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2596

June 8, 2007

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INDEPENDENT REGULATORY
REVIEW COMMISSION

Kim Kaufman, Executive Director
Independent Regulatory Review Commission
14th Floor, Harristown 2
333 Market Street
Harrisburg PA 17101

Re: IRRC No. 2596, Department of Revenue Regulations
<u>Pennsylvania Gaming Cash Flow Management</u>

Dear Mr. Kaufman:

I am submitting these comments to the above-referenced final form regulation on behalf of Greenwood Gaming and Entertainment, Inc. ("GGE") which holds a Category 1 slot machine license issued by the Pennsylvania Gaming Control Board ("PGCB") and under that license operates Philadelphia Park Casino in Bensalem, Pennsylvania. Philadelphia Park Casino opened for business on December 19, 2006 and to date has paid the Commonwealth over $68 million in taxes and assessments under Section 1402 of the Pennsylvania Race Horse Development and Gaming Act ("Gaming Act"), 4 Pa. C.S. § 1402. Within this context, GGE has a very serious interest in this set of Department of Revenue ("DOR") final form regulations and thanks the Commission for the opportunity to submit its views regarding the content of the regulations.

HAR:73514.1/PHI273-230266

BACKGROUND

The final form regulations before the Commission pertain to the system of cash management utilized by the PGCB and the DOR in collecting and applying monies due the Commonwealth under the Gaming Act. As you are probably aware, Pennsylvania has an extremely high tax rate on gaming revenues for the four licensed gaming facilities which have opened their doors for business and for those that will open in the future. Taking into account the minimum municipal local share contribution of $10 million, the current statutory tax rate on GGE under the Gaming Act is approximately 57%.

The principal and most powerful competitors for the Delaware Valley gaming dollar are the Atlantic City casinos where the comparable gross rate is 9.25%. Put simply, our client company pays 650% more tax on each gaming dollar that is spent in its casino than its rivals in New Jersey. This means, of course, that it has to manage and operate its business in the most stringent, cost effective manner possible, while still offering quality service and amenities that will keep its customer base here in Pennsylvania.

In this respect, it is noticeable that the Atlantic City casinos are currently conducting a ferocious marketing blitz here to hang on to their significant share of the Pennsylvania market. Free hotel rooms; triple cash back and multi-million dollar drawings have become standard elements in a promotional artillery that has been specifically aimed at GGE's core customer base, *e.g.*, the recent billboard campaign by Trump; Hilton and Resorts at the Street Road exit (to Philadelphia Park) of Interstate I-95.

The Commission will appreciate that, especially in this market environment, whatever additional mandated sum is deducted from GGE's gross gaming revenue has a much greater impact here than it does in New Jersey. For example, a 1.5% deduction from revenue after gaming taxes represents approximately 3.50% of the available revenue before expenses and other charges in Pennsylvania, whereas the same 1.5% deduction in New Jersey is the equivalent of approximately 1.65% of available revenue.

In this respect, GGE has already paid PGCB over $800,000 to reimburse it for its costs through investigatory and filing fees. Finally, as to regulatory assessments, DOR executed a draw down of $800,000 at the beginning of this calendar year as well as an ongoing draw equal to 1.5% of gross terminal revenue plus 1.5% of all complimentary "free" play (which is not statutorily taxable).[1] Overall, this has raised the effective gross tax rate for GGE to approximately 60%.

The result is that with the remaining less than 40% of available gross terminal revenue, GGE must cover all of its operating expenses, pay interest and cover depreciation. On the net revenue left over, it has to pay corporate income tax of 41%, leaving a very small margin to

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1 *See* January 29, 2007 letter from former Secretary Fajt and PGCB Chairman Decker attached hereto as Exhibit "A".

begin to recover the significant investment the company has already made and what it expects to further invest over the next few years. Under this scenario, only if GGE maintains the highest level of operational efficiency can it remain financially viable.

To further understand the economics of a Pennsylvania licensed gaming facility, the following breakdown of a hypothetical facility with $200 million in annual gross terminal revenue is useful:

Gross Terminal Revenue		$200 million
Property Tax Reform	34%	$ 68 million
Race Horse Development Fund	12%	$ 24 million
County Local Share	2%	$ 4 million
Municipal Local Share	5%	$ 10 million
Economic Development Fund	5%	$ 10 million
Regulatory Assessments[2]	1.9%	$ 3.8 million
Other Regulatory Fees[3]	.02%	$ 400,000
Subtotal of Gaming Act Deductions	**60.1%**	**$ 120,200,000**
Remaining Gross Terminal Revenue		**$ 79,800,000**
Operating Expenses	22%[4]	$ 44,000,000
Interest and Depreciation	12.5%	$ 25,000,000
Pre-Tax Income	**5.4%**	**$ 10,800,000**
Corporate Income Tax	41%	$ 4,4000,000
Remaining Income	**3.2%**	**$ 6,400,000**

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2 Based on the draw downs from the Section 1401 deposit fund for the first six months of this calendar year.

