Economic Impact Analysis
Virginia Department of Planning and Budget

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11 VAC 10-45 – Advance Deposit Account Wagering

Virginia Racing Commission

March 11, 2004

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. The analysis presented below represents DPB's best estimate of these economic impacts.

Summary of the Proposed Regulation

§59.1-369 of the Code of Virginia mandates that the Virginia Racing Commission promulgate regulations and conditions under which horse racing with pari-mutuel wagering be conducted in the Commonwealth. In addition, Chapter 682 of the 2003 Acts of Assembly amended the Code of Virginia to require that the Virginia Racing Commission promulgate regulations and conditions that regulate and control pari-mutuel wagering, permissible under the Interstate Horseracing Act, in which an individual may establish an account with an entity approved by the Virginia Racing Commission to place pari-mutuel wagers in person or electronically. Such regulations are to include (i) standards, qualifications, and procedures for the issuance of a license to such an entity, (ii) provisions regarding access to books, records, and memoranda and submission to investigations and audits, and (iii) provisions regarding the collection of revenues due to the Commonwealth from the placing of these wagers. With the exception of this method of pari-mutuel wagering, all other wagering on simulcast horseracing is to take place at a licensed racetrack or satellite facility.

The proposed regulation (1) establishes licensure requirements for individuals and entities conducting account wagering in Virginia, (2) specifies operating and other requirements in order for licensees to maintain or renew their license, (3) details the amount of the application fee, the licensure fee, and other fees to be charged by the Virginia Racing Commission (VRC), (4) specifies the distribution of source market fees, (5) establishes penalties for violation of the regulation, and (6) prohibits the use of any computers owned or leased by the Commonwealth or its subdivisions, by public elementary and secondary schools, and by public colleges and universities from being used for making pari-mutuel wagers.

The proposed regulation was adopted as an emergency regulation in 2003.

Estimated Economic Impact

Description of Regulation:

Chapter 682 of the 2003 Acts of Assembly amended the Code of Virginia to require that the Virginia Racing Commission (VRC) promulgate regulations and conditions that regulate and control pari-mutuel wagering, permissible under the Interstate Horseracing Act, in which an individual may establish an account with an entity approved by the Virginia Racing Commission to place pari-mutuel wagers in person or electronically. This form of gambling is known as advance deposit account wagering. Prior to the amendment, advance deposit account wagering occurred in Virginia without any regulatory oversight. The amendment makes it illegal to conduct this type of wagering in Virginia without a license. Individuals will now be legally allowed to place bets by phone or via the Internet to licensed businesses in Virginia and in other states that specifically permit these activities.

The proposed regulation establishes licensure requirements for individuals and entities conducting advance deposit account wagering in Virginia, including the application and license renewal procedures. A non-refundable application fee of $5,000 is to be paid to VRC at the time of application. The applicant is to be billed for any costs in excess of $5,000 incurred by VRC in reviewing the application. The application fee is intended to cover, among other things, the cost of a background investigation of the applicant (by VRC or by the Virginia State Police) and the cost of a review of the application by outside counsel. Licenses are to be valid for the calendar year in which they are issued and applications for renewal are to be received by VRC by 5.00pm on December 1 of each year. In addition to the application fee, individuals and entities seeking a license or seeking to renew their license are required to pay an annual $1,000 licensure fee. This fee is intended to cover any enforcement costs and the costs to review and monitor the activities of the licensee during the course of the year. Finally, VRC is to receive 0.5% of the gross handle from the source market area (which is the entire state for the purpose of this regulation), to be paid to VRC by the 10^{th} day of each month.

The proposed regulation also specifies the distribution of source market fees. Source market fees are a percentage of the total amount of money bet in the source market area payable by the licensee to the racetrack and to the majority horsemen's association. The percentage is to be based on a contractual agreement between the various parties. In case of a single racetrack licensee, the account wagering licensee is required to distribute the source market fee to the racetrack on the 10^{th} of each month and to the horsemen's association within 48 hours after receiving the money. The regulation also specifies the distribution of source market fees in case of more than one racetrack licensee (this provision is not currently applicable as Colonial Downs is the only licensed racetrack in Virginia). According to VRC, these requirements are similar to those applied in other states, such as California and Oregon, which allow advance deposit account wagering.

