



Minnesota Racing Commission: Oversight of Purse Contributions at Running Aces Harness Park

Special Review

July 8, 2014

Report 14-16

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OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

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This report presents the results of the Office of the Legislative Auditor's (OLA) review of various issues related to purse contributions at Running Aces Harness Park in Columbus, Minnesota. Officials of the Minnesota Racing Commission requested the review.

OLA received full cooperation from the Minnesota Racing Commission, Running Aces Harness Park, and Minnesota Harness Racing, Inc. (commonly referred to as the Horsemen's Association), which represents people who race horses at Running Aces.

Pat Ryan, OLA Audit Team Leader, assisted with this review.

A handwritten signature in black ink that reads "James R. Nobles".

James R. Nobles
Legislative Auditor

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Introduction

Approximately one year ago, a dispute developed at the Minnesota Racing Commission over purse contributions for live racing at Running Aces Harness Park (Running Aces) in Columbus, Minnesota, operated by North Metro Harness Initiative, LLC. Some commission members alleged that the owners of Running Aces had not been contributing the amounts to purses that are required by state law. The dispute has not been resolved because of differences of opinion among commission members and conflicts between Running Aces and Minnesota Harness Racing, Inc. (commonly referred to as the Horsemen's Association), which represents people who race horses at Running Aces.

The Office of the Legislative Auditor (OLA) became involved in the purse contribution dispute in response to a request from the executive director of the Minnesota Racing Commission. In response, we agreed to do the following:

- Review the Racing Commission's purse contribution oversight practices and determine whether they are adequate.
- Review the purse contributions made by Running Aces from betting on live races at Running Aces from 2008 through 2012, and determine whether they were in compliance with Minnesota law.
- Review the purse contributions made by Running Aces from betting on races simulcast to Running Aces from other racing facilities during the time period of live races at Running Aces from 2008 through 2012, and determine whether they were in compliance with Minnesota law.
- Calculate any underpayment if OLA determines that purse contributions made by Running Aces were deficient.

To accomplish these tasks, we reviewed state laws, transcripts of certain meetings of the Racing Commission and its Finance Committee, and purse contribution agreements between Running Aces and the Horsemen's Association. We interviewed the current and former executive directors of the Racing Commission and some commission staff to understand their interpretations of the requirements of the statute and the extent of the commission's oversight of the purse agreements for the period from 2008 through 2012. We also spoke with legal counsel and other staff from the Minnesota House of Representatives Research Department about the history and intent of state laws related to the Racing Commission and horse racing purses. We obtained wagering data from the Racing Commission for the period from 2008 through 2012. Finally, we obtained financial records from Running Aces supporting the expenses it claims benefited people who race horses at Running Aces beyond the amounts contributed to purses.

Preview of Findings

- The Minnesota Racing Commission failed to adequately oversee purse contributions at Running Aces, which allowed a serious dispute to arise and remain unresolved for a significant period of time.
- Purse contributions made by Running Aces from betting on live races at Running Aces from 2008 through 2012 were not in compliance with Minnesota law.
- Purse contributions made by Running Aces from betting on simulcast races that occur during “the time period of live races” from 2008 through 2012 were not in compliance with state law.
- Purse contributions made by Running Aces from 2008 through 2012 were deficient by \$436,865.

We will discuss the basis for each finding after providing background information about the Racing Commission and the Running Aces purse contribution dispute.

Background

The Minnesota Racing Commission consists of nine members appointed by the Governor. The commission’s primary responsibility is to ensure the integrity of horse racing in the state. The commission does this by enforcing laws and rules associated with horse racing, issuing licenses associated with the horse racing industry, supervising the conduct of pari-mutuel betting,¹ collecting and distributing pari-mutuel taxes, and conducting investigations and inquiries. The commission also provides oversight of the card clubs located at the race tracks. The commission operates under *Minnesota Statutes* 2013, chapter 240.

The Minnesota Racing Commission granted North Metro Harness Initiative, LLC a license in January 2005 to sponsor and manage pari-mutuel horse racing at the Running Aces Harness Park.² The track opened for live racing in April 2008. The Horsemen’s Association has been the exclusive bargaining agent and representative of people who race horses at the facility. Some aspects of operations at Running Aces are governed by agreements negotiated between the

¹ Pari-mutuel betting is a system of wagering in which all bets of a particular type are placed together in a pool, and winners are paid from the pool after certain authorized deductions are made.

² In addition to live horse racing, Running Aces offers betting on races at other horse racing facilities through simulcasting from those facilities, and it offers betting on various card games in a card club.

owners of the facility and the Horsemen's Association. In addition to Running Aces, the Racing Commission licenses and oversees operations at Canterbury Park, a horse racing and card club facility in Shakopee, Minnesota.³

Purse Contribution Dispute

Purse Contributions. During a meeting of the Racing Commission's Finance Committee on May 14, 2013, some commission members questioned whether the method used by Running Aces to calculate purse contributions complied with state law. The law in question, *Minnesota Statutes* 2013, 240.13, subd. 5(a)(1), states the following:

Purses. (a) From the amounts deducted from all pari-mutuel pools by a licensee, an amount equal to not less than the following percentages of all money in all pools must be set aside by the licensee and used for purses for races conducted by the licensee, provided that a licensee may agree by contract with an organization representing a majority of the horsepersons racing the breed involved to set aside amounts in addition to the following percentages: (1) for live races conducted at a class A facility, and for races that are part of full racing card simulcasting that takes place within the time period of the live races, 8.4 percent....⁴

Handle vs. Takeout. The primary issue in the Running Aces purse contribution dispute is whether the law requires the 8.4 percent purse contribution to be calculated on the "handle" or the "takeout." The "handle" is the total amount in all betting pools. The "takeout" is the amount the licensee deducts from the handle before paying holders of winning tickets.⁵ Because the handle is a significantly larger amount of money than the takeout, multiplying the handle—rather than the takeout—by 8.4 percent produces much larger purse contributions.

The dispute over purse contributions at Running Aces emerged at a meeting of the Racing Commission's Finance Committee on May 14, 2013. At the meeting, the commission's deputy executive director, who was the person assigned to oversee operations at Running Aces, said she believed that calculating purse contributions on the takeout was consistent with state law.⁶ She also noted that, starting with its

³ Canterbury Park (originally called Canterbury Downs) held its first race in June 1985.

