years ago. In fact, rebates have been the worst move that the industry could have made because the money that the computer players make has to come from some place. Unfortunately, that some place is the everyday player. What has resulted is the devastation of the flesh and blood player. The computer players will eventually bleed the casual players dry until they have no one to bleed but themselves and the industry may collapse or realize that rebates needed to be repealed generally. Many tracks and totes have already come to realize this. During a recent interview, Hasse Skarplöth, CEO of the Swedish tote company ATG, stated:

> We want people of flesh and blood to bet on horses, not robots. I do wish to emphasize that these account holders have not done anything wrong, violated any laws nor breached any rules, but they have, nonetheless, used a method that, in the long run, puts a great number of regular players at a considerable disadvantage, and consequently, is having a detrimental effect on the entire horse racing economy.[7]

Additionally, in response to whether Tampa Bay Downs is missing out on a larger handle by refusing to provide appealing discounts to CRW players, Tampa Bay Downs General Manager Peter Berube responded:

---

[6] *See* http://www.jockeyclub.com/factbook.asp?section=8.
[7] http://www.paulickreport.com/news/ray-s-paddock/i-robot-the-future-of-horse-race-wagering/.

> Oh, absolutely. But it's a slippery slope. You go down that road, and then all of the sudden, you get hooked on this handle, and you see the effect that it has on your pools, but you've already gone down that road, and it's hard to kick that handle out. So I'd rather not go down that road at this point and time.[8]

Moreover, the representation that Nevada and Wisconsin are the only states that do not allow rebates is plain wrong. The attached chart shows the other states that do not allow rebates.[9] Even if Nevada and Wisconsin were the only two, we are unique because we are the only two states where race books are an amenity to a tourist based casino industry and are on the right side of history because rebates are killing the industry. In fact, the tracks that remain successful are those that emulate Nevada's product by catering to flesh and blood patrons. As presented by Mr. Tony Nevill, Race and Sports Book Director at Treasure Island:

> The ones that are successful, you go there Friday night, Still Breeze was playing a concert for the young kids after the racing. Saturday they had a big Jack Daniels tent, they had a barbeque cook-off going on, [a competition for] who could make the best ribs. They also had Wheezer [sic] playing that night after the races. So it seems like what they are doing is emulating the product that we currently have here in Nevada. So the more entertainment they can bring to the more diverse individuals who are there, it is better for them, it is better for their bottom line.

As Art Manteris noted, the correct solution is to reduce the takeout so that flesh and blood players have the same pricing as the computer players. Think about it. Would you play in a poker game where the whales got a 10% rebate on every bet that they made?

Impact of Offering Rebates on Nevada's Race Books

The Nevada race books' inherent economic inability to compete against rebate houses would be devastating. Most notably, many race books would be forced to consolidate in an effort to counteract the increased costs due to rebating. The NPMA believes rebating would reduce the number of race book operations from about 80 to less than 20. Given the level of consolidation expected to occur in the industry, Applied Analysis, a leading business advisory services firm, forecasts the number of employees required for race wagering operations to decline by 40 to 80 percent and notes that "industry estimates may place this figure even higher, especially if considering the potential for negative impacts on employees in other departments at hotel-casino properties that retain race books solely as loss leaders."[10] To put these figures in perspective, the actual number of layoffs would be as follows:

> 40 percent of the estimated 97 race book employees in the state equates to a loss of 39 employees, 60 percent equates to 58 employees, and 80 percent equates to a loss of 77 employees. These figures represent the range of direct jobs expected to be lost as a result of allowing rebates in the state. Direct losses in terms of wages and salaries paid to race book employees are estimated to range from $1.4 million to $2.7 million.

---

[8] *Id*.

[9] *See* Exhibit A.

[10] *See* Exhibit B. Applied Analysis report "Comments on Issues Relating to the Offering of Rebates on Race Pari-Mutuel Wagers." September 24, 2013.