3 This is a very approximate figure.

4 This figure presumes an extremely efficient operation. In comparison, the average operating expense ratio for Atlantic City is approximately 34%

Accordingly, if Section 1402 regulatory assessments were increased from 1.5% of gross terminal revenue to 2% of gross terminal revenue, the increase would represent 16% of the remaining income in the previous chart.

Even though the General Assembly has yet to appropriate any monies for gaming regulatory costs to date, the DOR and PGCB have already announced an increase in the level of draw downs from the Section 1401 deposit funds for the coming '07-'08 fiscal year. Under this increase, the calculation of draw downs to Section 1401 deposit accounts will be calculated to add on the direct costs of the Pennsylvania State Police on top of the 1.5% of gross terminal revenue.[5] If implemented, this will again increase the effective tax rate and will further threaten the ability of Pennsylvania licensed gaming facilities to remain viable.

In part based on the fact that New Jersey's regulatory assessment rate to regulate all of the casinos in Atlantic City (and to license their 30,000 employees) was approximately 1.2% of gross revenue for last year, it has always been GGE's position that regulatory assessments in Pennsylvania should be capped at 1.5% of gross terminal revenue. This 1.5% should be based on the statutory definition of "gross terminal revenue" established by the General Assembly and, accordingly, should not include the value of promotional play in the revenue base.

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5 *See* May 14, 2007 letter from Secretary Wolf and Chairman Decker attached hereto as Exhibit "B". Note that, as explained in the letter, in calculating the draw down amounts, the agencies will not utilize the statutory definition of "gross terminal revenue," but instead will add the value of promotional play into the calculation base -- effectively and significantly increasing the amount of the draw down.

Furthermore, while in principal GGE has no objection to paying direct Pennsylvania State Police costs as long as they are necessary to protect public safety, those costs should be included in the 1.5% assessment rate like in the current fiscal year, and should not be treated as an add on to that rate.

STATUTORY BASIS FOR REGULATIONS

The focus of GGE's interest pertains to Section 1001.6 of the regulations which establish a methodology for assessment and collection of the Commonwealth's costs and expenses for regulating Philadelphia Park Casino and the other currently operating and future casinos in the Commonwealth.[6] More specifically, Section 1401 of the Gaming Act requires each slot machine license to deposit $5 million in an account within the State Treasury not later than two business days prior to the opening of the casino. The purpose of the deposit is to secure the reimbursement of the Commonwealth's regulatory costs and expenses incurred by DOR, PGCB, the Pennsylvania State Police and the Attorney General's Office for carrying out their respective responsibilities under the Gaming Act. However, the amount recovered is not without statutory limitation and all sums collected must be included in both the PGCB's annual budget **and approved by the General Assembly through the appropriations process.**[7] Once properly budgeted , appropriated *and actually incurred*, these agency regulatory costs and expenses

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6 To date, five casinos are opened for business and six other gaming entities have been approved for licensure.

7 *See* 4 Pa. C.S. § § 1402, 1402.1

are drawn down from the licensee's $5 million deposit and the licensee is obliged to replenish any draw downs on a weekly basis.

THE DOR REGULATION

Section 1001.6 of the DOR regulations before the Commission is promulgated under these statutory sections and intends to establish the formula or methodology for DOR draw down from the deposit funds. Under the regulation, DOR will issue periodic assessments to slot machine licensees of direct costs for expenses incurred by the four Commonwealth agencies which directly relate to a particular slot machine licensee and which were included in the board's budget and duly appropriated by the General Assembly.[8] As to costs which are not directly attributable to a particular slot machine licensee, which as GGE interprets the regulation are categorized as "general administrative costs," these costs are assigned to each licensee on a *pro rata* basis "at the discretion of the Secretary of Revenue" until all Category 1 and 2 licensed gaming facilities are opened for business.[9]

While, in theory, GGE does not oppose an assessment system under which it bears its direct costs and a fair share of general administrative costs, such a system is only workable, given the overriding taxation scheme, if two things happen. First, the four affected Commonwealth agencies must strictly control agency costs, operate efficiently and eliminate unnecessary waste

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8 Section 1001.6(d)(1).

