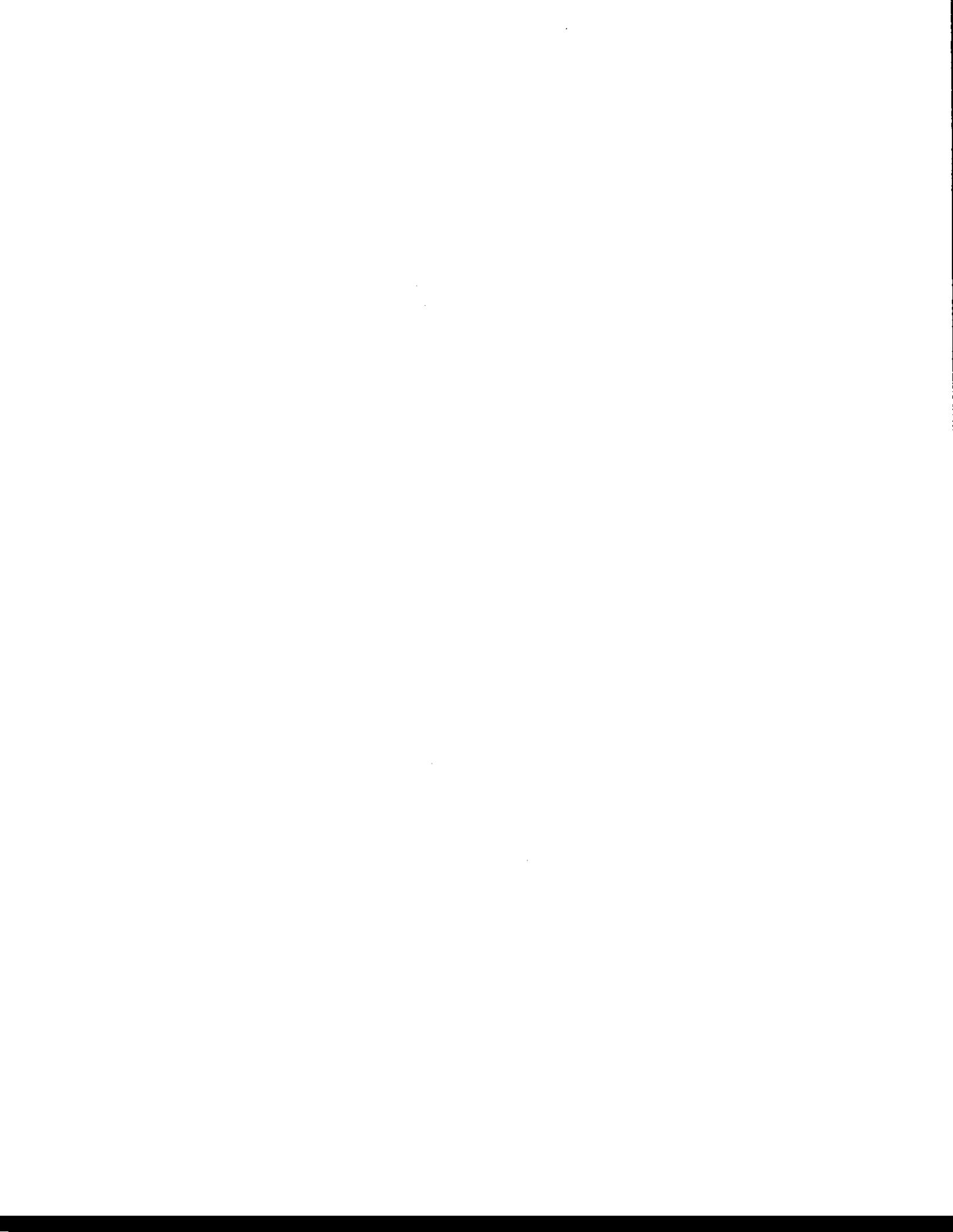


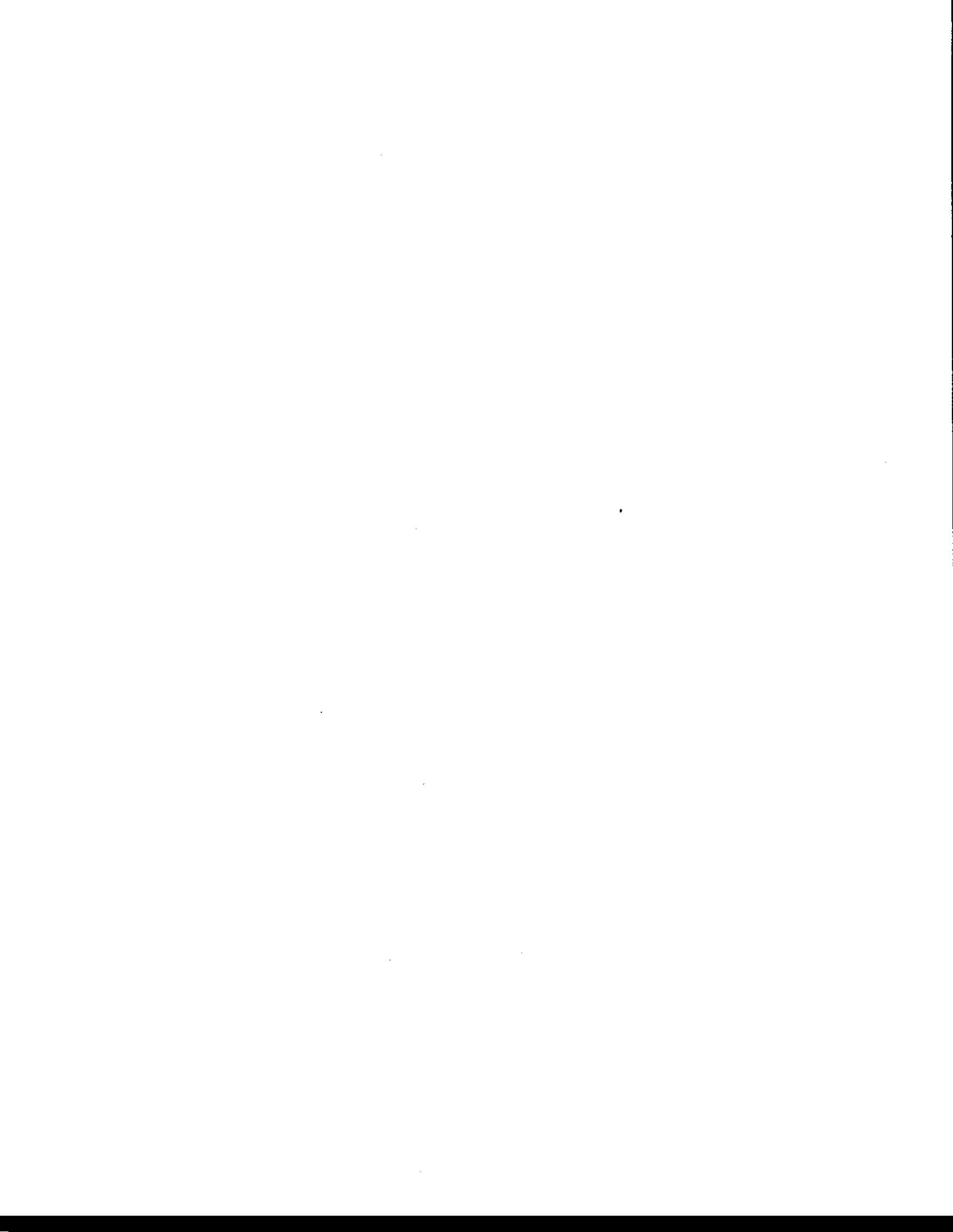
TEXAS
RACING
COMMISSION



STRATEGIC PLAN
2011-2015
Excerpt



EXTERNAL ASSESSMENT



An Uncertain Future: Competition and Proposals for Change

A variety of factors are contributing to the continuing decline of the pari-mutuel racing industry. According to data from all operating racetracks, over the past five years, there has been both a 12 percent drop in attendance and a corresponding decrease of more than 23 percent in the total amount of money wagered. Accordingly, the amount of revenue allocated to racetracks, horse and greyhound purses, local communities and the state has also decreased.

The losses to the pari-mutuel industry are due primarily to varying types of competition. It appears that competition from the broad range of entertainment options available has had significant impact. However, significant to members of the racing industry is the economic stress experienced due to advancements in technology, expansions in out-of-state racetrack gaming, and the proliferation of unregulated and illegal gambling.

No longer visiting the tracks to spend their recreational gaming dollars, instead many patrons are using changes in technology to participate in this evolving form of entertainment. Texans may now watch races via satellite television or their PDA and call in their bets from home, the airport, or their favorite restaurant. Fans get on the Internet to learn about pari-mutuel racing, place their wagers and watch races. In addition to this easy, any-where based gaming access, other Texans may go out to buy tickets from the state-run lottery, play bingo at state-approved bingo halls, or travel to neighboring states to see higher quality racing and play games at racinos, casinos and riverboats.

In addition, Texans find ample opportunities to spend their dollars at illegal eight-liner outlets and non-pari-mutuel tracks across the state. Official estimates of the revenue lost to illegal and unregulated gaming are not available though the industry estimates indicate significant amounts of revenue are lost. Provided below is a description of the competitive forces facing the industry.

Competition from Unregulated Sources

The racing industry suffers from competition with gaming alternatives that are unregulated at best and are frequently illegal.

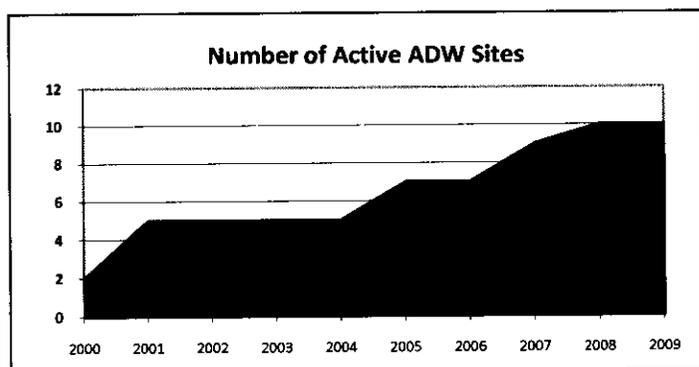
Eight-liner Machines

For the past year, the presence of illegal eight-liners has continued across the state. Local, state and federal entities have undertaken numerous law enforcement actions during the past few years, including:

- From 2008 and 2009, Houston Police Department’s video eight-liner enforcement team put 72 local game rooms out of business.
