

Testimony of Charles E. Hayward

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Senate Committee on Racing & Gaming

Hon. John Bonacic, Chairman

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Chairman Bonacic and other members of the Senate Racing Committee, NYRA appreciates your invitation to testify here today in Mineola, just a few miles from beautiful Belmont Park.

As you have heard from various speakers at your hearings in the Finger Lakes region and in Albany, and I suspect from several of your speakers here today, the racing and pari-mutuel wagering business in New York and in the United States is facing many challenges. With the exception of a few elite race meetings such as Saratoga and the big event race days such as the Belmont Stakes and the Travers, handle trends are generally negative. Attendance at most racetracks is down, and patronage at the regional OTBs is at an all-time low. These are the challenges facing our industry. They are real, and they are serious.

But unlike many of the speakers who have appeared before your committee, I'm here to tell you that all is not doom and gloom. We at NYRA do not view these challenges to be insurmountable. We believe that we have the tools available to stabilize and grow our racing and pari-mutuel businesses at NYRA, and I'd like to take a few minutes of your time this afternoon to explain to you how we intend to go about doing so.

NYRA produces the highest quality and most consistent racing product in the thoroughbred racing industry. NYRA's racing product is the undisputed leader in North America. In 2010 NYRA produced 23% of the graded stakes races. Our racing accounts for 10% of the US purses, generates 19% of the US handle and we accomplish these remarkable statistics with only 4% of the racing days produced in the United States. NYRA produces 240 race days and maintains physical plants with over 4,500 stalls, 2.7 million square feet of space under-roof, situated on 1005 acres of land.

Given the strength of the NYRA racing product, NYRA is focused on competing effectively in the national marketplace and making NYRA's racing operations profitable apart from subsidies from VLTs. To that end, NYRA is working proactively to implement a strategic plan to reverse the negative handle trends mentioned above and to preserve NYRA's status as the nation's preeminent racing association through the end of the current franchise in 2033 and beyond.

Specifically, NYRA is undertaking the following initiatives:

- Expansion into the NYC market through a self-service restaurant strategy: Under section 1009 of the racing law, NYRA has the right to pursue (subject to certain

approvals) the establishment of simulcast theaters within the City of New York. NYRA believes that by establishing pari-mutuel areas within selected bars and restaurants in NYC it can successfully recoup much of the handle that was lost when NYC OTB ceased operations in December of 2010. Moreover, NYRA believes this strategy would create new jobs within these restaurants, generate additional pari-mutuel taxes for the State, generate higher regulatory fees for the Racing & Wagering Board, and generate higher payments for the New York Thoroughbred Breeding Fund.

- Expansion of internet wagering by implementing a state-of-the-art wagering platform competitive with the national ADWs: NYRA has issued an RFP to solicit a vendor who will re-design the NYRA web site and wagering applications to create a state-of-the-art account wagering platform that will offer the best possible fan experience with live video streaming, logical betting platforms, and applications for mobile and personal electronic devices. NYRA needs to position itself to take maximum advantage of the fact that racing is the only legal on-line wagering option.
- Investment in the NYRA facilities from VLT capital funds: Under NYRA's Franchise Agreement with the State, NYRA will receive 4% of the net win derived from the VLTs at Aqueduct to be used for capital improvements to the 3 NYRA racetracks. NYRA has been working with a racing consultant with extensive experience in the design and re-design of world-class racing facilities to ensure that NYRA derives the maximum benefit from each capital dollar invested at each NYRA racetrack. This past August NYRA began a public roll-out of a master plan which identifies projects that will improve all facets of the racetracks, including fan experience and amenities for all NYRA patrons, from the grandstand to the clubhouse, and which addresses the needs and efficiency of our backstretch areas, including new and refurbished dorms for backstretch workers and additional stall space for our equine athletes. The master plan has been received with overwhelming support and enthusiasm by our constituents, and we envision major projects being considered by the Franchise Oversight Board next year, assuming no delays with the launch of VLTs at Aqueduct towards the end of October 2011.
- Increased purses from VLT purse funds: Under NYRA's Franchise Agreement, up to 7.5% of the net win from VLTs at Aqueduct will be dedicated to enhancing purses, thereby ensuring that NYRA will remain competitive with other racing jurisdictions for the best horses and ensuring full field sizes which is the biggest single driver of pari-mutuel handle. Moreover, the New York Breeding Fund will be receiving up to 1.5% of the VLT net win. Anticipation of this new revenue for NY Bred awards has already been a boon to the NY Bred program as evidenced by the strong NY Bred sales at Fasig Tipton this past summer in Saratoga.
- Expanded television exposure, such as NBC Sports Versus channel coverage to expand beyond Saratoga: An important industry report, produced by McKinsey &