⁴ Both Running Aces and Canterbury Park are "class A" facilities.

⁵ *Minnesota Statutes* 2013, 240.13, subd. 4, mandates the takeout and how some takeout money must be distributed. After the mandated distributions are made, the remaining money is available to the licensee to pay operating costs and retain as profit. However, in the next subdivision governing purses, the terms takeout and handle are not used.

⁶ The person who was deputy executive director of the commission at the time of the May 14, 2013, Finance Committee meeting is currently the director of government relations and communications for Running Aces. She was deputy executive director of the commission from December 8, 2006, until June 24, 2013. She became an employee of Running Aces in July 2013.

first negotiated purse contribution agreement with Running Aces, the Horsemen's Association agreed that purse contributions would be calculated on the takeout.⁷ While some commission members on the Finance Committee seemed to support the deputy executive director's position, others questioned her interpretation. For example, one member pointed out that, in its application for a license, Running Aces had indicated that purses would be calculated on the handle. In addition, he noted that purse contributions at Canterbury Park had always been calculated on the handle, not the takeout.

Aggregate Compliance. The May 14, 2013, meeting also showed that commission members had differences of opinion about how the Racing Commission should assess whether Running Aces was in compliance with state law. Some members said the commission should take into consideration all of the contributions Running Aces had made that benefited people racing horses at the facility, but other members said that the commission should only consider whether Running Ace had complied with the statutory requirements for calculating purse contributions.

Arguing for looking at aggregate compliance, one member said:

I believe Running Aces has put together some information for us... that can essentially validate that, in aggregate, they have paid more than statutorily required if you break down the individual components. So what is the point...if you look at the sum being more than the statutory requirements, to me it seems a little bit punitive to pull out one particular section of the statute and say you didn't pay this amount under that particular piece....

The suggestion that the commission should focus on aggregate compliance was not accepted by at least one commission member of the Finance Committee. He suggested that the commission's responsibility was to ensure enforcement of the statute that mandates how purse contributions are to be calculated.

Commission's Role. The May 14, 2013, meeting also showed that commission members had different opinions about the commission's role in resolving the dispute over purse contributions at Running Aces. Some members indicated that the dispute could be resolved by negotiations between Running Aces and the

⁷ The former deputy director of the commission told us that she based her opinion in part on the fact that the first purse contribution agreement between Running Aces and the Horsemen's Association (effective October 23, 2007) provided for contributions to be calculated on the takeout and not the handle. She told us that the 2007 agreement had been submitted to the then executive director of the Racing Commission, and she obtained a copy several months later. In a written statement to us, she said: "In receiving this agreement from the Executive Director 5 months after it was submitted I was under the assumption that it had been review[ed] for its compliance with MN law, by the Executive Director or Racing Commission Chair." Memorandum from Mary Manney, Director of Government Relations and Communications, to Jim Nobles, Legislative Auditor, June 17, 2014.

Horsemen's Association without action by the commission. In fact, one commission member, as well as a representative of Running Aces, announced that negotiations were in process that would likely result in future purse contributions being calculated on the handle rather than the takeout, and the commission's deputy executive director stated that there was no statutory requirement for the commission to approve a new agreement.

When asked whether the new agreement would address the need for repaying past underfunding of purses, the Running Aces representative said "no" because, in the opinion of Running Aces, there had not been an underfunding of purses in the past. In addition, some commission members argued that the focus should be on purse contributions for future live racing at Running Aces, not on the dispute about possible past underfunding. The Finance Committee meeting ended without the differences among commission members being resolved.

Letter of Agreement. On May 15, 2013, the day after the Racing Commission's Finance Committee met, officials representing Running Aces and the Horsemen's Association signed a letter agreeing to amend their 2013 Purse Contribution Agreement. The letter indicated that the method of calculating purses would be changed "to provide that 8.4 percent of handle on live racing and Standardbred simulcasting during live racing will be contributed to purses for the race season 2013 and forward."⁸

The letter of agreement said that Running Aces and the Horsemen's Association "acknowledge" that there is ambiguity in the Minnesota law that governs purse contributions and any purse calculations for prior years were made by Running Aces and accepted by the Horsemen's Association "in good faith." The letter also said that Running Aces and the Horsemen's Association "acknowledge" the following as well:

- Running Aces has in past years contributed to horsemen purses a total amount in excess of that required by statute and by an amount that would more than offset any perceived underpayment.
- [I]n the past, Running Aces has also paid for the benefit of harness racing at Running Aces amounts not required by statute.
- [N]otwithstanding the above [being the acknowledgement regarding additional value received] to the extent it is subsequently determined that the current ambiguity regarding the calculation of purse contributions for live racing is such that Running Aces should have paid more, MHRI [the Horsemen's Association] will recognize an equal, offsetting amount to contributions made from the card room.

⁸ Letter of Agreement, signed by the general manager of North Metro Harness Initiative, LLC (Running Aces) and the president of Minnesota Harness Racing, Inc. (Horsemen's Association), May 15, 2013, p. 1.

Finally, the letter indicated that Running Aces was agreeing to pay \$100,000 (in four \$25,000 annual increments) to settle the purse contribution dispute. The wording of this part of the agreement (which included hand-written adjustments) was stated as follows:

...the parties agree MHRI [the Horsemen's Association] will not look to Running Aces for any additional monies related to the 2012 racing season and prior. As an accommodation, however, for race seasons 2013–2016 Running Aces will contribute an additional \$25,000 per year in excess of that required under the Contract for MHRI administered Breeder Award Bonus.⁹

On May 16, 2013, the full Racing Commission met and discussed the May 15, 2013, letter of agreement. The agreement was generally well received, but some commission members were still concerned about the possible underfunding of purses in the past. As one member said:

The amendment of the purse agreement that the horsemen and the track agreed to last night solves the problem from today going forward. It does not deal with the possible underpayment of purses over the past five years.¹⁰

The issue of what state law requires and whether there were underpayments of purses at Running Aces in past years was referred back to the commission's Finance Committee. However, the issue continued to be discussed at full commission meetings.

At its August 15, 2013, meeting, the Racing Commission requested that Running Aces and Canterbury Park provide the commission with information on past purse contributions and how they were calculated. The information was presented at the commission's September 19, 2013, meeting, and the Horsemen's Association was asked to prepare a response for the next commission meeting. The association's response was contained in a letter to Running Aces dated October 16, 2013.