- In March 2009, the Nacogdoches County Sheriff’s Office arrested a couple in a double-wide trailer loaded with more than 70 eight-liner gambling machines, about 40 alleged patrons and several alleged casino employees. Officers found just less than \$10,000 in cash during the initial raid. Officers also seized a small amount of narcotics, gift cards and numerous financial documents. The couple faced charges of engaging in organized crime. Five alleged casino employees and the alleged patrons all faced lesser charges.
- In August 2009, a major operator of eight-liner machines in Texas entered a guilty plea that will cost him more than \$1 million according to Texas Attorney General, Greg Abbott. It is believed to be the largest coordinated gambling prosecution in Texas history.
- In November 2009, Laredo police raided the Mystic Amusement Center eight-liner establishment and its owner’s home. Police found three weapons, ammunition and close to \$114,000 in cash at the home. At the establishment, police seized more than \$12,000 in cash.
- In March 2010, the Laredo Police Department executed a search warrant on Atlantis Amusement Center. Police officers seized a total of 150 motherboards from eight-liner machines and \$11,453 in cash.
- In May 2010, officials in the Galveston area executed four simultaneous search warrants at game rooms. Investigators seized approximately \$100,000 in cash, several thousand dollars worth of items used to support the businesses, and motherboards from approximately 400 eight-liner machines.
- The Victoria Police Department maintains an on-going investigation into illegal eight-liner activity. They are coordinating efforts with the District Attorney’s office.

Online Gambling

Advance deposit wagering (ADW) companies first appeared in 2000. These businesses accept bets both through telephone-based interactive voice response systems and through the Internet. They also allow individuals to set up accounts to wager using a credit or debit card. As technology has advanced, ADW companies have proliferated.



In September 2006, Congress passed the Unlawful Internet Gambling and Enforcement Act (UIGEA). This law prohibits banks from processing payments for illegal Internet gambling. After passage of the law, many online casinos, sportsbooks and poker rooms left the U.S. market.

Congress carved out an exception in the UIGEA that allows banks to process payments for Internet wagering on horse races. The Racing Acts in many states, including Texas, expressly prohibit phone account wagers, but remain silent on Internet wagering. Other states maintain outdated laws that do not clearly establish regulatory authority over either online or phone account wagering. The situation creates ambiguity across states that, when combined with the difficulties presented by cross-jurisdictional regulation, fosters an environment ripe for ADW companies to take advantage. For example, several ADW companies claim legal authority to accept wagers from residents of a state where this form of pari-mutuel wagering is not authorized as long as the bet is not on a race held within the bettor's state.