> Including the broader indirect (supplier) and induced (employee spending) impacts of the consolidation, allowing rebates would be expected to result in the loss of 59 to 116 jobs paying between $2.2 million and $4.4 million in wages and salaries to Nevada employees in all sectors of the economy.[11]

Ultimately, even if rebates are permitted, the industry is consolidated, and numerous jobs are lost, the probability of success for the few remaining Nevada race books is bleak. *In light of our books' inability to truly compete in the rebate arena, rebates would do nothing to secure current patrons or attract those who are located elsewhere.* As Mr. Russell highlighted during the Commission's October 24th pari-mutuel workshop:

> ***[T]he is no data, there is no suggestion, there is no information that says that a person sitting in the state of California who has the ability to wager on his computer and watch horse racing on his television is going to get in his car and drive the four hours from LA or the one-hour flight from San Francisco on a regular basis and wager in a brick and mortar casino in the state of Nevada because all of a sudden we are offering rebates.***

Moreover, unlike the last time Nevada's race books offered rebates, the state would not attract new players because we cannot compete with other states that give rebates. The regulatory structures of Oregon and South Dakota are designed for rebates by having the lowest taxes, allowing the deduction of rebates from taxes, and having a considerably lower regulatory cost. A person in Arizona that wants the best prices is NOT coming to Nevada. They are going to bet remotely via a rebate house.

Rebate players are not interested in the amenities of the book or the entertainment Nevada provides. They are interested in one thing—money—which they can certainly get more of from offshore rebate shops or those licensed by Oregon and South Dakota than they can possibly get in Nevada. Rebate houses operate on margins as low as 1% and pay the rest of the amounts they receive as "hold" from the track back to the track as a simulcast fee and/or host fee and as a rebate to the player. This is due, in part, to the rebate houses operating in jurisdictions with lower regulatory costs. Besides having higher regulatory costs, virtually every aspect of the Nevada race book service is price controlled.[12]

Accordingly, as Mr. Asher noted at the August 2013 workshop, "we face a choice where if we are going to rebate, we are going to rebate in a situation where we can't compete with folks who are already in that business because of cost structure." Mr. Asher reiterated this point at the October workshop saying "[rebate players] are not coming back. They are gone. They are not coming back." And why would they? It is economically impossible to give them the rebates they are receiving elsewhere. This leaves Nevada race books in a precarious position. The few proponents of offering rebates readily admit that rebates are not intended to cater to current clients but instead to attract new patrons or patrons the industry lost to rebate houses. Given the inherent economic disadvantage Nevada race books face, it is impossible for the industry to offer rebates significant enough to regain (or capture) patrons lost to rebate houses. As a result, the casino industry that has invested millions in bringing tourists to town will lose tourists currently drawn to our race books' amenities without any offsetting benefit from new rebate players.

---

[11] *Id.*

[12] For instance, our industry is required to contract with the tracks to place our wagers into its pools (called track fees), we need contracts for communications and telecasting of the races and we need contracts for the hub services (called hub fees).

Rebates Introduce New Enforcement Concerns and Substantial Costs

In addition to their detrimental effect on Nevada's race book industry, the allowance of rebates also raises enforcement concerns and creates a heightened risk of criminal activity. This was evidenced on a national level by the unlawful activities of several individuals allegedly associated with the Gambino crime family (the "Uvari Group"). Through the exploitation of rebate shops, the Uvari Group was able to operate an illegal gambling business that brokered more than $200 million in illegal bets and collected commissions/rebates on the wagers. The abuse of such rebates allowed the Uvari Group to engage in large scale money laundering and tax fraud.[13]

At the October 10th Gaming Control Board hearing, the Enforcement Division acknowledged these concerns and noted that Nevada's prior unregulated rebate regime was discretionary and resulted in books giving rebates primarily to "suspect bettors, i.e., messengers and/or money launderers who wagered large amounts of money with the book." In fact, rebates were used locally in an attempt to circumvent prohibitions on sharing of revenue from pari-mutuel wagering. During that same meeting, Chairman Burnett emphasized that the typical internal controls and accounting oversight practices used by the Board to ensure money laundering and other improper activities do not occur would not be required until the legislature considered the matter in 2015, assuming they would even address the issue.

Even if regulatory protections are required, such protection comes at a significant cost. As demonstrated above, regulatory compliance imposes a substantial expense on operators, and additional reporting and accounting obligations only add to that burden. More important, however, is the cost identified by Mr. Joe Asher during the Commission's workshop on October 24th: complying with regulations is a disincentive for bettors to come to Nevada and they will instead take their money to other, less transparent markets.

In sum, rebates invite impropriety which often leads to illegal activity. Nevada is not currently equipped to regulate this issue. But even if Nevada can avoid the unwanted behavior associated with rebates, the costs of avoidance would nullify the potential gains—gains that were never certain to begin with.