9 Section 1001.6(d)(3).

in order to assure that only necessary regulation is funded through the legislative appropriations process. In reviewing necessary funding, we should look to the sister state of New Jersey (particularly since Atlantic City casinos are some of our biggest competitors), where regulatory costs have been controlled within reasonable levels based on an assessment of approximately 1.2% of revenue for last year.[10]

Second, the system of cash management must assure that the four (soon to be five) operating casinos do not bear an unfair share of general administrative costs until such time as all 14 authorized casinos are open for business. To allow a loading of the funding obligation for these costs on the casinos which have accelerated investment, opened early and are already generating tens of millions of dollars for the Commonwealth is neither equitable nor supportable. The comprehensive system of regulation which has been implemented under the Gaming Act, including four Commonwealth agencies and a brand new Board, (which was started from scratch and now employs over 200 employees) was not designed to regulate four casinos as is currently the case, but to regulate 14 casinos as is provided for by law. Accordingly, the general administrative costs associated with the comprehensive system of regulation must be equitably shared and amounts properly assigned to future licensed gaming facilities deferred for future collection as casinos are constructed and opened for business.

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10 GGE understands that regulatory cost controls imposed through the appropriations process is primarily within the jurisdiction of Legislature and not within the scope of this rulemaking and or the jurisdiction of this Commission.

While the DOR has shown some willingness to defer some of these general administrative costs through loans from the General Fund and otherwise, it is critical that these calculations and the Section 1401 deposit fund draw downs which result be conducted in a manner which avoids imposition of an unreasonable economic burden on existing operating facilities. Under Section 1001.6(d)(3) of the DOR regulations before the Commission, total discretion is assigned to the DOR Secretary to design the allocation and recovery of general administrative costs until such time as all casinos are up and running. While GGE certainly hopes the DOR Secretary is sensitive to the economic impact of any allocation and recovery of these costs, further controls are necessary to assure fairness and equity.[11] Implementing such controls on the regulatory assessment process is normal and assures that the calculation and recovery of assessments is not conducted in an arbitrary manner.[12]

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11 As indicated previously, the formula announced for the upcoming fiscal year increases draw downs over this fiscal year, departs from the statutory revenue base upon which the calculation should be made, is being imposed without disclosure of the underlying basis for the formula and would impose an undue economic burden on the four operating Pennsylvania casinos. Furthermore, in the past, the PGCB and DOR have announced even more draconian formulas for calculation of Section 1401 deposit fund draw downs. *See* email of December 18, 2006 and letter of January 11, 2007 attached hereto as Exhibit "C".

12 *See, e.g.*, Section 510 of the Public Utility Code, 66 Pa.C.S. § 510 which establishes a very detailed and non-discretionary system of regulatory assessments governing public utility assessments. Under Section 510(a), a cap on utility assessments is established at .3 of 1% of the prior calendar year jurisdictional utilities' gross intrastate operating revenues.

Because it is uncertain when and where future licensed gaming facilities will open and the level of their future gross terminal revenue as they start to conduct business, the simplest and most effective mechanism for assuring that administrative discretion is exercised without imposing undue financial burden on the regulated industry is by imposing a cap on the overall assessment level. As indicated previously, a cap of 1.5% of "gross terminal revenue," as that term is defined by 4 Pa.C.S. § 1103, to cover all direct costs and a fair share of general administrative costs is a reasonable cap -- a cap that exceeds the last year's regulatory assessment level for the New Jersey Casino Control Commission by 25% and should assure that operating casinos in Pennsylvania contribute their fair share to funding the comprehensive gaming regulatory system in Pennsylvania. Attached as Annex "A" hereto, is a redlined section of Section 1001.6(d)(3) which proposes language which would impose just such a cap and would result in a regulation which assures fairness and equity as Pennsylvania's infant gaming industry develops and expands.

GGE respectfully requests that the Commission disapprove DOR regulation No. 2596 until such time as the regulation is delivered to include provision for a 1.5% annual cap on DOR discretion on section 1401 deposit account draw downs.