The October 16 letter, prepared by an attorney retained by the Horsemen's Association, directly contradicted the May 15 letter of agreement. The association's attorney asserted that the state law governing purse contributions "clearly provide[s] that live racing purses should be calculated on 8.4% of handle, not takeout."¹¹ The letter also said:

Based upon our review of the statute and materials disclosed to-date, we believe Running Aces Harness Park and North Metro Harness

⁹ Letter of Agreement, May 15, 2013, p. 3.

¹⁰ Minnesota Racing Commission, transcript of May 16, 2013, meeting, p. 15, lines 2-6.

¹¹ Amanda E. Prutzman, Attorney, Eckberg Lammers, Attorneys at Law, letter to Robert Farinella, General Manager, Running Aces Harness Park, October 16, 2013, p. 1.

Initiative, LLC (Running Aces) has incorrectly calculated purse funds on takeout rather than handle for the five year period of 2008 and 2012. This has resulted in a material difference of at least \$382,000 for live racing purses which was not paid to standardbred horsepersons.¹²

In conclusion, the letter said: “Finally, the May 15, 2013 letter agreement executed by Running Aces and MHRI [the Horsemen’s Association] cannot rectify the past purse miscalculations because it is unenforceable and contrary to Minnesota law.”¹³ On October 14, 2013, the Horsemen’s Association withdrew its approval of the May 15, 2013, agreement.¹⁴

Running Aces’ position on the May 15, 2013, agreement was presented to the commission in a letter dated December 18, 2013, from the facility’s attorney.¹⁵ The attorney’s letter argued that the agreement between Running Aces and the Horsemen’s Association was valid, enforceable, and an appropriate way to resolve the dispute. He also argued that it was permissible for the association to accept less than full reimbursement of past purse underpayments because Running Aces had made other payments that benefited members of the Horsemen’s Association. He said: “When this issue is properly understood as a settlement discussion, it is clear that offsetting money can be recognized by MHRI [the Horsemen’s Association].”¹⁶ He also claimed that in the negotiations to achieve a settlement, the Horsemen’s Association recognized these offsetting payments and requested \$100,000 from Running Aces “to make up for the alleged shortfall” in past purse contributions. He added: “Running Aces accepted the \$100,000 figure as the parties’ joint, good faith estimate of the net amount of money MHRI [the Horsemen’s Association] believed it was owed after considering various overpayments [offsets].”¹⁷

After hearing from legal counsel representing Running Aces and the Horsemen’s Association at a Racing Commission meeting on December 19, 2013, commission

¹² *Ibid.*

¹³ *Ibid.*, p. 9.

¹⁴ In a letter to OLA explaining that action, the attorney representing the association asserted that Running Aces presented a draft letter of agreement at an association board meeting on May 15, and represented to the association that if the agreement was not executed before the Racing Commission meeting the next day, the upcoming 2013 live racing season would be in jeopardy. The attorney also stated that the association “did not have the opportunity for purposeful review nor the opportunity to consult legal counsel before signing the [May 15, 2013] letter,” and was informed the next day by the then chair of the Racing Commission “that the agreement was potentially in violation of state statute and advised [the association] to obtain legal counsel.” Amanda E. Prutzman, Attorney, Eckberg Lammers, Attorney at Law, letter to James Nobles, Legislative Auditor, May 27, 2014, pp. 1 and 2.

¹⁵ Thomas A. Keller, III, Attorney, Moss & Barnett, letter to Ralph Strangis, Chairman, Minnesota Racing Commission, December 18, 2013.

¹⁶ *Ibid.*, p. 3.

¹⁷ *Ibid.*, p. 4.

members discussed both the history and current status of the purse contribution dispute. Several commission members expressed strong frustration that the issues involved had not been resolved. However, there was still uncertainty among commission members as to whether the dispute should be resolved by action of the commission or through a negotiated settlement between Running Aces and the Horsemen's Association.

The only clear agreement to emerge at the December 19 meeting was for the commission to seek assistance from an outside, independent auditor. Because OLA is the independent auditor of Minnesota state government and our jurisdiction includes the Racing Commission, we accepted the request to review the purse contribution dispute.

Findings and Recommendations

The Minnesota Racing Commission failed to adequately oversee purse contributions at Running Aces, which allowed a serious dispute to arise and remain unresolved for a significant period of time.

Finding 1

The Minnesota Racing Commission has the responsibility and authority to enforce state laws enacted to ensure the integrity of horse racing and pari-mutuel gambling in Minnesota. Those laws provide specific provisions for how owners of horse racing facilities are to contribute to purses for live racing. The commission has failed for many years to ensure the enforcement of these laws.¹⁸

In 2005, before Running Aces was established, OLA issued an evaluation report, *Gambling Regulation and Oversight*, which pointed to weak oversight of purses by the Racing Commission at Canterbury Park. The report said:

...the Racing Commission has not paid sufficient attention to the allocation of revenue to purses. The commission relies on Canterbury Park to ensure that funds are properly allocated to purses for live races held at Canterbury Park. Canterbury Park provides a weekly report to the commission detailing contributions to the “escrow purse fund” account, but commission staff do not review the report or verify that the proper amount is distributed.¹⁹

Without conducting a follow-up review of commission purse oversight at Canterbury Park, we do not know whether the deficiency we noted in 2005 has been corrected. However, based on this review, we clearly see that there has been inadequate commission oversight of purses at Running Aces.

Because the Racing Commission failed for approximately five years to adequately oversee purse contributions at Running Aces, a significant dispute developed. The commission allowed its deputy executive director to decide whether Running Aces was complying with state law without review and action by the commission.

¹⁸ It is important to note that through the period of this review, there were changes in the membership and chairmanship of the commission, as well as changes in the executive director position. In October 2012, Richard Krueger, who had been executive director of the commission since 1989, retired. From June 2013 through December 2013, an employee from the Minnesota Department of Management and Budget was assigned to serve as a temporary executive director to the commission. In November 2013, Governor Dayton announced that he had appointed Thomas DiPasquale to be the commission’s executive director. Mr. DiPasquale had served for several months as a member of the commission before his appointment to be the executive director. Finally, as noted previously, the commission’s deputy executive director, and the person assigned to oversee Running Aces also changed. The previous deputy resigned in June 2013, and the commission hired a new deputy in June 2014.