Summary

The horse racing industry is undeniably in decline and no silver bullet can save it. Nevada is neither responsible for nor in a position to save the pari-mutuel industry. Nevada can, however, unintentionally surrender its valuable business model to inherently advantaged competition by entering the rebate market.

Unlike other jurisdictions trying to take advantage of high rebate, low margin offerings, Nevada has rejected this approach in favor of its established amenity market—brick and mortar, full-service race books. Accordingly, the offering of rebates poses serious concern to the NPMA. Most notably, the NPMA does not believe permitting rebates would allow Nevada race books, as they exist today, to continue. Rather, even with an extremely significant increase in Nevada's handle, which is improbable, the increased fees and costs associated with the rebates reflect a substantial increase in cost to do business for Nevada race books and will likely result in decreased profits. The Nevada race book industry will therefore be forced to move away from the smaller, amenity and customer service based approach to a model where

---

[13] For each bet, the Uvari Group allegedly returned a portion of its commission or rebate to the bettor, as an incentive for the bettor to continue to place bets through the Uvari Group. The Uvari group also concealed the identities of most gamblers in its operation thereby promoting tax fraud and money laundering.

patrons are left only with a few large books to choose between that attempt to cater to CRW play. This would do Nevada's race books and the overall Nevada gaming industry a disservice.

In closing, the NPMA believes the comments of Board Member Johnson, who took the lead in identifying the Board's thoughts on rebates per the request of the Commission, to be particularly apt:

> [I]f the Gaming Commission or the Legislature established a policy that said gaming must be open and accessible to all parties, well, notwithstanding a preference by the industry to the contrary, that is an example of where policy should prevail over the industry preference.
>
> But this is a case where I think that the industry's lack of support generally should be considered very carefully because we know our gaming industry is heavily dependent upon the support of those who operate within it and the revenue and the taxes that they generate and the employees that they employ.

Here, the economics simply do not support offering rebates. That is why the industry is overwhelmingly opposed to it. The NPMA asks that the Commission consider these concerns in its deliberations.

I hope this letter is helpful in demonstrating the issues and our concerns relating to the offering of rebates, or similar incentives, on pari-mutuel wagers. Please contact me, if you have any questions regarding the preceding.

Sincerely,

LEWIS ROCA ROTHGERBER

Anthony Cabot

Cc: Patty Jones, Executive Director of the NPMA

Exhibit A

Pari-Mutuel Rebate Maps

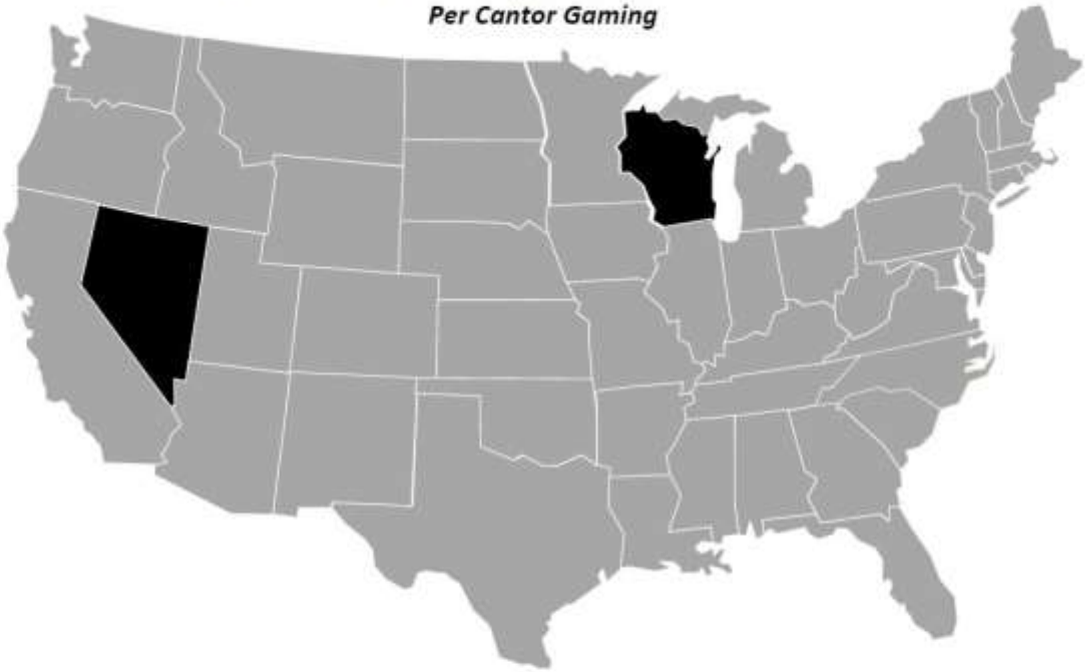
During the Commission's October Pari-Mutuel Workshop, Cantor Gaming presented a map depicting the pari-mutuel landscape in the United States. Cantor used its map to assert that rebating is common practice throughout the country by alleging that rebating occurs in 41 of the 43 states that allow pari-mutuel wagering.