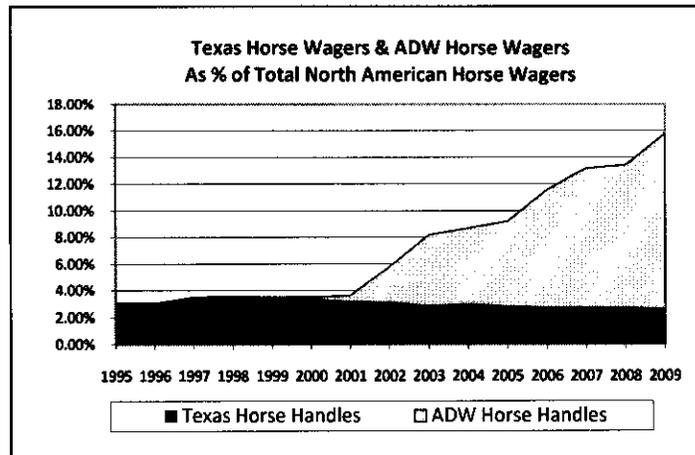
The federal law passed in 2006 is making it easier for ADW companies to execute their business plan. Since passage of the UIGEA, the number of active ADW companies taking pari-mutuel wagers has increased approximately 43 percent.

ADW companies provide a convenient, customer-friendly product that appeals to a tech-savvy audience, primarily those from 21 to 45 years of age. The companies offer free training on how to wager, using systems such as YouBet's learn-to-play Web site. The sites often offer prizes and rebates to bettors who use the ADW company's services to place wagers on pari-mutuel racetracks throughout North America.

Using ADW services, a bettor never has to leave home or set foot inside a racetrack to place a wager. The ADW business model is not that different from other newly emerging entertainment delivery mechanisms prevalent in the modern marketplace. Consumers regularly purchase and view on-demand feature movies at home on a cable or satellite service. Music lovers can easily purchase and download the latest music without ever visiting a retail music outlet.

Leveraging technological innovation to bring the track to the pari-mutuel bettor is proving to be a very successful endeavor.

In fact, the ADW companies have averaged a 19 percent per-year-growth-rate in pari-mutuel wagers placed through their systems over the past five years. As of calendar year 2009, ADW companies accounted for 13 percent of all wagers placed on North American horse races. In stark contrast, in 2002 ADW companies accounted for only 3 percent of the North American market share,



almost as much as the licensed Texas racetracks in that year. While the ADW companies have continued to gain in North American market share, the Texas racetracks have gradually lost ground.

Texas pari-mutuel industry officials claim that one of the causes for the Texas loss in market share is that many Texas bettors are choosing to place their pari-mutuel wagers on imported horse races simulcast from other states using one of the ADW companies. These Texans are no longer going to a Texas racetrack to place their wagers. Industry officials say that many of their frequent bettors claim to have opened an account with an ADW company for the convenience and comfort of wagering from home. If a person wishes to wager on a simulcast race, a television, computer monitor or smartphone delivers the event. And the bettor has no reason to go to a track to watch a television, computer monitor or smartphone.

Currently, the Commission does not license these ADW companies because the Texas Racing Act does not authorize pari-mutuel wagering unless the bettor places the wager on the grounds of the licensed racetrack. Texans using ADW companies violate the Texas Racing Act. Moreover, the wagers that the ADW companies accept from Texans result in lost tax revenue to the state and lost returns to the Texas racing industry. By contrast, for wagers placed on out-of-state races at a Texas racetrack, the state of Texas receives 1 to 1.25 percent, the breeders' associations receive 1 percent, the purse accounts receive 5 to 7 percent, and the receiving track receives 9 to 15 percent.

Industry losses to ADW companies are growing. According to financial reports filed with the Securities and Exchange Commission (SEC) and the Oregon Racing Commission (which licenses most of ADW companies), its regulated online companies reported \$1.63 billion in total wagering in 2009, an increase of 11 percent from \$1.47 billion in 2008. The Oregon Racing Commission shows

that over five years, Internet wagering has grown more than 89 percent from \$0.86 billion in 2004 to \$1.63 billion in 2009.

It is impossible to determine exactly how much Texans have wagered through ADW companies. However, if the amount Texans wagered via the ADW companies into the reported national pari-mutuel handle is proportional to the amount they wagered at Texas racetracks, Texans may have bet more than \$41 million through ADW companies in 2009. For the past five years, Texans may have wagered more than \$184 million through ADW companies. In this scenario, Texas would have lost access to about \$7.2 million in total pari-mutuel revenue in 2009 and about \$31.71 million in total pari-mutuel revenue over the past five years. If the ADW companies continue to increase market share and attract bettors, losses by 2014 could reach approximately \$56 million. By 2019, losses could reach approximately \$141 million. Further losses of revenue to allocate to the horse and greyhound purses and the Texas breeders program will escalate the decline in race dates, quality of race animals in Texas racing, and the number of animals participating in the accredited Texas breeders program.

Estimated Impact of ADW Company Operations to Texas				
<i>(Loss Expressed in \$ Millions)</i>	Current Impact		Future Impact	
	2009	5 Year 2005-2009	5 Year 2010-2014	10 Year 2010-2019
Total Wagers Lost	(\$41.96)	(\$184.88)	(\$327.48)	(\$820.78)
Revenue Allocation of Wagers Lost				
State Tax	(\$0.42)	(\$1.85)	(\$3.27)	(\$8.21)
Horse Purse	(\$2.62)	(\$11.55)	(\$20.47)	(\$51.30)
Texas Breeders Program	(\$0.38)	(\$1.66)	(\$2.95)	(\$7.39)
Texas Racetracks	(\$3.78)	(\$16.64)	(\$29.47)	(\$73.87)
Total Impact to Texas	(\$7.20)	(\$31.71)	(\$56.16)	(\$140.76)

Unregulated Racing

The proliferation of unregulated racing, particularly horse racing, remains a challenge to the Texas racing industry. A long standing tradition of “brush” or “bush” horse tracks exists across the state. There are perhaps as many as 25 to 50 of these tracks operating on any given weekend throughout the state. To a much smaller degree, greyhounds may also be participating in unregulated racing.