Company, recently commissioned by the Jockey Club has confirmed that increased exposure of racing on television is an essential element of sustaining and increasing racing's image and popularity with the general public. Prior to the release of this report, NYRA had already entered into an historic agreement with NBC Sports to present live weekly broadcasts of the biggest races at Saratoga called "Summer at Saratoga" which received rave reviews. Just recently NYRA announced that NBC had exercised its option to extend this agreement for another two years, and may look to add additional shows featuring the Belmont fall and spring race meets. Moreover, NBC's positive experience with NYRA has incentivized NBC to reach agreements with other top racing associations such as Keeneland to produce feature shows on graded races at those venues as well. Moreover, NYRA is expanding and improving its programming on the NYC Cable networks, with NYRA produced handicapping shows featuring industry experts, additional promotion spots for NYRA racing, and prime-time display of NY Harness racing in the evenings. NYRA would like this committee to consider an amendment to the Racing Law to give NYRA the authority to expand its harness simulcast menu to include out-of-state harness tracks.

- NYRA has partnered with Genting at Aqueduct to upgrade its simulcast facilities to a more fan-friendly sports bar venue with the expectation of increased patronage.

The above stated initiatives showcase just a sampling of innovative changes being implemented by NYRA. Our initiatives to redesign our business model to effectively compete are based upon an analysis by NYRA's professional staff of the economic consequences of any contemplated changes. NYRA consults regularly with our regulators to ensure they are informed of our strategic plans, and as you know NYRA is committed to a policy of transparency. NYRA's audited financial statements and budgets are readily available within the public domain.

NYRA has a vested interest in the regional OTBs – they are by statute our bricks and mortar retail distributors - however, the statute gives NYRA no voice in determining how the OTBs will package, promote, or display our product, nor does NYRA have any say in the business decisions made by the OTBs concerning efficiency, cost budgeting, and planning. The result is that NYRA is forced to rely upon an OTB retail network of questionable viability and solvency that is poorly suited to promote and grow pari-mutuel handle on the NYRA product. These concerns are not theoretical. It is a matter of public record that NYRA suffered a \$20 million loss stemming from the bankruptcy and eventual closure of NYC OTB. Suffolk OTB is also currently in bankruptcy and owes NYRA over \$2 million in pre-petition debt. OTB's, like NYRA, need to re-design their business models to survive in an increasingly competitive marketplace. It is not an answer to this challenge to assert that their payments to the racing industry are not appropriate. The facts demonstrate otherwise.

The fact of the matter is that NYRA receives more in payment for its product from out-of-state ADWs than it does from the in-state OTBs. Again, those OTBs may be paying additional taxes and fees to the State, State breeding fund, and Racing & Wagering Board – but the amount they pay to NYRA is less than the market rate for NYRA content.

Any decrease in payments by OTBs to NYRA would adversely impact NYRA's current operations. Despite assertions by OTBs that they overpay NYRA and the statutory payment scheme should be decreased, it is without dispute that NYRA's racing product commands more in the open market. NYRA receives 2.5% on a bet made at an OTB versus 6 to 8% on a payment from an out of state entity. OTB financial problems are a consequence of their business and distribution model, not with NYRA's payments. Michael Kane, President of Western OTB, indicated in his testimony to this Committee that the business model must change from parlor facilities to EZ Bet locations. NYRA is the only racetrack operation in the United States which does not control its home market. NYRA's pricing as a content provider in New York State is controlled by statute rather than the marketplace.