Respectfully submitted,

Alan C. Kohler
For WOLF, BLOCK, SCHORR and SOLIS-COHEN LLP

cc. Hon. Patrick M. Browne, Majority Chair
Hon. John N. Wozniak, Minority Chair
Hon. David K. Levdansky, Majority Chair
Hon. Steven R. Nickol, Minority Chair
Hon. Arthur Coccodrilli
Hon. Alvin C. Bush
Hon. David M. Barasch, Esq.
Hon. David J. DeVries, Esq.
Hon. John F. Mizner, Esq.
Scott Schalles, IRRC
Mary Sprunk, DOR
Richard Gmerek, Esq.
Eugene Knopf

<u>ANNEX A</u>

§ 1001.6 d(3) General administrative costs of the Commonwealth not specifically assessed to a licensed gaming entity under paragraph (1), shall be borne by each licensed gaming entity on a prorata basis, at the discretion of the Secretary of Revenue until such time as all Category 1 and Category 2 licensed gaming entities are operating as permitted under the act. <u>In no case shall the discretion of the Secretary of Revenue be exercised in a manner which results in a total assessment under this Section which exceeds an annual assessment rate of 1.5% of gross terminal revenue, as that term is defined in 4 Pa. C.S. § 1103.</u>

Exhibit A

PENNSYLVANIA GAMING CONTROL BOARD
HARRISBURG PENNSYLVANIA
17106-9060

January 29, 2007

Alan C. Kohler, Esq.
Wolf Block Schorr & Solis-Cohen, LLP
213 Market Street, 9th Floor
Harrisburg, PA 17101

Dear Mr. Kohler:

We are writing to inform you that, as authorized by the provisions of the Pennsylvania Race Horse Development and Gaming Act, the Secretary of Revenue will begin to draw against the accounts established under Section 1401 of that Act.

Despite ongoing discussions, including a series of exchanges of correspondence with interested and affected parties, no global resolution of the chargeback issue has been found that addresses funding for the upcoming FY 07-08 budget year. As a result, and to allow the Gaming Control Board to continue to operate past February 9, 2007, we will implement a method to draw down funds that meets the immediate requirements of the Gaming Control Board, but that does not address the outstanding costs of the Pennsylvania State Police or the Department of Revenue. These deferred costs will in all likelihood have to be covered in next year's budget. This method may be used through June 30, 2007 and will apply to all licensees beginning operation during that timeframe. However, it will not be considered as precedent or binding since it is neither realistic nor sustainable beyond June 30 of this year. As we have noted in prior correspondence, to maintain strict regulatory oversight going forward, the ongoing cost of regulation, given each agency's current plans, is anticipated to be about 1.8 to 1.9% of gross terminal revenue at stabilized operation. This is consistent with costs in similar states.

Pursuant to his authority under the Act, the Secretary of Revenue will draw a flat amount of $800,000 from each licensee's Section 1401 account on the first draw, which will take place on January 31, 2007. This amount will be treated similarly to the existing $36.1 million General Fund loan and will be recovered through compensating charges when all 14 licensees are up and running. Additionally, the Secretary will continue to draw against each licensee's account at the rate of 1.5% of gross terminal revenue through the remainder of this fiscal period which ends June 30, 2007. The initial draw will also include an amount calculated at 1.5% of gross terminal revenue earned retroactive to the date of each licensee's opening. Gross terminal revenue is calculated by subtracting amount won from wagers received as shown on the daily invoice without excluding promotional play.

We will continue to explore with the current decision makers the available options for continued funding of the Gaming Board, the Department of Revenue, the State Police and the Attorney

General through FY 07-08 and early 08-09 as we bring additional lice ısees online, and thereafter as we move into stabilized regulation of this growing industry.

As always, we are available to meet with you and your representat· es to explain this approach in more detail and to discuss strategies for addressing the regulatory requirements of the Gaming Board and related entities going forward.

Sincerely,

Thomas A. Decker
Thomas A. Decker,
Chairman, Pennsylvania Gaming
Control Board

Sincerely,

Gregory C. Fajt
Gregory C. Fajt
Secretary of Revenue

TAD/dka

Exhibit B

PENNSYLVANIA GAMING CONTROL BOARD
P.O. BOX 69060
HARRISBURG, PENNSYLVANIA
17106-9060

Phone: (717) 346-8300
Fax: (717) 703-2986

May 14, 2007

Via Facsimile
Mr. David Jonas, COO and General Manager
Greenwood Gaming and Entertainment, Inc.
3001 Street Rd
Bensalem, Pa 19020

Dear Mr. Jonas:

We are writing to advise you of the method that will be used to draw against the accounts established under Section 1401 of the Pennsylvania Race Horse Development and Gaming Act during Fiscal Year 07-08 which begins on July 1, 2007. We received two responses to the last communication on this matter dated January 29, 2007, suggesting that certainty and consistency are important in the assessment of expenses. With those comments in mind, we intend to implement a procedure that incorporates both consistency with current practice and certainty for gaming licensees going forward.

We intend to continue the current procedure described in the letter dated January 29, 2007 of drawing a flat amount of $800,000 from each licensee's Section 1401 account on the first draw after they come online. Additionally, the Secretary of Revenue will continue to draw against each licensee's account at the rate of 1.5% of gross terminal revenue during the next fiscal year. Gross terminal revenue for this purpose will continue to be calculated as it currently is by subtracting amount won from wagers received as shown on the daily invoice without excluding promotional play.