In the map, Cantor categorizes 14 states as jurisdictions where rebates are given although their legality is not expressly addressed in statutes or regulations. Cantor Gaming fails to mention, however, that many of these states nevertheless take an unequivocal position against the permissibility of rebates. Idaho, for example, does not allow rebates as a matter of practice. Montana does not impose rebate restrictions on advanced deposit wagering, but it does prohibit rebates at live race tracks. Connecticut employs a rewards program allowing bettors to earn points towards merchandise but absolutely forbids cash-back rebates. Representatives from racing commissions, gaming divisions, and even race tracks in 8 of these 14 states confirm that their state restricts rebates in some manner. And of the remaining states, some do not even have race tracks or regulatory authorities to comment on the matter, e.g. Tennessee.

Moreover, identifying states as either permitting or prohibiting rebates fails to acknowledge that the pari-mutuel industries of the various states are dissimilar. Kentucky has an established horse racing tradition while Missouri does not have a single track. Oregon has a thriving ADW industry, but Nevada has opted to pursue an entertainment based wagering experience. The map ignores variables among the states that have profound effects on policy decisions and economic realities.

Pari-mutuel landscape in the United States

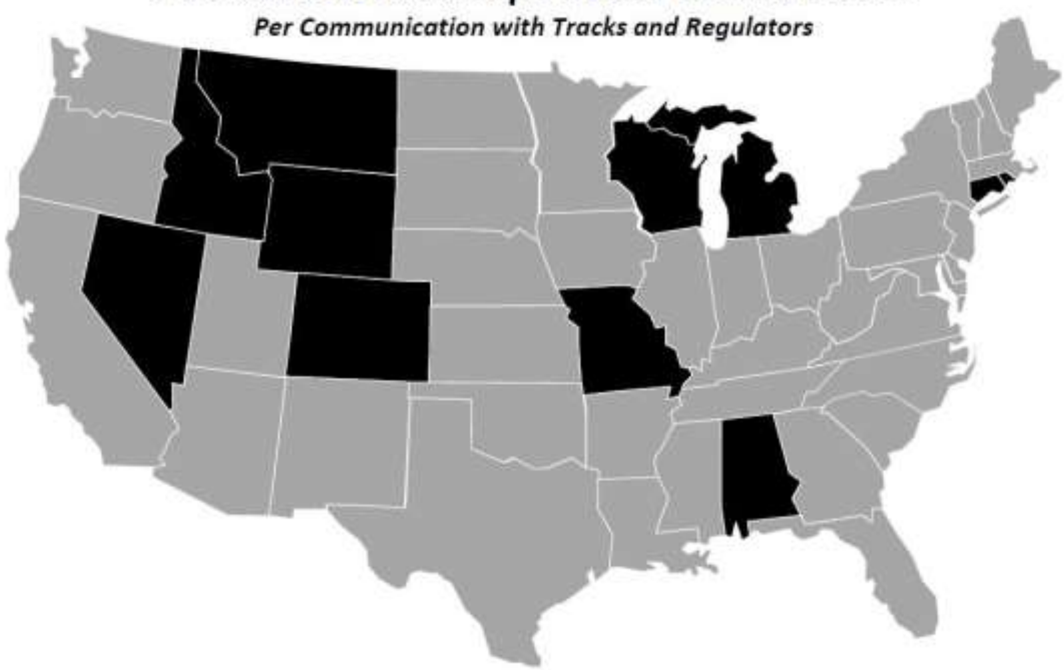
Per Cantor Gaming



States Where Rebates are Strictly Prohibited

Pari-mutuel landscape in the United States

Per Communication with Tracks and Regulators



States Where Rebates are Prohibited or Not Offered as a Matter of Practice

Alabama, Colorado, Connecticut, Idaho, Michigan (Requires MGCB Approval), Missouri (Pari-Mutuel Wagering and Rebates Prohibited), Montana (Not Permitted at Live Race Tracks), Rhode Island, Wisconsin, Wyoming