Case in point, Suffolk OTB derives more of its revenue from wagers placed on NYRA content than any other single source. But the truth of the matter is that if Suffolk OTB had paid NYRA nothing for its product in 2010, Suffolk OTB still would have lost money. If a retail store can get its single most popular and best-selling product for absolutely free and yet still operate at a loss you can be pretty sure the problem is not that the store pays too much to the manufacturer of its best product. Quite to the contrary.

Moreover, reducing the already artificially low prices the OTBs pay to NYRA for its product would undermine the viability of NYRA. Ironically, if the OTBs succeeded in reducing the already low percentages they pay to NYRA and as a result NYRA itself faltered the result would be an utter and complete collapse of the OTBs because there would be no NYRA content for them to sell. NYRA respectfully submits that any decrease in the already artificially low payments made by the OTBs to NYRA could potentially derail NYRA's objective to reach profitability without dependence on VLT revenue. Such an outcome would decimate the racing industry both in NY and the US, would result in lower tax collections by the State, lower regulatory fees, and more importantly would not result in greater profitability of the OTBs – it would lead to their demise.

The pari-mutuel industry in New York has long passed the point where a simple re-allocation of resources from the racetracks to the OTBs can maintain the status quo. Instead, the time has arrived for each segment of the industry to establish a viable financial model. This is the challenge NYRA is rising to, and OTBs must respond to this challenge as well.

The OTBs are independent public benefit corporations with defined territories for distribution of racing products. Each OTB has a board which sets policy for the OTB. The OTBs should be focused on an effective business plan in their respective territories. There is currently sufficient statutory flexibility for OTBs to enter into sharing, consolidation or other joint arrangements among themselves or with other industry participants including NYRA. An analysis of NYC OTB which is endemic of the other regional OTBs demonstrates that the parlor distribution system combined with excessive operational and legacy costs resulted in its financial demise. The problems inherent in the OTB financial model and distribution system are clear. This model should not be re-established or perpetuated in NYC particularly by an OTB with its own franchise territory.

Instead, NYRA should be granted the exclusive off-track franchise for NYC. NYRA has demonstrated its capability to effectively serve the marketplace by recapturing wagering business

not only on-track but through the operation of its off-track betting facilities at Aqueduct and Belmont. These facilities have the largest handle of any OTB facility in New York State. NYRA should be given the opportunity to replicate this success in NYC which is NYRA's own marketplace. Moreover, as a legal matter, if the State were to permit another OTB to expand in NYC it would raise legal questions about whether the only valuable asset of NYC OTB – its franchise to operate in NYC – was being transferred to another OTB without satisfaction or regard to the enormous existing debt obligations of NYC OTB that have yet to be satisfied and which are still very much due and owing. NYRA, on the other hand, already has statutory authority to operate in NYC pursuant to section 1009 of the Racing Law; therefore similar concerns are not presented by NYRA operating off-track locations within NYC.

Another issue that has become a capstone of the OTBs is that they cannot compete with out-of-state Advance Deposit Wager companies (ADWs) that solicit account holders nationally. Ironically, OTBs historically insisted that the live internet video streaming of racing in New York must be treated the same under the Racing Law as the in-home display of racing over cable television. Using the in-home argument, the OTBs were able to block NYRA and the other racetracks, and by extension the OTBs themselves, from being able to live video stream racing over the internet which is essential to building a successful internet wagering platform. Thus, the OTBs own parochial protectionism handed a significant marketplace advantage to the out-of-state ADWs, because they have offered video streaming for their internet wagering customers for at least 10 years. By contrast, video streaming has only been available for New York wagering entities for 9 months which accounts for gains by NYRA and the OTBs in internet wagering.

