

STATE OF MONTANA
DEPARTMENT OF JUSTICE
GAMBLING CONTROL DIVISION

DATE Feb. 1, 2005
HB 2: Dept. of Justice

Mike McGrath
Attorney General

January 27, 2005



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MEMORANDUM

TO: Harry Freebourn, Legislative Fiscal Division
FROM: Rick Ask
Subject: Bearing Point Report

Per our phone conversation this afternoon, enclosed is a report commissioned by the division from Bearing Point last year. The report Senator Schmidt requested at our meeting this morning – a comparison of video gambling machine tax rates among those who have authorized the activity – can be found on page 22 of section 3 (found under report segment divider number 5).

As I mentioned this report was commissioned to help the division decide what direction to take, technologically, after the vendor with whom we had contracted to provide the original AARS failed to deliver. If you find the report helpful and think it would be worthwhile to provide to all committee members, let me know and we'll have extra copies delivered.

If you have any other questions or concerns please let me know.

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3 JURISDICTIONAL REVIEW

3.1 HISTORY OF THE SLOT MACHINE AND VIDEO GAMBLING MACHINE

The story of slot machines started in San Francisco in the mid 1800's. The discovery of gold in California brought many adventurers. The people who came over were free from the limitations of their families and their church back in the east. They therefore indulged in as many forms of gambling as possible. Bets were made on anything from bullfights to card games.

Coin operated game machines, which were first developed in the East during the late 1880's, gained great popularity in San Francisco. Bars, saloons and cigar shops were prime spots for them.

Early slot machines included various spinning wheels, arrows, and coins dropping through metal pins. These early models relied on employees to provide payouts to winners instead of winnings being dispensed from the machine, as is commonplace today. During this period, gambling was frowned upon and outlawed. To circumvent this, the slot machines were called trade stimulators. Basically, instead of receiving a cash payment for winnings—which would be illegal—the individual would receive his or her winnings in prizes such as cigars and free drinks.

The first poker trade stimulators appeared in 1890, and by the mid-1890's San Francisco was in poker slot frenzy. (That is why slot machines are considered table gaming-based). Many cigar shops opened up, drawing their primary income from slot play. The early poker machine employed cards arranged on five spinning drums. Later models had cards attached to reels, and were similar to modern day slot machines. An attendant paid the winnings for all these early poker machines.

Charlie Fey, a German immigrant who arrived in San Francisco in 1885, created the first three-reel, automatic payout slot machine in 1898 in San Francisco. After that point, slot machines became popular and seemed destined to stay.

Throughout the next 100 years, many innovations occurred that ensured repeat customers. Examples of such innovations include making the slot machine quieter so that it could not be heard from a few feet away, creating themes to groups of slot machines, and the introduction of double and triple jackpots that gave customers increased chances to double or triple earnings much quicker.

Although Montana was the first state to license and regulate video lottery terminals in 1986, South Dakota was the first place in North America to legalize video lottery games and put it under the State Lottery's mandate. Canadian provinces followed soon after, but not before closely monitoring the results of video lottery gaming in South Dakota.

The adoption of video lottery terminals from 1989 onwards followed the automation trend. With the advent of computers and its continual advances and innovation, gaming machines got a notable facelift. The entire experience for users was changing. The computer processors within the video lottery terminals enabled the individual to stay at one terminal and play an assortment of games. There were sounds, lights, and even messages from the machine. Users can really immerse themselves into their gaming terminal and enter a whole different world. As computers started to rapidly change the world, so too did they change the way gaming machines operated.

The definition of a video lottery machine in the Delaware Code is as follows:

"Video lottery machine" shall mean any machine in which bills, coins or tokens are deposited in order to play in a game of chance in which the results, including options available to the player, are randomly and immediately determined by the machine. A machine may use spinning reels or video displays or both, and may or may not dispense coins or tokens directly to winning players. A machine shall be considered a video lottery machine notwithstanding the use of an electronic credit system making the deposit of bills, coins or tokens unnecessary. [Title 29 Del. C. Section 4803(g)]."