While the racing itself is legal, any wagering taking place at these locations likely is not. Obviously, it is difficult to determine to what degree these locations could affect the amount of money that patrons legally wager at the licensed Texas’ racetracks. For a full policy discussion on this issue, please see page 35.

National and Regional Racing Competition

Competition in the pari-mutuel industry compares well with other sports businesses in North America. The sport must compete for customers, as well as for the competitive athletes who perform. Racing fans choose an establishment to attend based on the competitive racing events offered, the convenience of the location and the comfort of the facility. Horse and greyhound owners and trainers choose a track based on the number of racing opportunities and the prize money, or purse, available.

Studies of racing by Dr. Margaret Ray, an economist and professor at the University of Arizona, show that the size and quality of the race field drives the entertainment value of the race. Bettors prefer betting on races with more, and more evenly matched, starters, and on races with higher purses. More starters give bettors more animals to choose from and a larger pool to win.

Higher purses generally draw better quality animals that have more extensive racing records and offer wagerers a better opportunity to handicap the contestants. Bettors also prefer wagering on races that offer exotic bets, such as the Trifecta and Superfecta. These wagers offer better handicapping opportunities and the chance for a larger return.

Many external factors affect the decisions of fan, owner and trainer, but none more so than the manner in which the athletes move from track to track in search of the biggest purse. Unfortunately, and by nearly every measure, Texas tracks are struggling to compete nationally and regionally.

National Horse Racing Competition

Thirty-two states with a total of 110 racetracks actively offer Thoroughbred racing where patrons wager. The national handle, the amount wagered on the Thoroughbred events, decreased in 2009 by nearly 10 percent. However, the prize money available to the athletes decreased by only about 6 percent, or 41 percent less than the decline in total wagered.

Why is the dip in prize money so much less than the dip in money wagered? Of the 32 states actively engaged in Thoroughbred racing, 14 now have legalized some form of alternative gaming at the track. All 14 of these states require some portion of the alternative gaming revenue to be set aside for prize money for the race athletes. In 2009, nearly \$319 million from alternative gaming went to purses. This accounted for approximately 29 percent of all prize money generated in North America and reflects a one year growth of 7 percent, a five year growth of 79 percent, and a ten-year growth of 382 percent.

A 2009 list of the top 15 states ranked by the total Thoroughbred prize money shows that more than 73 percent now have alternative gaming to supplement purses. Of the four states without alternative gaming, three offer additional forms of pari-mutuel wagering —Off Track Wagering locations (OTBs) or Advance Deposit Wagering (ADW) — to supplement the prize money. Texas is the only state in the top 15 that relies solely on pari-mutuel wagering at the licensed racetrack locations to generate all purse money. It is doubtful that Texas will make the top 15 in 2010. Texas fell two places from its ranking of 13th in 2008 and fell three places from its ranking of 12th in 2005.

2009 Top 15 States Ranked By Total Purses Paid For Thoroughbred Races			
State	Races	Average Purse	Total Purse (In \$Millions)
1. California [¶]	4,782	\$32,846	\$157.1
2. New York * [¶]	3,811	\$34,548	\$131.7
3. Pennsylvania * [¶]	4,566	\$23,741	\$108.4
4. Louisiana * [¶]	3,554	\$23,377	\$83.1
5. Florida *	3,249	\$22,354	\$72.6
6. West Virginia *	4,245	\$16,805	\$71.3
7. Kentucky [¶]	2,308	\$28,822	\$66.5
8. Illinois [¶]	2,417	\$19,324	\$46.7
9. New Jersey *	1,330	\$34,017	\$45.2
10. New Mexico *	1,731	\$17,850	\$30.9
11. Maryland *	1,397	\$20,308	\$28.4
12. Delaware *	968	\$24,829	\$24.0
13. Indiana *	1,150	\$18,015	\$20.7
14. Oklahoma *	1,248	\$16,482	\$20.6
15. Texas	1,351	\$14,324	\$19.4
*Has alternative gaming supplementing the purse payments.			
[¶] Has additional forms of pari-mutuel wagering (OTBs or ADWs.)			

Twenty-seven states with a total of 107 racetracks actively offer Quarter Horse, Arabian, Paint or mixed races. (A mixed race is one comprised of more than one breed of horse.) Although the agency was unable to obtain national handle amounts for these races, staff believes that the decline in handle for these breeds mirrors that of the Thoroughbred industry.

The state-by-state Quarter Horse, Arabian, Paint and mixed race purse data for the past five years reveals trends similar to those reflected in the Thoroughbred data. Unlike the Thoroughbred industry, however, the Quarter Horse, Arabian and Paint industries are concentrated in five major states: New Mexico, California, Oklahoma, Louisiana and Texas. Two of these states, California and Texas, saw reduced racing opportunities over the five-year period. The other three, New Mexico, Oklahoma and Louisiana, increased racing opportunities by 1 percent, 46 percent and 21 percent respectively over the five-year period. The three states experiencing increases in racing opportunities have authorized additional forms of gaming at their pari-mutuel facilities; the two states with reduced racing opportunities have not.

A 2009 list of the top states ranked by the total purses paid to the athletes shows that alternative gaming supplements prize money in eight of the top 15. Of the seven states without alternative gaming, three offer additional forms of pari-mutuel wagering — Off Track Wagering locations (OTBs) or Advance Deposit Wagering (ADW) — to supplement the prize money. While Texas ranks 5th on this list for 2009, its total purses paid is more than \$9 million short of the fourth place spot and nearly \$19 million below the top spot, which is a dramatic drop in performance in light of the state’s history in Quarter Horse racing.

2009 Top 15 States Ranked By Total Purses Paid For QH, AR, PA, or MX Races			
State	Races	Average Purse	Total Purse (In \$ Millions)
1. New Mexico *	1,380	\$21,363	\$29.5
2. California °	1,523	\$14,593	\$22.2
3. Oklahoma *	1,324	\$16,227	\$21.5
4. Louisiana * °	1,401	\$14,073	\$19.7
5. Texas	1,058	\$10,164	\$10.8
6. Indiana *	178	\$20,028	\$3.6
7. Iowa *	187	\$16,663	\$3.1
8. Florida *	160	\$11,779	\$1.9
9. Arizona °	354	\$4,746	\$1.7
10. Colorado	120	\$11,280	\$1.4
11. Delaware *	95	\$11,424	\$1.1
12. Idaho	270	\$2,702	\$0.7
13. Minnesota *	73	\$8,936	\$0.7
14. Oregon °	140	\$4,518	\$0.6
15. Michigan	128	\$4,401	\$0.5
*Has alternative gaming supplementing the purse payments.			
° Has additional forms of pari-mutuel wagering (OTBs or ADWs).			