In addition to these draws, beginning in FY 07-08, the Secretary will withdraw the share of the Pennsylvania State Police budget allocable to each licensed entity from that entity's section 1401 account. The PSP will allocate their costs to each individual entity based on the actual personnel and operating expense at each venue and its share of the headquarter expense.

The remaining funding required to cover the budgets approved by the General Assembly for the regulatory agencies will be covered by a loan (from sources other than the Commonwealth's General or Gaming Funds) that the Pennsylvania Gaming Control Board will obtain. The loan will be treated similarly to the existing $36.1 million loan from the Gaming Fund which will be recovered from all licensees when all 14 licensees are up and running.

We appreciate your prior input on these matters and, as always, will be happy to discuss this matter with you. We would also be happy to have any additional ideas you might have about this as long as they continue to assure the same level of regulation and are fair to all licensees.

Sincerely,

Thomas A. Decker
Chairman

Sincerely,

Thomas W. Wolf
Secretary of Revenue

Exhibit C

-----Original Message-----
From: McNulty, Eileen [mailto:emcnulty@state.pa.us]
Sent: Monday, December 18, 2006 5:28 PM
To: Welty, Patricia A.; Kohler, Alan C.
Cc: Donaghue, Frank (PGCB); Zettlemoyer, Christopher
Subject: RE: Thank you

Attached please find the documentation you requested this morning concerning the budgets approved by the PGCB and the calculation of the amounts to be charged to the accounts established under section 1401 of Act 71 of 2004. Please let me know if you have any further questions or desire a further reply to the letter just delivered to my office.

PGCB FY06-07 thru FY07-08 Adminstrative Chargeback

Note: Calculations of chargebacks based on the following opening dates:

Facility	Opening Date
Philadelphia Park	Dec-06
Chester Downs	Jan-07
Meadows	May-07
Pocono Downs	Nov-06
Presque Isle	Feb-07
Penn National	Jan-08
Cat 2	Dec-07
Cat 2	Dec-07
Cat 2	Jun-08
Cat 2	Jun-08
Cat 2	FY08

Chargeback to Casinos

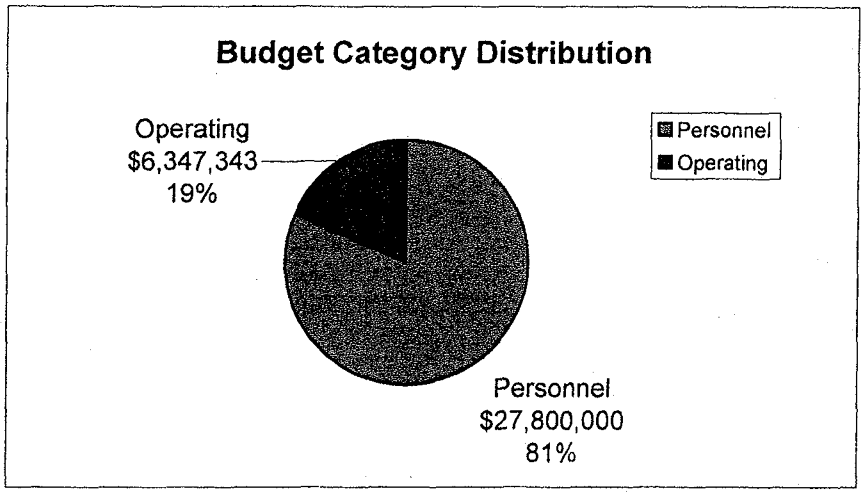
PGCB - FY06	11,235,000.00
PGCB - FY07	34,147,343.00
PSP - FY06	4,000,000.00
PSP - FY07	15,143,372.00
DOR - FY06	1,142,004.00
DOR - FY07	9,273,413.00
Attorney General - FY06	406,185.00
Attorney General - FY07	799,477.00
Total Chargeback	**76,146,794.00**

Chargeback Calculation by Facility

Facility	Estimated GTR	Chargeback as % of GTR	Chargeback Amount
Philadelphia Park	$418,411,500	5.00%	$20,920,575
Chester Downs	$361,460,000	5.00%	$18,073,000
Meadows	$154,292,688	5.00%	$7,714,634
Pocono Downs	$169,533,000	5.00%	$8,476,650
Presque Isle	$187,000,000	5.00%	$9,350,000
Penn National	$82,536,000	5.00%	$4,126,800
Cat 2	$91,605,000	5.00%	$4,580,250
Cat 2	$67,965,000	5.00%	$3,398,250
Cat 2	$0	5.00%	$0
Cat 2	$0	5.00%	$0
Cat 2	$0	5.00%	$0
Total	**$1,532,803,188**	**5.00%**	**$76,640,159**