Although the simple definition does not help much in distinguishing between VLTs and slot machines, the legal distinction does provide more insight into the matter. The legal distinction is based on the ownership and control of the video gaming machines. For instance, in any legal non-tribal casino in the United States, the slot machines are either leased or owned by the casino. The casino is bound to many rules and regulations concerning accounting for revenues, and is responsible for paying the state all applicable taxes.

On the contrary, in Delaware and other states with VLTs at racetracks, the State often owns (or leases) and operates the video lottery machines, through the State Lottery. The VLTs are centrally connected to the lottery's computer system, much like the State-owned lottery terminals you see at various convenience stores.

Typically, VLTs are often a part of a centralized lottery system controlled by the State. Slot machines, which are connected by a monitoring system for accounting and tracking purposes, are individually owned by casinos and are not linked except in the case of progressive slot machines.

But for users of these two machines, the most important difference between the two machines is the way winners are determined. Slot machines have a computerized random number generator in each machine that determines the outcome of a spin. Video lottery terminals can also have random number generators. But in most instances, the machines are connected to a central terminal that determines the winners. The central terminal sets a predetermined number of winners for a particular game, similar to lottery scratch games. Because of this, gamblers play against one another. With slot machines, a gambler plays against an individual machine.

That being said, each State Legislature has defined the type of games it permits under its own State lottery. For example, a state might not permit any slot machine type of game on its VLTs. In the end, it comes down to what the individual State Legislatures decide.

In order to assess the feasibility for the State of Montana to successfully implement a central control system for the management of VGMs, information from other states was gathered via interviews in order to gauge trends in the United States, as well as decipher alternatives available to the State of Montana. The first stage of research consisted of determining whether a particular state licensed VLTs. From this initial research, 12 states were determined to licence VLTs (excluding Indian Tribe gaming), and were thus the focus of the second stage of the review.

3.4 VLT GOVERNANCE MODELS

The 12 jurisdictions licensing VLTs were reviewed to determine the model for governing VLTs in the State. It was determined that six jurisdictions govern VLTs through gambling legislation (referred to as gaming in virtually all jurisdictions to mitigate potential negative connotations of the term gambling) while the other six were governed through lottery legislation.

systems and have electronic fund transfer arrangements with VLT operators, thus the entire system is automated. One jurisdiction—Delaware—is automated to the point that the regulatory organization has only five employees.

There are few large vendors of these online electronic data capture systems—they include IGT, GTECH, Ballys and Aristocrat. The state, the manufacturer of their central online system, and capital cost where available is as follows:

Gambling Governance			Lottery Governance		
State	Online Electronic Data Acquisition System Vendor	Capital Cost	State	Online Electronic Data Acquisition System Vendor	Capital Cost
Montana	Manual Reporting	N/A	Delaware	IGT	1% of net rev (\$5.24 million)
Colorado	Manual Reporting	N/A	New York	Multimedia Games	0.8% of net rev
Iowa	IGT, Aristocrat Technologies or Bally	N/A	Oregon	GTECH	~\$90,000 per year
Louisiana	IGT	\$2 million	Rhode Island	GTECH	2.5% of net rev (\$7.03 million)
New Mexico	IGT	\$5 million	South Dakota	IGT	\$2.8 million plus 0.2925% of net revenue (\$600,000)
North Carolina	Manual Reporting	N/A	West Virginia	IGT	\$5 million plus \$300,000 per year

3.6 JURISDICTIONAL REVIEW—OVERALL FINDINGS

Montana is unique among states that license VGMs in their jurisdiction. Montana licenses VGMs based on a gambling governance structure, whereby VGMs are privately owned, with the operators paying the lowest income tax rate in the country.

- Montana has the highest VGM to population ratio (Nevada excluded) and lowest gambling taxes in North America.