The proposed regulation also establishes operating and other requirements in order for licensees to maintain and renew their license. Operational requirements include submitting proof to VRC every six months that account holders will be guaranteed the full value of their accounts regardless of the activities of the licensee and other entities, ensuring that all employees working on behalf of the licensee are permitted or licensed by VRC, and submitting quarterly reports detailing all account wagering activity. Other requirements include allowing wagers to be placed only on behalf of established account holders, administrative requirements dealing with opening and managing advance deposit wagering accounts, and record-keeping requirements that allow VRC to review and monitor the activities of licensees. The proposed regulation also establishes penalties for violation of the regulation. Failure to comply with any of the requirements of the regulation or failure to get a license could result in the imposition of fines and suspensions and criminal or civil prosecution.

Finally, the proposed regulation prohibits the use of any computers owned or leased by the Commonwealth or its subdivisions, by public elementary and secondary schools, and by public colleges and universities from being used for making pari-mutuel wagers. This provision is required under the Code of Virginia.

Estimated Economic Impact:

The proposed regulation is likely to impose additional costs on businesses seeking to conduct advance deposit account wagering. These businesses will now be required to pay a non-refundable application fee of $5,000, any additional costs in excess of the $5,000 incurred by VRC in reviewing the application, a license fee of $1,000 for the issuance and renewal of licenses, a fee of 0.5% of the gross handle from the sources market area to VRC, and a negotiated percentage of the gross handle from the source market area to the licensee racetrack (currently only Colonial Downs) and the recognized majority horsemen's association.

The non-refundable application fee of $5,000 was determined based on a $3,000 estimate for outside counsel to review an application (charged at an hourly rate of $120). Applications tend to be between 500 and 1,000 pages long. In addition, the application fee is to cover the cost of background investigations. According to VRC, the cost of background investigations varies greatly depending on the applicant, with some investigations costing over $20,000. Any cost in excess of $5,000 incurred by VRC in reviewing the application is to be covered by the applicant. VRC believes that the non-refundable $5,000 base fee is the minimum required to cover the cost of reviewing an application. It is also the minimum required to cover costs incurred by the agency when an application is withdrawn midway through the process. In addition to the application fee, applicants will be required to pay an annual license fee of $1,000 in order to receive or renew a license. This fee is intended to cover the enforcement costs and the cost of reviewing and monitoring the activities of the licensee during the year. Only two other states, California and Oregon, currently allow advance deposit account wagering. According to VRC, neither of the two states charges an application fee. However, they do charge significantly higher annual license fees.

It should be noted that the proposed fee structure for the application fee could be designed in a more efficient manner. In order for VRC to charge applicants the exact cost to the agency in reviewing an application, it would be more appropriate for the agency require applicants to make a $5,000 deposit, rather than charging a $5,000 non-refundable fee. The cost to the agency to review the application, conduct background investigations, and have outside counsel review the application varies from applicant to applicant. These costs could be charged against the $5,000 deposit. Any deposit in excess of these costs could be returned to the applicant following the review. An economically efficient fee is one that charges an applicant the exact cost incurred by the agency in conducting the review. The proposed fee structure is efficient insofar that it allows the agency to charge applicants any costs in excess of $5,000. However, it could be made even more efficient by allowing for the refund of any money in excess of the cost of the review.

The regulation also proposes to charge businesses conducting advance deposit wagering 0.5% of the gross handle, to be paid to VRC by the 10th day of each month. Revenue generated from the handle is to be deposited in the State Racing Operations Fund, with any excess revenue deposited in the general fund at the end of each fiscal year. According to VRC, the 0.5% handle is consistent with the license tax charged when wagering at Colonial Downs or a satellite facility and with similar regulations in other states. Applicants are also required to pay a certain percentage of the gross handle to the licensee racetrack and to the horsemen’s association. VRC expects between 7% and 8% of the total handle to be divided between Colonial Downs and the horsemen’s association.

According to VRC, Virginians are wagering approximately $28 million a year. Of this, approximately 80% (or $22.4 million) are through offshore accounts. There is a great deal of uncertainty in estimating the gross handle from the source market area that the proposed regulation will be successful in capturing. VRC expects the racetrack and the horsemen’s association to get approximately $150,000 each in the first year of operation under this regulation. Future revenues will depend on the number of businesses currently engaging in these activities that choose to become licensed in Virginia.

In addition to the above costs, the proposed regulation is also likely to produce economic benefits. By establishing licensing requirements, the proposed regulation will allow VRC to monitor businesses engaged in advance deposit account wagering and protect individuals utilizing these companies to place wagers from financial and other types of fraud. Businesses involved in advanced deposit account wagering have the potential to create a public hazard by conducting their activities in an improper or inappropriate manner. The aim of the proposed regulation is to enforce certain compulsory minimum standards of operation for such businesses and to reduce the risk to the public from their activities. Thus, the cost of applying for and obtaining a license can be viewed as part of the compliance cost incurred by these businesses to ensure that they do not create a public hazard. Prior to promulgation of the emergency regulation, these businesses were paying none of the costs associated with the risk posed to the public from their activities. This could potentially have resulted in unsuitable and undesirable individuals and entities entering the business. Charging fees that reflect the cost associated with reducing the risk to the public from the activities of these businesses to an acceptable level is likely to result in more efficient allocation of resources.