PGCB
FY 2007-08 Budget Request

Total Budget Request $34,147,343



Complement

Total	342

Operating Budget Summary

Real Estate	$1,649,518	26.0%
Information Technology	$995,600	15.7%
Specialized Services	$783,075	12.3%

Source of Funds

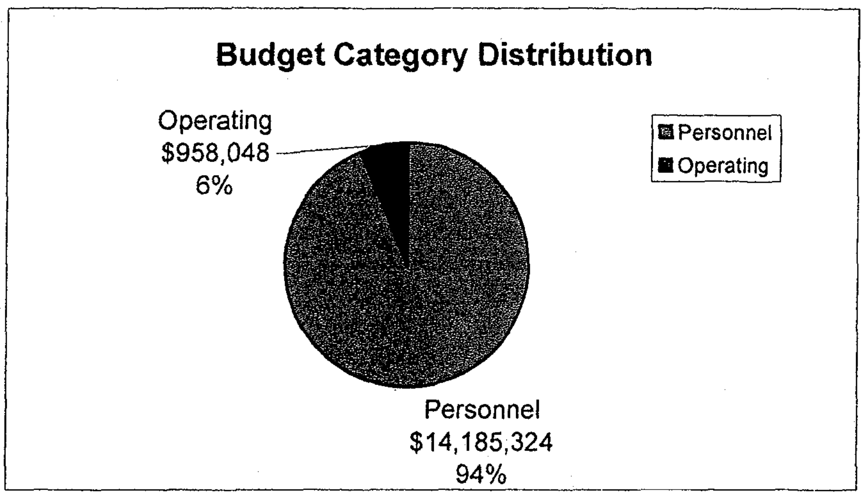
Casino Chargeback	$34,147,343	100.0%
Total	**$34,147,343**	**100.0%**

Fiscal Year Comparison

	FY2006-07	FY 2007-08	Difference	% Change
Personnel	$20,320,539	$27,800,000	$7,479,461	26.9%
Operating	$6,114,461	$6,347,343	$232,882	3.7%
Total	**$26,435,000**	**$34,147,343**	**$7,712,343**	**22.6%**

PSP
FY 2007-08 Budget Request

Total Budget Request $15,143,372



Complement

Total	139

Operating Budget Summary

Radio Equipment	$214,462	22.4%
AFIS Equipment	$217,092	22.7%
Vehicles	$255,414	26.7%

Source of Funds

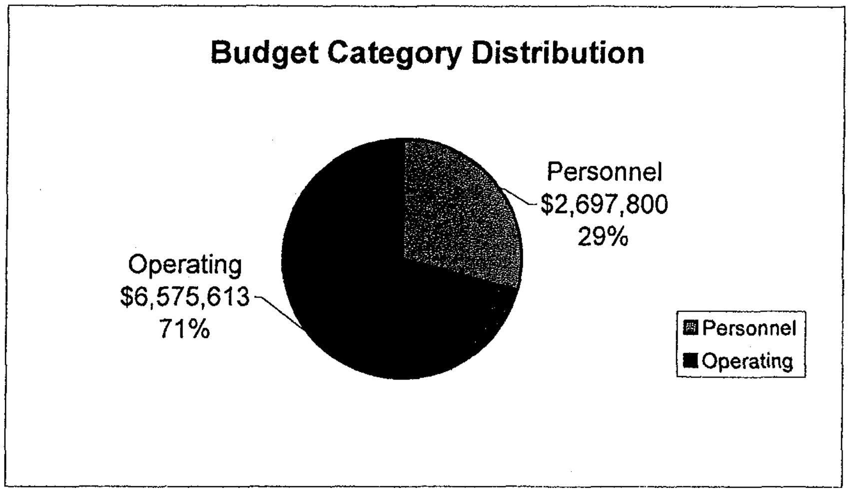
Casino Chargeback	$15,143,372	100.0%
Total	**$15,143,372**	**100.0%**

Fiscal Year Comparison

	FY2006-07	FY 2007-08	Difference	% Change
Personnel	$8,989,241	$14,185,324	$5,196,083	36.6%
Operating	$1,136,889	$958,048	($178,841)	-18.7%
Total	**$10,126,130**	**$15,143,372**	**$5,017,242**	**33.1%**