Regional Horse Racing Competition

Currently five horse and three greyhound racetracks operate in Texas. Fourteen horse racetracks and one greyhound racetrack operate in the surrounding states of Arkansas, Louisiana, New Mexico and Oklahoma.

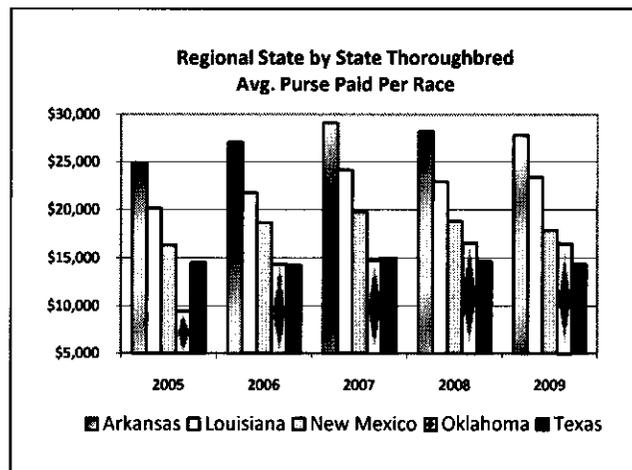
For the past five years, Texas has not faired well in the regional competition to attract the best athletes to its tracks. While the numbers vary, Thoroughbred, Quarter Horse, Arabian, Paint and greyhounds all are experiencing a downward trend in Texas. This is not the case in Texas’ neighboring states.

Since 2005, neighboring states have generated significant increases in Thoroughbred prize money from alternative gaming operations. Arkansas, Louisiana, New Mexico and Oklahoma have increased their total Thoroughbred prize money by 6 percent, 23 percent, 30 percent and 140 percent respectively during the past five years.

Thoroughbred – Regional 5 Year Change (2005-2009)					
State	Change In P-M Purse	Change In Gaming Purse	Change In Total Purse	Change In Avg. Purse	Change In # of Races
Arkansas	(\$523,300)	\$1,400,000	\$876,700	\$2,958	(28)
Louisiana	\$5,810,046	\$9,780,679	\$15,590,725	\$3,243	202
New Mexico	\$5,125,432	\$2,044,690	\$7,170,122	\$1,519	278
Oklahoma	\$2,245,589	\$9,738,089	\$11,983,678	\$6,994	343
Texas	(\$7,764,740)	n/a	(\$7,764,740)	(\$192)	(517)

Additional purse funds have allowed tracks in the neighboring states to add more racing opportunities and/or increase the average prize money paid per race. Tracks in these states attract more and higher-quality athletes and offer a better quality racing product, resulting in a growing Thoroughbred industry.

In contrast with the regional racetracks' considerable increases in purses, Texas racetracks saw a 29 percent decline in total prize money for Thoroughbred racing. The overall decrease in the amount of money wagered is part of the reason for the decline. Exacerbating the situation, many of the athletes are no longer competing in Texas because their owners and trainers have taken their animals to neighboring states with higher prizes. To remain somewhat competitive, Texas tracks reduced Thoroughbred racing opportunities by 517 to keep average purses as high as possible.



Still, Texas continues to lose ground regionally and nationally. As of 2009, the average Thoroughbred purse per race in Texas was \$14,324, or more than 28 percent below the regional average of \$20,046 and nearly 32 percent below the national average of \$21,061.

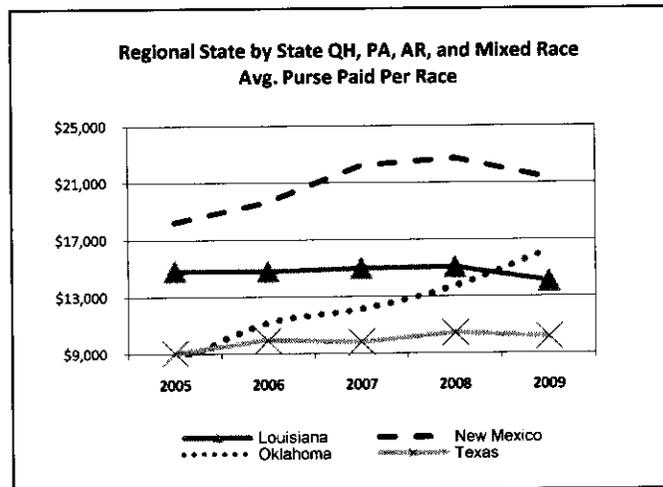
Since 2005, Louisiana, New Mexico and Oklahoma have seen significant increases in their total prize money for Quarter Horse, Arabians, Paints and mixed races. The prize money available in these states increased by 14 percent, 19 percent and 180 percent respectively during the past five years.

With additional purse funds, tracks in the region have either added more racing opportunities or increased the average prize money per race. In some cases, tracks have done both. The result is a growing industry for breeds within these respective states. The tracks attract more and higher-quality athletes to compete and offer better quality racing to the consumer.

QH, AR, PA, & Mixed Race – Regional 5 Year Change (2005-2009)					
State	Change In P-M Purse	Change In Gaming Purse	Change In Total Purse	Change In Avg. Purse	Change In # of Races
Louisiana	(\$330,236)	\$2,825,148	\$2,494,912	(\$748)	239
New Mexico	\$3,300,052	\$1,363,126	\$4,663,178	\$3,128	19
Oklahoma	\$5,045,739	\$8,764,281	\$13,810,019	\$7,775	416
Texas	(\$938,655)	n/a	(\$938,655)	\$1,128	(236)

Unfortunately, during the same period, Texas racetracks have experienced an 8 percent decline in total prize money for Quarter Horse, Arabians, Paints and mixed racing. The decline is the result of decreased wagering and the exodus of athletes to neighboring states with higher prizes. Texas racetracks have reduced racing opportunities by 18 percent to increase the average purse per race to be more competitive in the region.

Although these efforts did yield a slightly higher average purse per race, Texas prize money still lags behind the region and nation. As of 2009, the average purse per race in Texas for these breeds was \$10,164. That number stands 36 percent below the regional average of \$15,773 and 25 percent below the national average of \$13,571.