The net economic impact of the proposed application and licensure fees will depend on whether the fees being charged are commensurate with the risk posed to the public from the activities of advance deposit account wagering businesses. If fees are commensurate with the risk, the proposed application and license fees are likely to lead to a more efficient allocation of resources and produce a positive net economic impact. However, if the fees being proposed are in excess of the cost of reducing the risk to the public, the proposed fees are likely to lead to a waste of resources and have negative economic impact. According to VRC, the fees being proposed are the minimum required to ensure that the risk to the public from the activities of these businesses is reduced to an acceptable level.

VRC is not aware of any problems with businesses that have been conducting advance deposit wagering prior to the promulgation of the emergency regulation. Thus, the extent of the risk to the public from such activities is unclear. By setting a minimum of $5,000 for the application fee and $1,000 for the issuance and renewal of a license, the proposed regulation could very well be charging applicants a fee that is in excess of the risk they pose to the public from their activities. As suggested earlier, a fee structure that allowed for the refund of any unused portion of the application and licensure fee would be more appropriate and would reduce the likelihood of the fees producing a negative economic impact.

In addition to the application and license fees, the proposed regulation also imposes additional costs on businesses conducting advance deposit account wagering in the form of payments of a percentage of the gross handle to VRC, the licensee racetrack, and the horsemen’s association. The net economic impact of these payments will depend on whether the benefits to the licensee and to the public from these fees are greater than or less than the proposed costs. While any benefits associated with the application and license fee are in the form of a reduced risk to the public from advanced deposit account wagering, the benefit of paying a percentage of the gross handle to VRC, the licensee racetrack, and the horsemen's association is not readily apparent. While the 0.5% handle fee is necessary in order to ensure that advanced deposit account wagering does not receive a competitive advantage compared to other methods of wagering (a similar tax is charged when wagering in person at the racetrack or its satellite facilities), the benefits of such payments are not clear. Thus, the net economic impact of a percentage of the gross handle being paid to VRC, the licensee racetrack, and the horsemen's association will depend on whether the payment provides the licensee with any benefits (such as improved horseracing and other related services provided by the state, improved racing facilities, and better and more interesting races being run in Virginia) and whether any of these benefits are greater than or less than the additional cost to businesses conducting advance deposit account wagering.

Overall, the net economic impact of the proposed change will depend on whether the benefits of the proposed regulation to the public (in terms of reducing the risk to the public from these activities) and to the licensees themselves (in terms of better horseracing facilities, an improvement in the quality of races, etc.) are greater than or less than the additional cost to businesses conducting advance deposit account wagering. A precise estimate of the benefits of the proposed regulation to the public and to the licensee is not available at this time.

Businesses and Entities Affected

The proposed regulation will affect all businesses and entities seeking to conduct advance deposit account wagering in Virginia. These businesses will now be required to obtain and maintain a license in order to be able to conduct these activities. The additional costs include a $5,000 non-refundable application fee, payment of any costs in excess of $5,000 incurred by VRC in reviewing the application, a $1,000 annual fee for the issuance and renewal of a license, payment of 0.5% of the gross handle from the source market area to VRC, and payment of a negotiated percentage of the gross handle from the source market area to the licensee racetrack and the recognized majority horsemen's association.

There are 28 businesses currently operating in the United States that conduct advance deposit wagering activities. VRC currently has applications pending from five of these businesses. The agency expects two or three more applications in the future.

Localities Particularly Affected

The proposed regulation will apply to all localities in the Commonwealth. However, it is not likely to impose any additional costs on localities.

Projected Impact on Employment

The proposed regulation is not likely to have a significant impact on employment. To the extent that the proposed regulation captures some of the gross handle from betting by Virginians, it could lead to a shift of employment toward horseracing-related activities.

Effects on the Use and Value of Private Property

Businesses conducting advanced deposit wagering activities will now incur additional licensing and other costs, lowering their asset value. However, by establishing standards of operations for such businesses, the proposed regulation could encourage more Virginians to use advance deposit account wagering, mitigating some of the negative impact on the asset value of businesses engaged in these activities. The proposed regulation is also likely to provide additional funds to the licensee racetrack (Colonial Downs) and to the horsemen’s association, raising the asset value of these businesses.