Exhibit B

Applied Analysis Letter

6385 S. RAINBOW BLVD., SUITE 105
LAS VEGAS, NEVADA 89118
T: 702.967.3333
F: 702.314.1439
APPLIEDANALYSIS.COM

APPLIED ANALYSIS

September 24, 2013

Mr. Anthony Cabot
Lewis Roca Rothgerber
3993 Howard Hughes Parkway, Suite 600
Las Vegas, NV 89169

Sent via email (ACabot@LRRLaw.com)

RE: Comments on Issues Relating to the Offering of Rebates on Race Pari-Mutuel Wagers

Dear Mr. Cabot:

Applied Analysis ("AA") was retained to analyze potential economic and financial considerations related to the offering of rebates of race pari-mutuel wagers in the state of Nevada. While available data on the activity itself is somewhat limited in terms of public reporting requirements of pari-mutuel wagering and the related financial and operating information reported by Nevada regulatory entities, the statistics that are available provide insight into the potential impacts of offering rebates.

1. **Allowing rebates would likely result in the loss of jobs and wages in the state of Nevada.** Race and sports books in the state of Nevada currently employ approximately 1,125 managers, writers and other staff.[1] While not an exact measure of employee service demand, race wagering comprises approximately nine percent of total race and sports wagering in the state and is expected to support a similar share of race and sports book employment, or approximately 97 employees. Consolidation of race wagering in the industry due to rebating is expected to reduce the number of race book operations from approximately 80 to less than 20 (source: Nevada Pari-Mutuel Association). Furthermore, of the 20 or so remaining race books, only 2 to 3 are expected to be profitable; the remaining 17 or 18 race books that will remain in operation are expected to function as loss leaders for casino-hotel properties that are able to support such a burden.[2] With this level of consolidation, AA has calculated a range of potential losses in terms of both jobs and income.

   Given the level of consolidation expected to occur in the industry, AA would expect the number of employees required for race wagering operations to decline by a factor ranging from 40 to as high as 80 percent, respecting that industry estimates may place this figure even higher, especially if considering the potential for negative impacts on employees in other departments at hotel-casino properties that retain race books solely as loss leaders. To put these figures in perspective, 40 percent of the estimated 97 race book employees in the state equates to a loss of 39 employees, 60 percent equates to 58 employees, and 80 percent equates to a loss of 77 employees. These figures represent the range of direct jobs expected to be lost as a result of allowing rebates in the state. Direct losses in terms of wages and salaries paid to race book employees are estimated to range from $1.4 million to $2.7 million.

   Including the broader indirect (supplier) and induced (employee spending) impacts of the consolidation, allowing rebates would be expected to result in the loss of 59 to 116 jobs paying

[1] Source: Nevada Pari-Mutuel Association

[2] Id.

between $2.2 million and $4.4 million in wages and salaries to Nevada employees in all sectors of the economy. Please refer to the table that follows for additional detail.

Range of Economic Losses Resulting from Allowing Rebates on Race Pari-Mutuel Activity in Nevada

	Direct	Indirect	Induced	Total
Current Nevada Employment and Wages Supported by Race Pari-Mutuel Activity				
Current Estimated Employment:				
Employment	97	19	30	146
Wages and Salaries	$3,400,999	$937,821	$1,180,790	$5,519,610
Range of Nevada Employment and Wage Losses Resulting from Consolidation of Operations				
40 Percent Decline in Direct Employment:				
Employment	(39)	(8)	(12)	**(59)**
Wages and Salaries	-$1,369,832	-$377,729	-$475,591	**-$2,223,152**
60 Percent Decline in Direct Employment:				
Employment	(58)	(12)	(18)	**(87)**
Wages and Salaries	-$2,037,186	-$561,751	-$707,289	**-$3,306,226**
80 Percent Decline in Direct Employment:				
Employment	(77)	(15)	(24)	**(116)**
Wages and Salaries	-$2,704,539	-$745,773	-$938,987	**-$4,389,300**