The OTBs have focused on out-of-state ADWs, alleging that their presence in New York has resulted in lost handle and customers, despite their presence in the New York marketplace for over ten years. This is a red herring. The OTBs possess no facts or accurate figures to back up their claims. The obvious question is why an out-of-state ADW should be so much more effective in attracting in-state customers when the out-of-state ADW possesses none of the advantages in the in-state OTBs possess, including local outlets where deposits and withdrawals can be made in-person, the OTBs instead seek to eliminate the competition through excessive regulation and fees or an outright ban on the ability of ADWs to operate in New York.

Putting aside for now the legal viewpoint that each of these approaches is likely unconstitutional and banned as a matter already pre-empted by federal law, what is most troubling about the OTBs position on the ADWs is the lack of any factual basis for their assertions. This committee has heard representatives of the OTBs testify that out-of-state ADWs are “stealing” pari-mutuel handle from New York residents in unsubstantiated ranges from between \$300 to \$500 million dollars per year. In fact, there is no accurate measurement to determine how much New York-based wagering has migrated to out-of-state ADWs. In order to bring some lucidity to the conversation, NYRA has proposed that the Racing and Wagering Board, which has the ability to capture this information, should do an audit of the accounts held by out-of-state ADWs so that the actual amount can be determined as a matter of fact.

If the OTBs claims about the “unfair advantage” enjoyed by the out-of-state ADWs were true one would logically expect that NYRA's account wagering business would be suffering handle losses similar to that being experienced by the OTBs. After all, NYRA pays all the same taxes and fees as the OTBs on handle generated through its accounts, so NYRA must be just as

un-competitive as the OTBs. In fact, the opposite is true. For the first 8 months of 2011 NYRA's internet handle increased by 184% over the prior year's results and its phone account wagering business during the same period increased by 125%. So why is NYRA's account wagering business growing so dramatically in the same market and at the same time as the OTBs account wagering businesses are suffering dramatic losses? Because NYRA aggressively promotes its account wagering business and designs its account wagering product to deliver the services and amenities that its research shows the account wagering customer demands. Any business that does not offer products and services that its customers want should express no surprise that its customers are taking their business elsewhere, and yet that is exactly what the OTBs are doing.

NYRA is not concerned about its ability to compete in the open market with the out-of-state ADWs; in fact, the ADWs are very good customers for NYRA. NYRA projects to receive \$28.7 million in fees from ADWs in 2011, which is split 50/50 with the NYRA purse account. As stated above, the out-of-state ADWs pay a market rate for the NYRA product while the in-state OTBs receive the same NYRA product at an artificially low rate as determined by the Racing Law. The imposition of additional regulatory burdens, fees, or tax payments on out-of-state ADWs would necessarily result in a decrease in the payments those ADWs pay to NYRA and the NYRA horsemen. Most importantly, there is no reason to conclude that any amount of burdens placed on the out-of-state ADWs would result in new accounts being opened with an in-state OTB.

So the result of the OTBs position on the ADWs, if enacted by the legislature, would be to harm NYRA and the horsemen who produce the product upon which the OTBs rely, with no residual benefit what-so-ever to be obtained by the in-state OTBs.

As stated above, NYRA welcomes the opportunity to compete in the open market place, and NYRA is focused on being even more competitive in the near future. NYRA has issued an RFP for a new account wagering platform to more effectively compete with out-of-state ADWs. What's more, NYRA has indicated a willingness to talk to the in-state OTBs about NYRA becoming the operator of the OTBs account wagering internet platforms. This approach would provide cost efficiencies to those OTBs that are currently paying a premium to outsource their internet wagering operations to out-of-state third parties. NYRA believes it could successfully operate a consolidated account wagering business on behalf of all in-state pari-mutuel operators under a fee arrangement that would net a higher yield for these operators than they are receiving now by operating their own account wagering systems. This offer remains open.