¹⁹ Office of the Legislative Auditor, Program Evaluation Division, *Gambling Regulation and Oversight* (St. Paul, 2005).

If the commission had been more actively involved, it is likely that members would have quickly noted that Running Aces was making purse contributions using a different method from that used at Canterbury Park and different than what Running Aces proposed in its license application.

It is also concerning that the commission apparently learned about the issue by the action of one member rather than through a commission-established process of review. And, as noted before, once discovered, the commission has been unable to take action to resolve the dispute for almost a full year. When the dispute was last discussed at a commission meeting, members again deferred commission action and strongly encouraged the parties to settle the dispute. In addition, the commission continued to show uncertainty about the commission's role, responsibility, and authority.

Recommendations

- *The Minnesota Racing Commission should take prompt action to resolve the dispute over purse contributions at Running Aces.*
- *The Minnesota Racing Commission should establish procedures to ensure that the commission reviews and approves (or disapproves) any agreement that affects implementation of state laws at facilities licensed by the commission.*

Finding 2

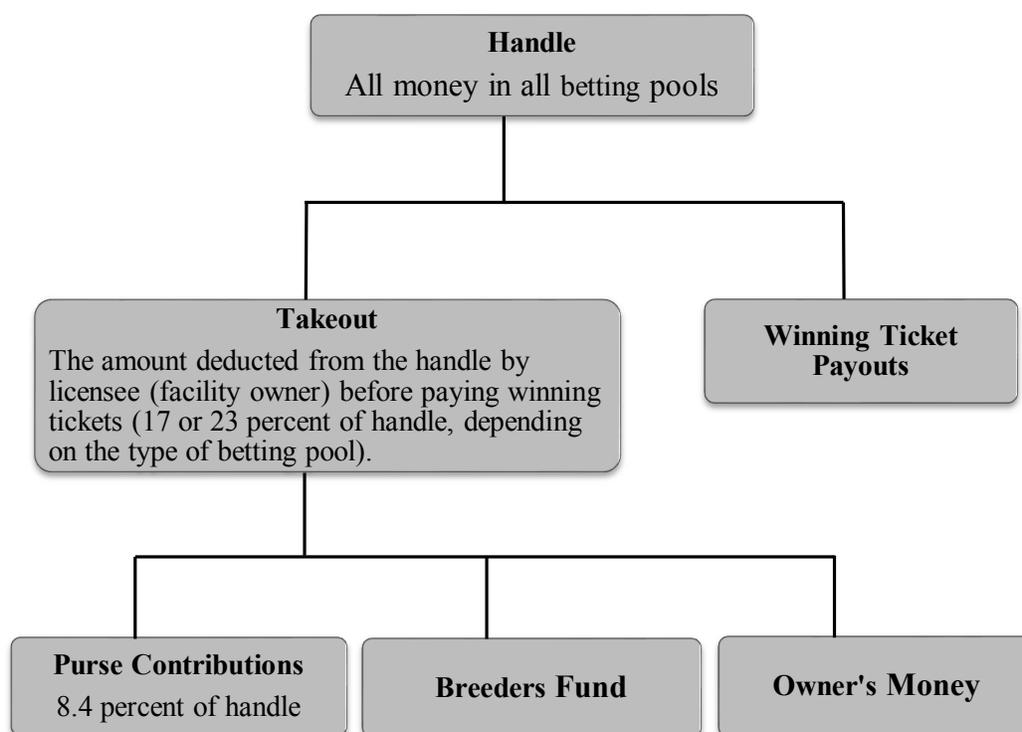
Purse contributions made by Running Aces from betting on live races at Running Aces from 2008 through 2012 were not in compliance with Minnesota law.

As discussed earlier, the dispute addressed in this review arose from conflicting interpretations of *Minnesota Statutes* 2013, 240.13, subd. 5(a)(1), a provision of state law that governs purse contributions. Running Aces contends that it was in compliance with the provision when it calculated purse contributions on the takeout, while the Horsemen's Association argues that those calculations were not in compliance with state law; that they should have been calculated on the handle. As noted previously, members of the Racing Commission have had differing opinions about what that provision of law requires.

While we concluded that the law requires purse contributions to be calculated on the handle, we think the law is confusing, especially at first reading. For us, the law's meaning only became clear after considerable analysis of the language of the law itself. In addition, we reached our conclusion after taking into consideration the following:

1. Purse calculations at Canterbury Park have for the past 25 years been based on the handle (i.e., all money in all betting pools) not on the takeout.
2. When seeking a license to operate a harness horse racing facility, North Metro Harness Initiative, LLC said it would calculate purse contributions on “all money in all betting pools” (i.e., on the handle).
3. Staff at the Research Department for the Minnesota House of Representatives, who were involved in drafting *Minnesota Statutes* 2013, 240.13, subd. 5, advised us that it requires purse contributions to be calculated on the handle.

The following figure depicts our understanding of how the law requires purse contributions to be calculated:



Recommendation

- *The Minnesota Racing Commission should seek an amendment to Minnesota Statutes 2013, 240.13, subd. 5(a), that makes it indisputable that purse contributions must be calculated on the handle.*

Finding 3

Purse contributions made by Running Aces from betting on simulcast races that occur during “the time period of live races” from 2008 through 2012 were not in compliance with state law.

As noted earlier, *Minnesota Statutes* 2013, 240.13, subd. 5(a)(1), requires a class A racing facility licensed by the Racing Commission (Canterbury Park and Running Aces) to make purse contributions from betting pools for live races at their facilities and “for races that are part of full racing card simulcasting that takes place within the time period of the live races.”²⁰

State law defines “full racing card,” “simulcasting,” and “racing season,” but it does not define “the time period of live races.”²¹ In addition, the Racing Commission has not used its rule-making authority to define the meaning of “within the time period of the live races” for the purpose of calculating races simulcast into Minnesota racing facilities.²²

In the absence of a state definition either in law or rule, Canterbury Park and Running Aces have interpreted “the time period of live races” differently. According to Racing Commission staff, Canterbury Park defines “the time period of live races” to mean from the time horses are released from the starting gate for the first live race until the last race of the day is declared “official.” When asked how Running Aces defines “the time period of live races,” commission staff were unsure. A representative of Running Aces told us that Running Aces had been defining the term to mean anytime during a day when live races are run at Running Aces, but changed in 2013 to the definition used by Canterbury Park.