DOR
FY 2007-08 Budget Request

Total Budget Request $9,273,413



Complement

Total	42

Operating Budget Summary

Central Control Computer	$5,934,685	90.3%
Change Orders for CCS	$500,000	7.6%
Travel	$72,000	1.1%

Source of Funds

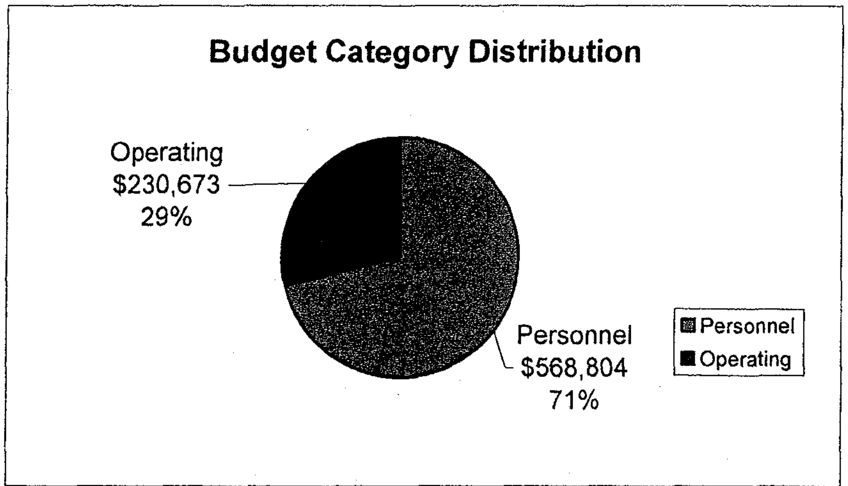
Casino Chargeback	$9,273,413	100.0%
Total	**$9,273,413**	**100.0%**

Fiscal Year Comparison

	FY2006-07	FY 2007-08	Difference	% Change
Personnel	$1,205,481	$2,697,800	$1,492,319	55.3%
Operating	$5,685,329	$6,575,613	$890,284	13.5%
Total	**$6,890,810**	**$9,273,413**	**$2,382,603**	**25.7%**

Attorney General
FY 2007-08 Budget Request

Total Budget Request $799,477



Complement

Total	5

Operating Budget Summary

Expert Witnesses	$100,000	43.4%
Operating	$52,200	22.6%
Extensive Travel	$24,000	10.4%

Source of Funds

Casino Chargeback	$799,477	100.0%
Total	**$799,477**	**100.0%**

Fiscal Year Comparison

	FY2006-07	FY 2007-08	Difference	% Change
Personnel	$271,112	$568,804	$297,692	52.3%
Operating	$135,073	$230,673	$95,600	41.4%
Total	**$406,185**	**$799,477**	**$393,292**	**49.2%**

PENNSYLVANIA GAMING CONTROL BOARD
HARRISBURG PENNSYLVANIA
17106-9060

January 11, 2007

Alan C. Kohler, Esq.
Wolf Block Schorr & Solis-Cohen, LLP
213 Market Street, 9th Floor
Harrisburg, PA 17101

Dear Mr. Kohler:

We are writing to notify you that the Pennsylvania Department of Revenue (the "Department"), acting on behalf of the Pennsylvania Gaming Control Board (the "Board"), will now seek reimbursement, in accordance with Section 1402 of the Pennsylvania Race Horse Development and Gaming Act ("Act"), 4 Pa. C.S. § 1101et seq., from each licensed slot machine operator. See 4 Pa. C.S. § 1402.

In an effort to reduce costs while still maintaining a strict regulatory environment, as mandated by the Act (and as exemplified by the operations of our counterparts in New Jersey), the Board has reduced its overall total expenditures by more than 10% through cost reduction and the elimination of selected outsourcing requirements, the Department has committed to reduce its budget by 10% and we intend to ask the Pennsylvania State Police to also reduce their budget by 10%. After these net operating reductions, the net operating expenditures for FY 06-07 are $14.3 million and the net operating expenditures budget for FY 07-08 are $52.6 million.

