



April 1, 2015

Representative Alissa Keny-Guyer, Chair
House Human Services & Housing Committee
136 State Capitol Building
900 Court Street, NE
Salem, Oregon 97310

Re: Public Hearing, HB 3316, Deems establishment of lottery game retailer or applicant to be casino when 50 percent or more of annual net income of establishment is, or is projected to be, derived from sale of tickets or shares in lottery games. (Amending ORS 461.300)

Dear Representative Keny-Guyer and Committee Members,

HINooN (Hayden Island Neighborhood Network), a recognized Portland neighborhood association supports HB 3316 amending ORS 461.300. We do so because factors such as financial responsibility, accessibility of the place of business or activity to the public, security of the premises, number of existing Video LotterySM retailers – all of these, resonate with our community.

For the past several years, residents and businesses of the Hayden Island Community have experienced the effects of policy and contracting decisions made by the Oregon State Lottery (OSL) in such a manner that it has affected community livability and has become a public safety issue. We have also experienced, and witnessed, the City's effort on the amount of local community manpower and funding it takes to attempt to correct OSL decisions gone awry.

Video Lottery retailers operating as mini casinos have been one of our main concerns, particularly when they are concentrated in one location. For years, the Oregon State Lottery (OSL) has ignored the Income Analysis and Casino Determination authority that are memorialized in the Oregon Constitution and current Oregon Administrative Rules (OAR). In our opinion, it is the main reason for many of the problems associated with video lottery. The following is why we believe that to be accurate and why we support HB 3316 amending ORS 461.300.

Excerpts of the current Oregon Constitutional authority and Oregon Administrative Rules (OARs) by which the OSL is to administer the lottery are provided below.

The Oregon State Constitution states the following:

Constitution of Oregon, Article XV, Section 4. Regulation of lotteries; state lottery; use of net proceeds from state lottery. (10) states,

"The Legislative Assembly has no power to authorize, and shall prohibit, casinos from operation in the State of Oregon...."

The Oregon Administrative Rule dealing with the Oregon State Lottery reaffirms the intent of the Oregon Constitution. Specifically:

OAR 177-040-0061 Casino Prohibition states,

"(1) General: The operation of a casino is constitutionally prohibited in the State of Oregon. It is the policy of the Oregon State Lottery to place Video LotterySM terminals only in an establishment that does not operate as a casino."

Moreover, the **Lottery Mission Statement**, engraved in granite in the OSL lobby, is to:

"Operate a Lottery with the highest standards of security and integrity to earn maximum profits for the people of Oregon commensurate with the public good."

OAR 177-040-0017 Additional Video Lottery SM Retailer Business Operation Criteria and Application Requirements (1) General:

"It is the policy of the Oregon State Lottery to place Video Lottery SM game terminals in retail businesses which are viable businesses on their own without benefit of selling Video Lottery SM."

Yet, on December 3, 2014, at an OSL hearing regarding a proposed change in compensation, small Mom and Pop establishments offered that they purchased their business based on lottery revenue, others were stating they might go out of business if the compensation was changed. This did not appear to be a *"viable businesses on their own without benefit of selling Video LotterySM."*

(2) 90 Day Requirement: states, *"a person shall be considered for a Video LotterySM contract for a specified premises only if the business at that premises has been operating continuously for at least 90 days prior to the date the application is accepted by the Lottery."*

HINooN's concern begins with the applicant not being required to show little, if any, financial viability of their business when they apply for a Video Retailers contract with the OSL.

OAR 177-040-0001 General Application Requirements (1) General: states, *"Any person may request an application from the Lottery."*

The physical environment and character of the applicant's business dominate the "viability" of the establishment's qualification for a contract with OSL as a Video Retailer.

However, OAR 177-040-0061 Casino Prohibition (5) (a) General

"The Director shall conduct a review of the establishment's total income which, for the purpose of this rule, shall equal the sum of the establishments total annual Lottery compensation and the establishment's annual non-Lottery sales."

This continues even as the Video Retailer pursues the business that originally qualified it as *"...operating continuously for at least 90 days..."* for a Video Retailer's contract with the OSL.

OAR 177-040 states that the business must not operate as a Casino and provides a ratio involving Lottery Compensation and the Non-Lottery Gross Sales Revenue. The distribution of the Lottery Revenue appears to be exhaustively audited. However, the OSL contracted establishment's annual Non-Lottery Gross Sales are self-reported and subjected only to a "review."

In the case of the Oregon State Lottery, the Video Retailers have been assigned the burden of proof and are only required to "self-report" a Gross Sales Report (See exhibit A). The self-reported gross sales reports prevent the OSL from enforcing its "Casino Prohibition" oversight responsibilities, and ensure the possibility of non-compliance with the State Constitution and the OAR mentioned above.