NYRA's message to the members of this Committee is that any legislation taxing or limiting ADW wagering needs to be carefully analyzed because of its potential impacts on the New York racing stakeholders (racetracks and horsemen). Limiting New York bettors to an in-state wagering platform may negatively impact an expansion by NYRA outside of New York State. It is hard to see why other states would not adopt similar retaliatory wagering policies which would inhibit internet and phone wagering. It is exactly this type of interstate interference with commerce that the US Constitution and the Interstate Horse Racing Act prohibit, and thus any such legislative measure faces significant legal issues. In a global economy, it is just poor public policy.

On the topic of whether the State should consider a constitutional amendment to permit full commercialized casino gambling at certain defined locations within the State, NYRA would like to review any proposals which are developed. It would be premature to offer any meaningful opinion until an actual proposal is under active consideration by the Legislature. As the Committee members are aware, particularly those members from the upstate regions of the State, the racing industry is a major component of the State's agricultural sector and the racing industry's activities have a significant positive impact on the State's economy. Any proposal to expand casino gaming in the State should give careful consideration to the potential impacts upon the racing industry and the State's entire agriculture industry by extension.

Lastly, another important issue facing the racing industry and the State of New York is the funding for the Racing & Wagering Board. Effective regulation is essential to the public confidence in the integrity of racing and pari-mutuel operations. It is not just good policy, it is also good business. In an attempt to address the perennial budget shortfalls of the Racing & Wagering Board the executive budget proposal in 2010 recommended a 2.75% regulatory fee be assessed to purses to pay for costs incurred by the New York State Racing and Wagering Board. This new fee would be on-top of a substantial regulatory fee that is already being imposed upon the handle generated by the racetracks and the OTBs. It is also in addition to the regulatory "mount fee" that is charged for all horses which enter a race in NYS. These fees bear no relationship to the cost of the Racing & Wagering Board to regulate the entities that are paying the fees. If the State is going to rely upon fees to cover the cost of regulation, NYRA would urge that the regulated entities be charged an actual assessment of the cost to regulate the entity being assessed, such that each regulated entity is paying the cost of its own regulation. It is only fair that each entity - NYRA and the other tracks, the Indian casinos, and the charitable gaming participants, should pay the Board for the costs of their own regulation. It is not fair, nor is it legal, for a fee to be assessed in excess of the amount needed to cover the cost of the regulatory activity or to pay for regulatory activity not reasonably connected to the fee being charged. NYRA believes a pure fee-for-service approach would be more equitable and legally sustainable than targeting purses to pay for unrelated regulatory costs.

In closing, I would like to urge the Committee members to consider that there is a world of difference between running a pari-mutuel only business (OTB, ADW) and operating a racetrack. Running a pari-mutuel wagering business is relatively simple. It can be done with limited physical space, labor, and overhead – in fact the most efficient pari-mutuel wagering is conducted in cyberspace over the internet.

Running a racetrack, on the other hand, is a complicated undertaking. It requires a large amount of land, grandstand and clubhouse facilities, vast parking areas, stables and maintenance buildings, dirt and grass racing surfaces, an armada of equipment, and a small army of workers – many of whom live on the premises. But without the racetracks producing racing product there are no pari-mutuel wagering opportunities. Another way to look at it is that NYRA does everything an OTB or ADW does; OTBs and ADWs do not do everything NYRA does.

So there is an important distinction here that we would like the Committee members to keep in mind when considering the issues and proposals involving racing that come before the Committee during the legislative session. Apart from pari-mutuel wagering, NYRA and the

OTBs / ADWs are not in the same business. Our purposes are not the same, our costs are not the same, and our needs are not the same.

So when thinking about the “racing industry” and the testimony you have heard, I would ask that you consider these important distinctions.

Chairman Bonacic, I thank you and your committee for allowing me to present this testimony on behalf of NYRA, and I will look forward to answering any questions you or the members of the Committee may have.

Thank you.