Unlike the question of whether state law requires purse contributions to be calculated on the takeout or handle, we did not find a basis either in the language of the law itself or its history to conclude what is meant by “the time period of live races.” This is, therefore, another aspect of racing regulation that needs to be

²⁰ The law also mandates in *Minnesota Statutes* 2013, 240.13, subd. 5(a)(2), how betting pools for simulcast races received by a Minnesota licensed facility during a racing season but not during the time period of live races at that facility will be distributed and, in subd. 5(a)(3), how betting pools will be distributed for simulcasts conducted outside of the racing season.

²¹ *Minnesota Statutes* 2013, 240.01, subd. 23, defines “full racing card” to mean “three or more races that are: (1) part of a horse racing program being conducted at a racetrack; and (2) being simulcast or telerace simulcast at a licensed racetrack.” *Minnesota Statutes* 2013, 240.01, subd. 19, defines “simulcasting” to mean “the televised display, for pari-mutuel wagering purposes, of one or more horse races conducted at another location wherein the televised display occurs simultaneously with the race being televised.” *Minnesota Statutes* 2013, 240.01, subd. 22, defines “racing season” to mean “that portion of the calendar year starting at the beginning of the day of the first live horse race conducted by the licensee and concluding at the end of the day of the last live horse race conducted by the licensee in any year.” According to this statutory definition, “the racing season begins before the first Saturday in May and continues for not less than 25 consecutive weeks.”

²² *Minnesota Statutes* 2013, 240.13, subd. 5, which, as noted previously, is the subdivision of statute that regulates the calculation of purse contributions from pari-mutuel betting, states: “The commission may by rule provide for the administration and enforcement of this subdivision.”

addressed either by the Racing Commission promulgating a clarifying administrative rule or the Legislature adding a definition in state law.

Recommendation

- *The Minnesota Racing Commission should either promulgate an administrative rule or seek a statutory provision to define the meaning of “the time period of live races” in Minnesota Statutes 2013, 240.13, subd. 5(a)(1).*

Purse contributions made by Running Aces from 2008 through 2012 were deficient by \$436,865.

Finding 4

Based on our conclusion that the law requires purse contributions to be calculated on the handle, and using wagering data provided to us by the Racing Commission, we calculated the amount of purse underpayments for live races at Running Aces in 2008 through 2012, as shown in Table 1.

Table 1
Calculation of Purse Underpayments
Live Races for the Years 2008 through 2012

<u>Year</u>	<u>Live Racing Handle¹</u>	<u>Purse Contribution Based on Handle²</u>	<u>Total Takeout³</u>	<u>Purse Contribution Based on Takeout⁴</u>	<u>Purse Contribution Underpayment⁵</u>
2008	\$1,223,877	\$102,806	\$ 230,279	\$19,343	\$ 83,462
2009	1,152,523	96,812	223,444	18,769	78,043
2010	1,182,873	99,361	226,687	19,042	80,320
2011	908,791	76,338	174,323	14,643	61,695
2012	<u>1,182,011</u>	<u>99,289</u>	<u>226,609</u>	<u>19,035</u>	<u>80,254</u>
Total	<u>\$5,650,075</u>	<u>\$474,606</u>	<u>\$1,081,342</u>	<u>\$90,832</u>	<u>\$383,774</u>

¹ The handle amounts in this table include only the amounts wagered on live races held at Running Aces; they do not include handle on races simulcast to Running Aces from other racing facilities during live racing time periods at Running Aces.

² This column represents the purse contribution amounts required by *Minnesota Statutes* 2013, 240.13, subd. 5(a)(1), calculated as handle x 8.4 percent.

³ Total takeout is the amount Running Aces is allowed to deduct from wagering pools before payments to holders of winning tickets per *Minnesota Statutes* 2013, 240.13, subd. 4.

⁴ This column represents the purse contribution amounts paid as specified in the agreements between Running Aces and the Horsemen’s Association, calculated as takeout x 8.4 percent.

⁵ Underpayment is the difference between purse contributions calculated on the handle and contributions calculated on the takeout.

Source: Office of the Legislative Auditor analysis of Sportech PLC wagering data.

Table 2 presents our estimate of the amount of purse underpayment by Running Aces for races simulcast to Running Aces during the time period of live races in

years 2008 through 2012. As noted previously, neither state law nor the Racing Commission’s administrative rules clarify what is meant by races simulcast “within the time period of the live races.” To make the calculation shown in Table 2, we accepted the definition used by Running Aces from 2008 through 2012 (i.e., simulcasts received anytime during a day when live races occurred at Running Aces).

Table 2
Calculation of Purse Underpayments
Simulcast Races for the Years 2008 through 2012

Year	Simulcast Racing Handle ¹	Purse Contribution Based on Handle ²	Total Takeout ³	Purse Contribution Based on Takeout ⁴	Purse Contribution Underpayment ⁵
2008	\$ 351,325	\$29,511	\$ 76,575	\$30,755	\$ (1,244)
2009	230,013	19,321	51,285	4,308	15,013
2010	179,407	15,070	39,476	3,316	11,754
2011	209,453	17,594	46,811	3,932	13,662
2012	212,673	17,865	47,137	3,960	13,905
Total	<u>\$1,182,871</u>	<u>\$99,361</u>	<u>\$261,284</u>	<u>\$46,271</u>	<u>\$53,091</u>

NOTE: In 2008, the purse contribution was calculated based on 50 percent of the takeout less Breeders Fund tax and Host fees. In subsequent years, the purse contributions were calculated based on 8.4 percent of the takeout.

¹ The handle amounts include amounts wagered on standardbred simulcast races held on live racing days at Running Aces.

² This column represents the purse contribution amounts required by *Minnesota Statutes* 2013, 240.13, subd. 5, calculated as handle x 8.4 percent.

³ Total takeout is the amount Running Aces is allowed to deduct from wagering pools before payments to holders of winning tickets per *Minnesota Statutes* 2013, 240.13, subd. 4.