OAR 177-040-0061 Casino Prohibition (3) Directors' Casino Determination:

"The director shall determine whether an establishment is operating or may operate as a casino before entering into a Video LotterySM contract for that establishment. The Director may also initiate a review of an existing Video LotterySM retailer whenever the Director has reason to believe that an establishment is operating as a casino, or may operate as a casino. The Director may rely on whatever resources and information are available in deciding to initiate a review of an existing Video LotterySM retailer. A Video LotterySM retailer, or person applying to become a Video LotterySM retailer, has the burden of proof to show to the satisfaction of the Director that an establishment is not operating, or will not be operating, as a casino. The Director's determination is final."

OSL's weak internal operating procedures provide little incentive for Video Lottery Retailers to provide accurate revenue reports. Video Retailers can expect their "self reporting" of non-lottery revenue to be accepted with little or no scrutiny. The lack of oversight results in a perverse incentive for Video Retailers to avoid scrutiny by the OSL Commission and, therefore, to defy accurate, timely, agency, or public, oversight. So long as the "self-reports" satisfy the Director there is no need to seek more reliable figures for non-Lottery revenue information.

"(4) Conclusive Evidence that an establishment is Not a Casino:

The following establishments are not casinos for purposes of this rule:

- (a) an establishment whose annual non-Lottery sales are at least 50% of the establishment's net income as defined in section (5) of this rule....."*

"(5) Income Analysis:

In determining whether an establishment meets the criteria set forth in section (4) of this rule, the Director shall conduct an income analysis as set forth below:

- (a) General: The director shall conduct a review of the establishment's total income which for the purpose of this rule, shall equal the sum of the establishment's total annual Lottery compensation and the establishment's annual non-Lottery sales....*

....The ratio of an establishment's total annual Lottery compensation to its total income shall be determined by dividing the establishment's total annual Lottery compensation by the sum of:

- (A) The establishment's actual, or in the case of an applicant, reasonably projected annual non-Lottery sales; and,*
- (B) The establishment's actual or projected total annual Lottery compensation.*

The Income Analysis equation is stated as follows:

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The Income Analysis Formula stated in OAR 177-040-061 is not an “Apples to Apples” comparison. To obtain the Ratio (Quotient), the Dividend, (B) above, is divided by a Divisor, (A) + (B). The Divisor is composed of values (gross financial figures added to net financial figures) that are not compatible in Generally Accepted Accounting Principles (GAAP). Adding “before expenses” Gross Sales to “after expenses” Lottery Compensation” in the Divisor of the Income Determination Equation violates GAAP. The Income Determination Equation as specified in **177-040-0061 Casino Prohibition (5)** uses incompatible financial figures (most, if not all, unaudited) that distort the Income Analysis Ratio (Quotient) in such a manner that it provides an inaccurate income analysis Ratio. It does not offer the Director accurate, “...conclusive evidence that an establishment is not a casino.”

OAR 177-040-0061 Casino Prohibition “(5) Income Analysis (d) Business Records:

“For the purposes of this rule, a Lottery retailer must acquire, compile, retain, and make readily available to the Lottery all business sales and expense records that are pertinent to the calculation and determination of the establishment’s total income for a period of 24 months. Required records of the gross non-lottery sales must be detailed and correct including, but not limited to, records of the cost, price and amount of goods sold, bank statements, records of daily sales, and other relevant sales records. Lottery staff shall be allowed to perform examinations of these records, and make any copies necessary to complete the review. Records and accounting information must be reported, at the retailer’s expense, in any form or format reasonably requested by Lottery staff. Retailers operating multiple establishments must separate and complete records as specified in this paragraph for each establishment they operate. In the absence of adequate records, Lottery staff will make a reasonable estimate of annual non-lottery sales based on available records and information. In making a reasonable estimate, the Lottery will only rely on records and information that the Director concludes are credible and accurate.”

The above OAR specifies the business records to be made available for calculation of total income.

At a Hayden Island Neighborhood Network (HINooN) Association General Meeting on December 12, 2012 the then Oregon State Lottery (OSL) Director Larry Niswender was asked if the Video Retailer’s Gross Sales Reports to OSL (Attachment 1) were audited reports. Mr. Niswender’s response was the retailers “self-report” their establishment’s figures on the OSL Gross Sales Report, a Level 3 Restricted OSL Form (See Exhibit A). There is no record the OSL gross sales reports are audited for reporting accuracy.

With non-Lottery revenue being an integral part of the OAR Casino Determination formula, accurate reports are essential to ensure that Video Lottery Retailers are in compliance with Oregon's constitution and administrative rules. Without audited reports there is no reliable way to verify that retailers are in compliance with either the applicable OAR's or the Oregon Constitution. Moreover, as shown earlier, the formula specified in OAR 177-040-0061 is incorrect. It combines retailer self reported, unaudited, gross sales with lottery audited, net revenue.