2. **The current tax structure applied to pari-mutuel gaming in Nevada is not competitive with other states allowing rebates on this type of gaming activity.** Preliminary research indicates that the tax rate imposed on race pari-mutuel wagering in Nevada is significantly higher than those rates found in certain states where rebating operators are concentrated. Based on discussions with the Nevada Pari-Mutuel Association and other primary research, it is expected that the competitive landscape for race pari-mutuel operators would expand considerably if rebating is permitted. It is also important to note that should rebates be allowed, taxes imposed on pari-mutuel wagers in Nevada would be applied to the amounts rebated to customers. Such a practice is akin to paying a tax on money that was never received by the book.

   Nevada imposes a special pari-mutuel wagering tax of three percent on the gross amount of money wagered on each racing or sporting event other than in-state horse or mule racing (in-state racing is taxed at a rate of two percent). Such a rate is in line with rates imposed on actual horse racing track operators; for example, Kentucky (3.5 percent) and Ohio (a rate of one percent to four percent depending on the amount wagered) are home to a number of actual racing tracks.

   However, most states (including Nevada) do not have substantial operations of actual horse racing tracks. That said, some states have evolving tax structures making it favorable for wagering operations to exist. Recently, the Oregon Racing Commission clarified the tax rates due from pari-mutuel "hub operators", also referred to as Advance Deposit Wagering Licensees or "ADWs", as 0.125 percent of the first 60 million dollars in gross mutuel wagering receipts during the license period and 0.25 percent of the gross mutuel wagering receipts in excess of 60 million dollars during that period. However, *if the hub operator conducts business in a state where hubs are specifically authorized and the tax rate is less than 0.25 percent, the tax rate for wagers by*

APPLIED ANALYSIS

the residents of such state would be that of the state in which they reside. Such language appears to be specifically intended to allow rebating operators to remain competitive with other jurisdictions. Currently, Nevada offers no competitive tax advantages to its race pari-mutuel operators, which are expected to be required to increasingly compete with rebating operators in other states, should rebating be allowed. The requirement to pay Nevada pari-mutuel taxes at a rate of 3 percent – including on amounts rebated to customers – would put Nevada's existing race books at a significant disadvantage compared to other rebating operations.

3. **Additional fees imposed by racing operators (primarily out-of-state entities) on pari-mutuel operators allowing rebates (i.e., in-state Nevada race books) would be significant.** Our review of available data suggests that the increase in fees that would be imposed by race track operators if rebating is allowed will more than double the current rate paid in most cases. Furthermore, significant additional fees that are not generally charged at present will be imposed, such as source market fees and simulcast fees. Overall, cost percentages owed to host race tracks are expected to increase from around 4 percent to around 10 percent. A more than doubling of host fee costs due from the pari-mutuel books in Nevada, combined with the pay-out of rebates to customers, the 3 percent tax on all amounts wagered (including on amounts rebated), and the expenses unique to Nevada race books that will remain, such as complimentary drinks, are all expected to result in an overall reduction in profit margins for Nevada race books. Holding other factors constant, reductions in profit margins would be expected to lead to consolidation within the industry.

   Field research indicates that if Nevada permits rebating on race pari-mutuel wagering, all operators in the state, including brick-and-mortar operations, will be viewed – and treated – by racing track operators in a manner similar to how other existing ADWs are treated today. With many ADWs having little to no overhead costs and locating in states with favorable tax climates, such treatment will pose a competitive disadvantage to Nevada's existing race book operators. Data obtained from third parties confirms that both the operating environment and competitive landscape will evolve dramatically should rebating be allowed on race pari-mutuel wagering, including an increased level of automation. The combination of automation and consolidation within the industry would likely be material, resulting in a loss of jobs and wages and salaries in the state of Nevada.

   Furthermore, it is worth considering that a shift in visitor spending behavior may occur in locations where race pari-mutuel is no longer offered as a result of consolidation in the industry due to rebating; these shifts may have other unexpected or unintended negative consequences on the leisure and hospitality industry in the state of Nevada.

##############

We welcome the opportunity to discuss this letter at any time. Should you have any questions or require additional information, please contact Jeremy Aguero at (702) 967-3333.

Sincerely,

Applied Analysis

Applied Analysis
By: Jeremy Aguero, Principal Analyst