⁴ This column represents the purse contribution amounts paid as specified in the agreements between Running Aces and the Horsemen’s Association calculated as takeout x 8.4 percent.

⁵ Underpayment is the difference between purse contributions calculated on the handle and contributions calculated on the takeout. This amount would be less if calculated on the more narrow definition of “within the time period of the live races” now being used by Running Aces. However, as noted above, given uncertainty about the meaning of that phrase, we applied the meaning used by Running Aces from 2008 through 2012.

Source: Office of the Legislative Auditor analysis of Sportech PLC wagering data.

Combining the calculations from Table 1 and Table 2, the total underpayment of purse contributions by Running Aces from 2008 through 2012 amounted to approximately \$436,865.

As indicated in Finding 1 and its related recommendations, we think the Racing Commission needs to take action as soon as possible to resolve the Running Aces purse contribution dispute. Because purse contributions will be calculated on the handle going forward, the primary issue to be resolved now is how much the commission will require Running Aces to pay to satisfy its past underpayment of

purse contributions, and what mechanism of enforcement will the commission use to obtain the payment.

In most situations, when an entity has not complied with a state law, OLA would recommend that the state agency in the executive branch responsible for enforcing the law (in this case, the Racing Commission) obtain full payment of the amount owed. However, from experience, we also know that state agencies, in consultation with the Office of the Attorney General, often settle for less because of various mitigating factors. We think such factors may affect the commission's ability to obtain full payment from Running Aces to resolve its prior noncompliance with state law's purse contribution requirements. Those factors are as follows:

- First, as noted in Finding 1, the Racing Commission contributed significantly to the dispute and allowed it to remain unresolved for a significant period of time. Even more significant, the commission's staff were aware that Running Aces was using takeout to calculate purse contributions and, by inaction, gave tacit approval to Running Aces' interpretation of state law.
- Second, the Horsemen's Association—the organization that represents people directly affected by how purse contributions are calculated—agreed three times to the use of takeout in calculating purse contributions at Running Aces.²³ It is important to note, however, that the association's attorney argues that these provisions in the agreements were not valid because they were in conflict with state law.²⁴
- Third, the Horsemen's Association entered into an agreement with Running Aces to resolve the purse contribution dispute without requiring payment of past underpayments.²⁵
- Fourth, Running Aces claims that it should be given credit for non-purse benefits it provided members of the Horsemen's Association. Specifically, Running Aces wants credit for sharing revenue with the Horsemen's Association from a simulcast export fee and for certain insurance payments it made.²⁶

²³ Those agreements were executed in October 2007, February 2011, and March 2013.

²⁴ For example, in her letter to the general manager of Running Aces dated October 16, 2013, the attorney said: "Because the Agreements all specifically provide that Minnesota law controls, the 8.4% calculation on takeout provided in the last three Agreements is not valid." Op. cit. p. 7.

²⁵ As noted previously, the Horsemen's Association later withdrew the letter of agreement on October 14, 2013.

²⁶ Running Aces contractually agreed to pay the Horsemen's Association 50 percent of the net profits from selling its export signal. According to the information we reviewed, Running Aces has never earned a profit on selling its export signal, but decided to contribute 50 percent of the revenues it earned from selling its export signal to the Horsemen's Association. We reviewed documentation provided by Running Aces and concluded that the benefits were provided.

- Fifth, state statutes do not provide the Racing Commission with an enforcement mechanism to obtain a payment for past purse contribution underpayments.²⁷

It will, of course, be up to the Racing Commission to decide whether to take these factions into consideration as it decides how much payment to require from Running Aces. It will also be up to the commission to decide what mechanism it will use to formulate a payment requirement and how to enforce it.

In our opinion, it would be reasonable for the commission to consider the factors noted above as it formulates a payment requirement for Running Aces, and it would be appropriate for the commission to negotiate an amount with Running Aces. In addition, we think it would be important for the commission to include the Horsemen's Association in the negotiation as an affected party. However, it should be the commission that controls the negotiation process and makes the final determination as to the amount of payment that is required.

Recommendation

- *The Minnesota Racing Commission should promptly institute a negotiation process that will result in resolution of the Running Aces purse contribution dispute. The resolution should include a reasonable payment by Running Aces for past underpayments of purse contributions, and the final result of the negotiations should be approved by a majority vote of the commission.*

²⁷ While Minnesota statutes do not provide the Racing Commission with an explicit mechanism to obtain a payment from Running Aces for past purse contribution underpayments, *Minnesota Statutes* 240.03 (3) grants the commission the power and duty "to enforce all laws and rules governing horse racing."

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MINNESOTA RACING COMMISSION

June 30, 2014

Mr. James Nobles, Legislative Auditor
Office of the Legislative Auditor
Room 140, Centennial Building
St. Paul, MN 55155

Re: Purse Contributions at Running Aces Harness Park

Dear Mr. Nobles:

On behalf of the Minnesota Racing Commission (MRC), thank you for your thoughtful and thorough special review of various issues related to purse contributions at Running Aces ("Report"). As you noted, this review was requested by MRC in January 2014 following several months of dialogue involving MRC, Running Aces and Minnesota Harness Racing, Inc. (MHRI) regarding underpayment of purse contributions for the period 2008-2012. MRC also requested that the audit scope include a review of its oversight practices and procedures. MRC's confidence that your office could assist in its investigative and compliance assurance efforts has been confirmed by your Report.

The MRC accepts the Report's findings and recommendations. In sum, from 2008 through 2012 the Commission failed to exercise adequate oversight of purse contributions during the relevant period which resulted in an undetected statutory underpayment of purse contributions in the amount of \$436,865. The Report's recommendations, together with steps already taken by MRC, will ensure continuing review and oversight on a regular basis. (See response to Recommendation 1).

Our response is divided into two parts. First, we look back to the May-December 2013 time period to provide more context to the Commission's efforts to resolve this dispute. Second, we respond to the recommendations.

MAY-DECEMBER 2013

At the May 14, 2013 MRC Finance Committee meeting, the then-Chair and Vice-Chair took the position that the statute, Minn. Stat. 240.13, subdivision 5, governed and that it required purse contributions in the amount of 8.4% of handle. The Vice-Chair stated as follows:

"We appear to have a problem. And now that we know we've got a potential problem, we've got to verify it...and then decide what to do about it. If the statute says that you'll pay X to purses and the actual agreement between the parties has for five years provided something else, we've got...an

accumulated underpayment of purses. ...The distinction is between 8.4 percent of handle, which is what the statute requires, and 8.4 percent of takeout, which is what the purse fund (contribution agreement) provides."