National & Regional Greyhound Racing Competition

Since 2005, the Texas greyhound industry has experienced significant declines. Purses dropped 33 percent due to decreased wagering. Additionally, the Texas tracks lost greyhound athletes to other racetracks in Arkansas, Florida, Iowa and West Virginia. These states have legalized alternative gaming at their pari-mutuel facilities and set aside prize money from the gaming revenue for purses.

Texas Greyhound - 5 Year Change (2005-2009)					
State	Change In P-M Purse	Change In Gaming Purse	Change In Total Purse	Change In Avg. Purse	Change In # of Races
Texas	(\$1,656,024)	n/a	(\$1,656,024)	\$241	(6,731)

To counter, the Texas greyhound racetracks reduced greyhound racing opportunities, as did the Texas horse racetracks, in an attempt maintain or raise the average purse money per race.

Current Trends and Industry Reaction

The pari-mutuel racing industry is evolving across the nation, producing hybrid establishments like Racinos (pari-mutuel facilities with other forms of on-site gaming available), in a radically changing environment. The state-by-state data for the past five years reveals an alarming development: tracks in states without alternative forms of gaming have cut racing opportunities. Following that trend, Texas tracks have slashed the number of live racing dates.

Even with fewer live dates, the average purse for every kind of racing in Texas lags behind states where alternative forms of gaming exist. Simulcast signals from other racetracks have replaced the live race opportunities. This practice reduces the overall total prize money awarded during a given race meet.

Although reducing racing opportunities helps prop up purses in the short term, there are negative long-term effects. With fewer racing opportunities and less overall money available, there is a reduced incentive for breeders to produce more horses or to stay in Texas. The pool of quality Texas-based owners, trainers and jockeys is dwindling. Racing-related businesses, such as stables, hay suppliers, tack vendors and food service businesses that provide products or services either to the associations or to the occupational licensees or both also suffer.

Currently, there is a great deal of anxiety about the status of horse racing in Texas. In an attempt to adjust to the changing landscape and to meet the continuing challenges presented at the national and regional levels, certain industry participants are considering far-reaching cuts to and consolidation of race dates.

Consolidation and deep cuts are a path the greyhound industry has already chosen. In early 2009, the Texas greyhound industry, led by the Texas Greyhound Association (TGA), headed an initiative to radically change the greyhound racing landscape in Texas.

In a presentation to the Commission, a TGA spokesman said:

“While the cost of raising greyhounds has increased, purses have remained static or decreased for the past several years. During this same time frame, the number of greyhounds and greyhound breeders in Texas has declined. The TGA has always favored year-round racing at each greyhound racetrack. However, the TGA has come to recognize that the greyhound industry needs to make some hard choices to keep greyhound racing viable in Texas.”

The TGA proposal consolidated year-round live racing to one Texas greyhound racetrack. Under the plan, the two remaining racetracks will host one week of live racing per year with a fixed prize per race. All three greyhound racetracks continue to offer simulcast wagering on racing from other racetracks to generate prize money for the Texas greyhound tracks. The two racetracks running the short meets keep only enough prize money to cover their purses and transfer the remaining money to the year-round track. The TGA testified to the Commission that they believed that their proposal would:

- Attract more greyhounds to compete by positioning the one remaining Texas racetrack running year-round to offer the highest purse money of any non-casino facility in North America.
- Encourage Texas greyhound breeders to continue their operations due to higher prize money at the remaining year-round Texas racetrack.
- Showcase greyhound racing at the two remaining Texas greyhound racetracks in a “county fair” atmosphere similar to that of Gillespie County Fair, a county fair horse racetrack currently operating in Fredericksburg, Texas.
- Enable all three greyhound racetracks to remain viable.
- Reduce operating cost for the Texas Racing Commission.

The Commission adopted the TGA plan for calendar year 2010 and the first eight months of 2011. The Commission will receive updates on the progress of the plan during the upcoming race date allocation process.

Proposed Solutions to the Decline and Potential Impact on the Agency

In the past, the racing industry has attempted to address these pari-mutuel decline issues primarily by working on legislation to expand authorized gaming at the race tracks. Members of the industry currently support legislation permitting video lottery terminals (VLTs) at pari-mutuel racetracks. The industry has not pursued other approaches, such as off-track betting outlets and account

wagering, also referred to as Advance Deposit Wagering, in recent years. However, testimony received through the Sunset review process did yield a proposal to authorize account wagering.

Past legislation has varied widely. Bills have ranged from authorization of VLTs and electronic or traditional poker gaming at race tracks to approval of VLTs with the creation of a new gaming commission encompassing the functions of both the existing Lottery and Racing Commissions.

Through the consideration of the legislation and the fiscal note process, the Commission has reviewed the potential impact of expanded gaming on the Commission, its structure and regulatory programs. Any expansion of gaming at the racetracks, regardless of the format, would involve regulatory oversight by the Commission and necessitate increases in appropriations and FTEs to ensure the proper level of oversight. The most significant costs to the agency for additional oversight would generally include additional licensing, auditing and investigative functions with corresponding increases in FTEs. However, the existing organizational structure already includes the regulatory functions needed to regulate expanded gaming. Therefore, responding to a legislative change would require an increase in the number of staff in those existing functional areas. The agency would need to develop some additional technical expertise.

Similarly, any expansion of gaming that includes Internet gaming and/or ADW would affect the Commission. Some states that authorize ADW have a licensing process in place to ensure that the entities conducting the wagering are appropriately and continuously reviewed when a license is issued. Depending on the type of ADW the legislature may authorize, the agency is well-positioned for licensing and auditing such systems.

The agency has also reviewed the impact of proposed gaming legislation taking into consideration its impact on existing inactive racetrack licenses. Expanded gaming could result in the building of overdue tracks and expansions of racing schedules at active tracks. The agency routinely forecasts the resources needed to open a track based on the projected live and simulcast racing schedule. Resources include personnel as well as some capital expenditures. With the industry growth that expanded gaming could bring, the agency would need additional staffing to oversee the live racing, including the stewards or judges, veterinarians and test barn supervisors, licensing personnel and investigators.

For any of the industry-proposed solutions, the agency would be well-positioned to address these needed resources through the use of contingency appropriation riders in the General Appropriations

Act. The Legislative Budget Board has supported the Commission's use of contingency appropriation riders to address the fluctuating staffing and resources needed with racetrack regulation.

While the legislature and industry consider potential solutions, the Commission will continue to allocate resources as efficiently as possible and work with tracks to ensure that agency regulations are both fair and cost-effective.