Furthermore, Mr. Dan Fischer, President of Oregon Restaurant Services Inc. (ORSI), sent a letter to House Speaker Tina Kotek regarding HB 2007 considered in 2013. In that letter, Mr. Fischer acknowledged his reliance on gambling profits. Mr. Fischer reportedly operates 40 lottery delis, including the popular Dotty's chain. The **OSL Comprehensive Annual Financial Report for Fiscal Year ended June 30, 2013 & 2014** lists Dotty's among OSL's top ten retailers for the current year and nine years prior.

Additionally, The Portland Tribune also reported in the March 28, 2012 issue that Mr. Bob Whelan, who has represented many gambling and liquor industry clients and an economist at Portland's ECONorthwest is quoted, *"If it wasn't for the lottery, there would be no Dotty's."* The Tribune likewise reported that for years, Mr. Whelan has inspected the books of many lottery retailers. *"Effectively, they lose money on food and drink and they make it up on lottery. That's been my experience looking at dozens of these businesses. Dotty's is a casino business."* maintains Mr. Whelan. The Tribune article also then reports Mr. Whelan as agreeing the actual cost of hosting video slot machines is minimal, mainly electricity, phone lines and a portion of the space inside bars and restaurants, plus labor costs.

Who in the OSL determines a business to be "viable?" At a House Interim Committee on Human Services and Housing OSL Director Jack Roberts, in a response to a question from then Chair Carolyn Tomei, stated, "OSL doesn't have an obligation to support the businesses. We (OSL) have the responsibility to maximize revenue for the State." So is there any wonder that the "no casino" mandate in the Constitution and OAR's is ignored?

OAR 177-040-0061 Casino Prohibition *"(6) Factors to Consider (a) History cites: "...a longstanding history as a neighborhood pub..." as a factor that may demonstrate that the establishment is not operating as a casino."*

Such an OSL definition of a "neighborhood" is absent in both OAR 177-040 and OAR 177-045. The lack of a "neighborhood" definition encourages the formation of Lottery Impact Areas such as experienced in Lottery Row on Hayden Island and other neighborhoods.

It ignores the longstanding **OAR 177-040-0061 Casino Prohibition** that has been available to the Director to make a casino determination. As a result, we have a proliferation of "neighborhood casinos."

In conclusion, HINooN supports HB 3316 because:

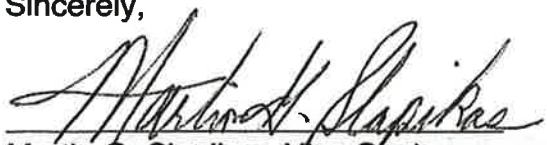
1. Former OSL Director Larry Niswender revealed to HINooN that non-lottery gross sales, a key component of the Income Analysis equation is self-reported and unaudited;

2. The OSL does not offer transparency and oversight on the internal control and compliance of the Agency to the citizens of the State of Oregon;
3. Recent experience with Lottery Row issues on Hayden Island has led to the conclusion that the Oregon State Lottery is inaccurately calculating, (if calculating at all), the ratio involving lottery revenue and non-lottery revenue that would determine if a Video LotterySM retailer is, or is not, operating in conformance with the Constitution of the State of Oregon and applicable Lottery OAR's;
4. The OSL practices "selective non-enforcement" by practicing the absence of any auditing procedures of video LotterySM retailer's non-lottery revenue;
5. Assuming the Casino Determination Ratio is even calculated, the OSL inserts unaudited figures to be included in the Casino Determination formula;
6. The OSL incorporates those unaudited non-lottery gross revenue figures in an Income Analysis Ratio equation in such a manner that inserts incompatible gross sales revenue and net lottery income to render the results inaccurate;
7. The OSL's Classification Internal Operating Policy is such that it exempts, from disclosure, the Video Retailer's "Self Reporting" of the Retailer's Gross Sales Reports further impeding public oversight of the Video Retailers adherence to the Oregon Constitution and the Oregon State Lottery Mission statement;
8. No certifying signature is required on OSL's Gross Sales Report. The following is an example of such certification as required by citizens of Oregon:
"Under penalties of perjury, I declare that I have examined this form, including any attachments, and to the best of my knowledge and belief, it is true, correct, and complete."
No such certification is required on the OSL's Video Lottery retailer's Non Lottery Gross Sales Report; and,
9. The OSL claims no responsibility for the businesses with which they contract.

In summary, the Oregon State Lottery casts a blind eye in upholding the "no casino" provision of Oregon's Constitution. OSL's inability to enforce the "no casino" provision results in a subversion of policy that the Citizens of Oregon deemed important when they enacted the new constitutional amendments. In our opinion, passing HB 3316 will encourage financially viable business to contract with the OSL. It will provide an administrative certainty for all citizens of Oregon.

It is for these reasons that we believe it to be imperative that ORS 461.300 is amended.

Sincerely,



Martin G. Slapikas, Vice Chair
Hayden Island Neighborhood Network (HINooN)