May 14, 2013 Finance Committee transcript at 39.

The then-Commission Chair put it more succinctly:

"No agreements can trump the statute."

Id. at 44

As noted in the Report at footnote 18, MRC experienced significant leadership changes over the next several months. A new chair was appointed; three new commissioners were appointed (one to replace the current Executive Director who was appointed to his current position in December 2013); and the commission operated without a Deputy Director until June of 2014. Despite these changes, throughout this period the purse contribution matter remained a Commission priority. Efforts were made to gather the facts, determine the parties positions, and encourage a negotiated settlement. Running Aces' lack of cooperation with the designated representative of the horsemen made resolution of the dispute more difficult.

Commission leadership from the date of discovery in May 2013 was unequivocal in its position that purse contributions were substantially underpaid and impressed upon the parties the importance of resolution. The Executive Director drafted proposed Findings and Conclusions in December 2013 which are largely consistent with the Report's findings. And the current MRC Chair has repeatedly communicated his intent to use the Commission's statutory enforcement authority following the grant of an informal "stay" while awaiting the Report.

We have now reached that point and the MRC intends to act swiftly.

FINDINGS and RECOMMENDATIONS

FINDING 1

The MRC failed to adequately oversee purse contributions at Running Aces, which allowed a serious dispute to arise and remain unresolved for a significant period of time.

MRC has conducted its own internal assessment of how the discrepancy occurred between its interpretation of Minn. Stat. Section 240.13, subd. 5 purse contribution requirements for Standardbred racing at Running Aces and Thoroughbred/Quarter horse racing at Canterbury Park. As a result of that review, the following measures are or shortly will be in place:

MRC staff will conduct the following:

- (a) weekly reviews of racing association live and simulcast handle reports focusing on the proper allotment of purse monies, Breeders' funds, and other pari-mutuel taxes;

- (b) weekly reviews of total purse distributions by racing associations including a current status of under or over payments;
- (c) spot reviews of source information from Tote companies and simulcasting venues.

These reviews will be summarized monthly and shared with the Executive and Deputy Directors, Commissioners and horsemen's groups to ensure that any discrepancies in statutory purse set asides, perceived or actual, are addressed in a timely manner.

RECOMMENDATION

The MRC should establish procedures to ensure that the commission reviews and approves (or disapproves) any agreement that affects implementation of state laws at facilities licensed by the commission.

Running Aces and the MHRI entered into agreements governing "purses, back side conditions and all other matters of Horsepersons' concern which are subject to negotiations and related to the conduct of a horse racing meet" in November 2003; October 2007; February 2011 and March 2013. The 2003 agreement mirrored the language set forth in statute and required purse contributions of 8.4% of handle. This agreement, evidencing a clear understanding of the statutory obligation, was submitted to the MRC and approved as part of the license application of Running Aces' predecessor in interest in January 2005.

Subsequent purse contribution agreements between the racing association and harness horsemen's association, starting in October 2007, provided that purse contributions "shall be set aside in accordance with Minn. Stat. Section 240.13, subd. 5(a)", but altered the language to read "8.4% of the takeout."¹

These subsequent agreements which changed the word "handle" to "takeout" were apparently filed with the MRC but not formally approved. MRC's failure to have an explicit contract review and approval process in place for these agreements to ensure statutory compliance contributed to the circumstances that were discovered in May 2013.

MRC is authorized by Minn. Stat. 240.19 to review and approve all contracts entered into by the racing associations for goods and services. Contracts for goods and services that potentially affect the integrity of racing are subject to greater scrutiny as described in the implementing rules. See Minn. Rule 7870.0500

Thus, the MRC currently follows very specific guidelines for contract review as set forth in its Rules. The MRC will extend its contract review process to include agreements between the racing associations and their horsemen's representatives or any other contracts that fall within the scope of its powers and duties described in 240.03.

¹ Footnote 7 of the Report states that the former Deputy Director referred to the October 2007 agreement as the "first purse contribution agreement." As noted above, the 2007 agreement was actually the second agreement and the one which amended the purse contribution below the statutory rate.

FINDING 2

Purse contributions made by Running Aces from betting on live races at Running Aces from 2008 through 2012 were not in compliance with Minnesota law.

MRC agrees with this finding.

FINDING 3

Purse contributions made by Running Aces from betting on simulcast races that occur "during the period of the live races" from 2008 through 2012 were not in compliance with state law.

MRC agrees with this finding.

RECOMMENDATION

The MRC should seek an amendment to Minn. Stat. 240.13, subd. 5(a) that makes it indisputable that purse contributions be calculated on the "handle."

MRC agrees with this recommendation. As noted in the Report, the May 15, 2013 agreement between Running Aces and MHRI stipulates that the method of calculation will be 8.4% of handle on live racing and Standardbred simulcasting during live racing for race season 2013 and forward. Thus, the statutory ambiguity, if it ever existed,² has been resolved and the racing associations are essentially interpreting the purse contribution requirement the same but for the definition of the phrase "within the time period of the live races" for the purpose of calculating purse contributions for races simulcast into the associations.

Nevertheless, Minn. Stat. 240.13 is unnecessarily complex and needs simplification. MRC will make that a priority in its reform package for the next Legislative session.

RECOMMENDATION

The MRC should either promulgate an administrative rule or seek a statutory provision to define the meaning of "the time period of live races" in Minn. Stat. 240.13, subd. 5(a)(1)

The MRC agrees with this recommendation. We plan to review how other jurisdictions are handling this issue, obtain input from affected parties, and include a clear definition in our next rule making or statutory reform proposal.

FINDING 4

Purse contributions made by Running Aces from 2008 through 2012 were deficient by \$436,865.

² It is notable that Canterbury Park has always based purse contributions on 8.4 percent of handle.

RECOMMENDATION

The MRC should promptly institute a negotiation process that will result in resolution of the Running Aces purse contribution dispute. The resolution should include a reasonable payment by Running Aces for past underpayments of purse contributions, and the final result of the negotiations should be approved by a majority vote of the commission.