Recognizing that the legislature may or may not adopt industry proposed solutions, one of the recommendations in the Sunset Commission Staff Report is to continue the Commission for six years, instead of the standard 12 years. According to their report, this will allow the legislature the opportunity to re-evaluate the Commission's role in regulating a declining industry in a timely fashion.

Technological Advances in the Industry

Technology continues as a fundamental concern for the racing industry. Complex computer systems called totalisators ("totes") process all pari-mutuel wagering at Texas racetracks. Totalisator systems consist of central processing servers, tote boards, wagering terminals, operating consoles, routers, etc. Each of the three major tote companies, AmTote International, Scientific Games and United Tote, provides services to the racetracks in Texas.

Industry Issues: Consolidation and Staffing

In the recent past, every pari-mutuel track had a tote central processing server on-site. In an attempt to reduce costs, tote companies offered more cost-effective methods of operation. To cut the price for totalisator-contracted services, the tote companies offered centralized server operations that networked multiple racetracks through one central processing server. In other words, racetracks no longer had on-site servers, but were networked to off-site servers. The industry embraced this concept and stand-alone single-site server operations ceased to exist. Now the tote companies are consolidating many of the networked server sites into regional central processing servers. Ultimately, they hope to have just two U.S. server sites per tote company. Today, Texas does not host a stand-alone server site or a networked server site. All Texas racetracks are networked through a regional central processing server located outside the state.

The tote companies are exploring additional ways to reduce costs. One concept involves shifting responsibility for certain tote system operations to racetrack employees. Texas rules, as in most states, assign specific racing officials with certain responsibilities and tasks. Before implementation of

this new approach, the Commission would have to review the rules of racing to analyze the specifics of the new staff roles, responsibilities and tasks.

Regulatory Oversight of Wagering Systems

Regulation of pari-mutuel wagering and the totalisator systems that process this betting has been evolving. The Commission has worked in collaboration with other Racing Commission International (RCI) member jurisdictions to achieve more efficient and consistent regulation in this area. RCI is the national association of government pari-mutuel regulators. The adoption of RCI model tote standards rules is one example of this successful collaborative effort. RCI is leading the initiative to combat wagering system fraud by advocating a national program of independent monitoring and fraud investigation. RCI proposes to accomplish this via two methods: an independent review of totalisator systems by certified testing laboratories; and independent real time monitoring of pari-mutuel wagering. Supportive of RCI's efforts in these areas, the Commission reviewed the two proposed regulatory methods to determine how they aligned with the short-term and long-term goals and needs of the agency.

The first method, independent review of totalisator systems by a certified testing laboratory, fit the agency's short-term needs best. The agency contracted with Gaming Laboratory International (GLI) in July 2008 to perform an independent review of tote systems operating at Texas racetracks. By July 2009, GLI had tested the tote systems for each of the seven Texas racetracks. The Commission provided GLI's findings to the tote companies and requested written comment and feedback. The Commission's Wagering and Racing Review Division prepared a final compilation report — this included both GLI's final report and the tote companies' written comments — and submitted it to the Commissioners in October 2009. The final report showed:

- That GLI validated the integrity of the tote systems operating at the Texas racetracks.
- The areas for improvement in tote system operations.
- The need for the Commission to adopt wagering terminal standards.
- A need to update Commission rules to maintain continuing advances of tote system technology.

By using a certified testing laboratory, the agency satisfied a finding issued by the State Auditor's Office (SAO) in May 2006 that the agency strengthen its Electronic Data Processing (EDP) reviews of the tote systems to ensure the data coming from and stored within the systems is reliable. The agency requested and received additional appropriations to continue pursuing this goal during the

2010-11 biennium. The agency will include a request to continue funding for this project in the 2012-13 biennium.

As a result of the recommendations issued by GLI, the agency determined that it needed technical assistance to develop tote terminal standards and to review Commission Rules concerning totalisator standards. The agency awarded a contract to BMM Compliance in April 2010 to review the applicable rules and standards. After its review, BMM Compliance will submit written recommendations for rules and standards regarding tote terminal and wagering system technology advances. The Commission's goal is to adopt BMM's final recommendations no later than January 2011.

RCI's second method to combat wagering system fraud, an independent real-time monitoring of pari-mutuel wagering, aligns with the agency's long-term goals. However, the tote industry must fully implement Wagering Transaction Protocol (WTP) to develop a system that can monitor racetrack pari-mutuel pools. WTP is a communication protocol used to transfer wagering data between the racetrack running the race and the off-track wagering location betting into its pari-mutuel pools. Full-scale implementation of WTP is not expected until 2015. The agency will be in a better position to assess the effectiveness and need for this regulatory tool during the next strategic planning period. The Commission is well positioned to assess WTP as an option, since it currently has its own pari-mutuel regulatory program. That program combines two effective tools: an independent testing laboratory review of the tote systems; and a Texas monitoring system that is designed to operate using the current Inter Tote System Protocol (ITSP).

Sunset Review

A productive Sunset review process, which began in the summer of 2007, resulted in a number of Sunset recommendations. The Sunset Commission report concluded that the Commission is well-managed and is currently meeting its mission, but is increasingly challenged because the Racing Act has not kept pace with changes in the industry — specifically the decline in wagering and overall industry profits. According to the report, the significant decline has resulted in increasing limitations on the Commission's ability to oversee racetrack license holders, ensure adequate racing facilities, and respond to changes in wagering technology.

The agency agreed with the Sunset Commission's recommendations for the following statutory changes:

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1. Require the commission to review each racetrack license on a periodic basis and develop renewal criteria along with associated sanctions for failure to comply.
2. Clarify the Commission's revocation authority and ability to refuse to renew a racetrack license.
3. Eliminate uncashed winning tickets as a source of Commission revenue.
4. Clarify that all unlicensed entities are prohibited from accepting wagers placed by Texas residents.

The agency recommended a modification that would have changed the Racing Act to allow the Commission to require racetrack license holders to post security at any time, instead of only when a new license is issued. This would have allowed the Commission to ensure that licensees fulfill their statutory obligation to build their tracks and run live race dates.

The second area of recommendations related to improvements in the agency's occupational licensing program. The Racing Act provides that all people involved in racing must be licensed without consideration of the individual's level of involvement in pari-mutuel racing. This means everyone, from the racetrack parking lot attendant to the chef, must be licensed and submit fingerprints. Sunset concluded that licensing to that level is not an efficient use of resources and recommended two statutory changes that would have enhanced the agency's occupational licensing program:

1. Require the Commission to license only those individuals who can affect pari-mutuel racing.
2. Require the Commission to obtain criminal history reports every three years.