As you are aware, the Act as amended provides that the costs and expenses of the Board, the Department, the Pennsylvania State Police, and the Attorney General that are associated with the implementation of gaming in this Commonwealth be reimbursed by the licensed slot machine operators through their Section 1401 Accounts.[1] To implement this requirement, the Department intends to withdraw an equal share from each licensee's Section 1401 Account over the course of a 365 day period. We do not presently anticipate this amount to exceed $5 million, based upon the projected scheduled opening dates of the eleven licensed slot machine operators. These projections assume that the anticipated opening dates will not be delayed as a result of a lawsuit or other

[1] Pursuant to Section 1401 of the Act, each slot machine licensee is required to establish an account within the State Treasury with an initial deposit of $5 million (the "Section 1401 Account"). 4 Pa. C.S. §§ 1401(a) and (b). The Section 1401 Account must be established by the slot machine licensee no later than two (2) business days prior to the commencement of its slot machine operations. Id. at § 1401(b). On a weekly basis, the slot machine licensee is required to deposit funds into the Section 1401 Account in an amount equal to the amount deducted by the Department so that a $5 million balance is maintained. Id. at § 1401(c).

unforeseen event. In accordance with Section 1402(a), monies would be withdrawn, as needed, to cover agency expenses on a weekly basis. Id. at § 1402(a). The 365 day period would begin on the day the Section 1401 Account was established.

Under this proposal, the amount contributed by each licensed slot operator during the course of the fiscal year would vary due to the staggered openings of the slot machine facilities and the creation of the corresponding Section 1401 Accounts. The Board and the Department estimate that this method of withdrawing from the Section 1401 Accounts would be in place for no more than two consecutive 365 day periods for each licensed operator, commencing on the initial date of their respective openings. This plan would allow all regulatory and enforcement agencies to receive the necessary funding to meet their projected budgetary needs until all eleven licensees are in operation which is expected to occur in December, 2008 (the "start-up").

At that time, the Board and the Department intend to transition to weekly deductions from the Section 1401 Accounts based on a percentage of Gross Terminal Revenue ("GTR"), as discussed below. We also intend to implement for a limited period a "true up" of the payments by the initial licensees/operators of a portion of the agencies' expenses during this start-up period through a reduced share of the agencies' future expenses after the start-up period. Following such true up, each licensee would be required to pay the identical percentage of its gross terminal revenue to reimburse the Board's expenses. We currently anticipate that when all fourteen licensees are in operation, the percentage will be reduced to between1.5% to 1.8%.

Although the Department will implement the above method for collecting agency reimbursements from each slot machine licensee, we will continue to examine all viable alternatives for the collection of future reimbursements. In particular, the Department and the Board are currently reviewing the two alternative proposals described below.

The first alternative proposal, which the Board is actively pursuing at this time, calls for the imposition of a 2.9% charge against GTR for each licensee. The remaining funding would come from a loan obtained from a commercial source. In order for the Board to enter into such a loan agreement, the Department almost certainly will be required to agree that, in the event of a default on the loan by the Board, the Department will draw down on the Section 1401 Accounts to cover the amount necessary to satisfy the loan amount.

In the alternative, the licensed operators may have to act as guarantors of the loan. It is anticipated that any such loan will only require the payment of interest for the first few years and that the payments on the principal interest will subsequently be amortized over no less than five (5) years. All interest and principal payments will be considered an expense of the Board, to be repaid consistent with the requirements of section 1402 of the Act. Once all licensees have commenced operations, the Department would collect reimbursements through the withdrawal of funds from the Section 1401 Accounts based on a percentage of a licensee's GTR.

Under the second alternative proposal, the Department, pursuant to Section 1001.6 of its regulations, would collect reimbursements through a weekly deduction from the Section 1401 Accounts in amount equal to 4.3% of each licensed operator's weekly GTR. See 61 Pa. Code § 1001.6. The deductions would begin on January 16, 2007, and would be applied to revenue received on or after

January 1, 2007. We project that the assessed percentage of 4.3% will remain consistent until a stabilized year is reached, when all eleven of the current slot machine licensees are operational. At such time, it is contemplated that the assessed percentage of GTR will be reduced for each slot machine licensee. Again, these projections assume that the anticipated opening dates will not be delayed as a result of a lawsuit or other unforeseen event.

It is worth noting that the Board with the cooperation of the Department, and the anticipated cooperation of the Pennsylvania State Police and the Attorney General, will have all reduced their budgets to the minimal level necessary to maintain the strict regulatory environment mandated by the Act and exemplified by the New Jersey Casino Control Commission and Division of Gaming Enforcement. In doing so, our agencies benchmarked their compliment against those of other gaming jurisdictions, and we believe that our numbers are within acceptable levels for the type of strict regulatory oversight contemplated by the Act and required to ensure the safety and security of the citizens of the Commonwealth and of the gaming industry as a whole.

We invite your reactions to the Department's selected approach and to the alternative proposals outlined herein.

Sincerely,

Thomas A. Decker,
Chairman, Pennsylvania Gaming
Control Board

Sincerely

Gregory C. Fajt
Secretary, Department of Revenue

TAD/dka
cc: Counsel of each Approved Slot Machine Operator
Mr. John Estey, Chief of Staff, Governor's Office