The agency agreed with these two recommendations and has already adopted a change to the rule to obtain criminal history reports on a three year rather than a five year basis. With DPS' and their contracted vendor's assistance, the agency also is moving to electronic fingerprinting equipment, phasing out the outdated, time-consuming ink and paper fingerprinting. Using this new technology to fingerprint approximately 5,000 licensees a year means the agency will get a much faster turn-around on any criminal histories that may exclude a person from licensure.

Noting that the Commission is regulating an industry in decline, Sunset's third recommendation is to continue the Commission as an independent agency for six years, instead of the standard 12 years. According to their report, "while the State should continue regulating the pari-mutuel racing industry, the future of the industry is unknown at this time and the Commission may need additional tools to again readjust to a further decline or a revived industry."

The changes that the Sunset Commission recommended provided clearer statutory authority and gave the Commission added flexibility to oversee today's racing industry. Despite the vast amount of time, effort and resources devoted by the Racing Commission, the Sunset Commission and numerous legislators and their staff members over a two year period, the bill failed to pass. The Commission was one of five agencies whose Sunset legislation failed passage. Governor Perry called a Special Session in July to continue the five agencies until 2011. The bill passed during the Special Session limits the Sunset Commission's review to the appropriateness of recommendations to the 81st Legislature and authorizes the Sunset Commission to include any other recommendations it considers appropriate.

The Commission remains committed to the Sunset process. Although the Sunset Commission recommendations were not enacted, the agency did respond to the Sunset's recommendations for management actions. The agency's implementation of the recommendations resulted in an expedient method of obtaining criminal history reports through electronic fingerprinting, a process for oversight of practical examinations for licensing horse trainers, more consistent oversight from racetrack to racetrack by changing staffing patterns and requiring better reporting on enforcement actions, and improved integration of field staff effort with central office efforts.

The Development of National Standards

The national nature of the racing industry applies to the regulatory effort as well. Racing participants often race at tracks in several states resulting in the desire for regulatory consistency across state lines. To address the industry's quest for uniformity, racing commissions across the U.S. are working together through the RCI, the national association of government pari-mutuel regulators.

The Commission has been a member of RCI since February 2006. Through its membership, Texas is directly involved in the intensive national dialogue and active assessment of the status of racing regulation. The Commission's Executive Director is currently serving a third term on the RCI board of directors. In recognition of her effective and tireless commitment to ensuring racing integrity, this year her fellow Executive Directors selected Texas' Executive Director as the recipient of the Len Foote Award, the highest award presented to an Executive Director.

Board membership has enhanced the Commission's ability to increase other jurisdictions' awareness of Texas' regulatory priorities and the strict standards that exist in the Lone Star State.

For example, the Commission's totalisator standards were one of the key documents that helped formulate the national totalisator standards adopted as a part of RCI's wagering integrity initiative. Additionally, the Commission's Compliance Audit Administrator now chairs the RCI Pari-mutuel Auditors Committee. This committee provides technical assistance in drafting wagering model rules and helps establish best practices across jurisdictions.

Participation in the development of national standards has also led the agency to pursue regional cooperation with the border and regional states of Arkansas, Colorado, Kentucky, Louisiana, New Mexico and Oklahoma. This initiative is resulting in regularly scheduled meetings where member states exchange policy and practice information to enhance and make more consistent the enforcement efforts throughout the region. This directly supports the RCI's efforts to adopt model rules throughout the country and in other participating racing jurisdictions.

Increasing Federal Government Interest in Racing

Potential changes at the federal level may affect the sport of racing as well as the states' racing regulators. A focus on performance-enhancing drugs in all major league sports, including horse racing, by the House Subcommittee on Commerce, Trade, and Consumer Protection of the Committee on Energy and Commerce, has been underway for some time. This subcommittee has primary jurisdiction over the commercial practices of sports and gambling, including the Interstate Horseracing Act (IHA) which authorizes simulcasting across state lines. Two catastrophic injuries to horses, one in the 2006 Preakness and one in the 2008 Kentucky Derby, brought the discussion to the forefront.

In late May of 2008, the subcommittee issued a request to RCI for information from the "multitude of various racing commissions" it represents, noting that racing lacks a central regulatory body or "league" to govern the rules of the game.

On June 19, 2008, the subcommittee conducted a hearing entitled, "Breeding, Drugs and Breakdowns: The State of Thoroughbred Horseracing and the Welfare of the Thoroughbred Racehorse." Invited testimony covered a range of issues regarding Thoroughbred racing from race-day medication to equine health and safety. There was ample discussion on the need for reforms in these areas — whether attained through federal intervention or an industry-led central body.

Less than a week before the 2010 Kentucky Derby, a member of the Senate Committee on Commerce, Science and Transportation and a member of the House Committee Energy and

Commerce issued a new request to RCI for answers about the current state of horse racing in the United States. The letter again noted that the sport of horse racing, unlike every other major professional sport, lacks a governing body or 'league' that is capable of imposing mandatory regulations for universal compliance.

Observers believe that the 2008 Congressional hearing with the threat of federal intervention served as a catalyst to bring racing stakeholders together to find common ground for industry reforms on several fronts.

Through the RCI Regulatory Veterinary Committee, racing jurisdictions are considering guidelines and recommendations for pre-race horse exams and the use of non-steroidal anti-inflammatory medications and corticosteroids. The Racing Medication and Testing Consortium, a not-for-profit organization consisting of 25 racing industry stakeholder members, is providing research into pre-race exams to ensure the horse is not being compromised. Initiatives by the National Thoroughbred Racing Association are designed to certify race track adherence to alliance safety and integrity standards.

Interstate Compact May Facilitate State Regulation of Racing and Wagering

Following an intensive study, RCI, in conjunction with the Council of State Governments and an Advisory Steering Committee comprised of several industry stakeholders, developed interstate compact language that will allow racing to adapt to the multi-jurisdictional dimensions of racing. If widely adopted, the compact would provide for collective and uniform action while preserving the prerogative of the individual jurisdictions to continue their regulation. Its proposed structure avoids the creation of an additional and potentially redundant costly layer of oversight.

RCI, working with the Council of State Governments, has targeted the 2011 legislative sessions for initial consideration of a racing compact by the various states.

Staff has just begun its in-depth analysis of the compact's model legislation to assess the viability of Texas' participation. If the Commission finds it would be in the best interest of Texas racing to participate in an interstate racing compact, a recommendation will go to the legislature for a final determination.