The MRC played an active role in late 2013 to resolve this dispute. The MRC recognized the importance of ongoing collaboration between the horsemen and the track and thus encouraged a settlement on terms acceptable to MRC. At the Commission's direction, the Executive Director spent December and January, prior to requesting OLA's involvement, urging counsel for both sides to reach a reasonable resolution that could be approved by the Commission. MRC consulted with counsel from the Attorney General's office on the nature and extent of its legal authority and, in particular, on how a remedy could be fashioned that benefitted those who had been underpaid by the purse shortfall. In sum, the MRC did everything but invoke the authority noted in the Report to "enforce all laws and rules governing horse racing."

Although these efforts did not produce the desired outcome, they have put the Commission in a position, together with the findings in this Report, to promptly institute a process to resolve the dispute. We agree with the Report's concluding sentence that "it should be the Commission that controls the negotiation process and make(s) the final determination as to the amount of payment that is required."

We thank you for the quality and the clarity of your Report. We intend to act on it immediately.



Ralph Strangis
Chair, Minnesota Racing Commission



Thomas DiPasquale
Executive Director, Minnesota Racing Commission



June 30, 2014

James Nobles
Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
Saint Paul, MN 55155-1603

Re: *Minnesota Harness Racing, Inc.'s letter of response to OLA Review entitled "Minnesota Racing Commission: Oversight of Purse Contributions at Running Aces Harness Park."*

Dear Mr. Nobles:

This office represents Minnesota Harness Racing, Inc. ("MHRI"), the organization which represents horsepersons who race at Running Aces Harness Park ("Running Aces"). This letter serves as MHRI's formal response to the Office of Legislative Auditor's ("OLA") report entitled "*Minnesota Racing Commission: Oversight of Purse Contributions at Running Aces Harness Park.*" There are three main points MHRI wishes to make in response.

First, the positions MHRI has taken during this dispute reflect its goal of ensuring that its actions are in compliance with statute. MHRI recognizes the importance of the statutes governing pari-mutuel horse racing in Minnesota and it is extremely important to MHRI that it is in compliance with these statutes at all times.

Second, MHRI agrees with the OLA's findings that Running Aces did not make purse contributions as required by law. Per the contracts between MHRI and Running Aces, any agreements the made that are in conflict with the statute are no longer valid. The most current contract states, "To the extent any of the provisions of this Agreement conflict with or would be inconsistent with any laws or rules relating to horse racing or card clubs, each party will comply with those laws or rules ..." (Section 10, March 29, 2013 Purse Contribution Agreement). All purse contribution contracts between MHRI and Running Aces since the inception of the racetrack also include this provision. Simply put, if MHRI agreed to anything that is contrary to Minnesota law, either in its main contract or the "letter of agreement," that specific agreement is invalid and Minnesota law controls. As already agreed to by Running Aces and MHRI, none of MHRI's prior agreements should be considered when determining the amount Running Aces is required to pay to resolve its prior noncompliance with state law.

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James Nobles
June 30, 2014
Page 2 of 2

Finally, if the Minnesota Racing Commission will not order an amount due from Running Aces, then MHRI agrees with the OLA's recommendation that the Commission institute and control a negotiation process which involves both Running Aces and MHRI. Any resolution to this issue must include MHRI as its members have been directly affected by purse contributions which were not in compliance with state law.

MHRI thanks the OLA for the time and effort involved in compiling the report as well as for the opportunity to provide these comments.

Sincerely,



Amanda E. Prutzman

c: Minnesota Harness Racing, Inc.



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June 30, 2014

Mr. Jim Nobles
Legislative Auditor
Office of the Legislative Auditor
Centennial Building – Suite 140
658 Cedar Street
Saint Paul, MN 55155

Subject: OLA's audit report: *Minnesota Racing Commission; Oversight of Purse Contributions at Running Aces Harness Park*

Mr. Nobles,

We reviewed the subject report. It recognizes that the conflicting interpretation of the statutory requirement for how purse contributions should be calculated resulted in part because the terms "handle" and "takeout" are not defined in the Statute. It also indicates the calculation should be based upon "handle" but concludes "the law is confusing".

Importantly, the calculation method used by Running Aces in 2008 – 2012 was clearly defined in Running Aces agreements with its horsemen since 2007 and each was submitted to the Minnesota Racing Commission. Such agreements specifically referenced the MN statute governing the purse calculation and clearly stated the use of "takeout" for the calculation.

When notified of a potential issue we immediately worked with our horsemen on an agreement to settle any possible miscalculation caused by the confusing Statute. The May 2013 agreement with our horsemen stipulated a net settlement of \$100,000 over four years for past periods and established the use of handle which elevated purses on a going forward basis. Such net settlement recognized the potential handle underpayment and offsetting amounts paid in favor of the horsemen.

Overview Table; by year regarding under (*as verified*) and overpayments (*as recognized*) in the OLA Special Report:

YEAR	2008	2009	2010	2011	2012	2013	2014	Total
Handle Underpayment	(\$82,218)	(\$93,056)	(\$92,074)	(\$75,357)	(\$94,159)	\$0		(\$436,864)
Export Overpayment	\$12,452	\$16,247	\$46,097	\$55,559	\$70,726			\$201,081
Horsemen's Benevolent Insurance	\$19,925	\$14,832	\$15,660	\$19,980	\$21,170	\$24,060	\$21,605	\$137,232
Net over/(under)	(\$49,841)	(\$61,977)	(\$30,317)	\$182	(\$2,263)	\$24,060	\$21,605	(\$98,551)

*The export contribution of \$38,316 for 2014 was correctly reduced to zero in December 2013.

In February 2014, as a result of the ongoing dispute regarding the purse calculation ambiguity and the MHRI repudiation of the May 2013 agreement, we accelerated the four year settlement period contained therein by depositing our calculated full amount of the handle underpayment into the horsemen's purse account. We also deducted for the export contributions and horsemen's benevolent insurance payments. As a result the horsemen's purse account was increased by a net of \$100,000 as shown in the below table;

December 2013	Purse contribution	\$25,000
February 2014	Purse contribution	\$434,965
February 2014	Purse deductions	(\$359,965)
		<u>\$100,000</u>

The above February 2014 purse deductions of \$359,965 included reimbursement for the \$25,000 we contributed in December 2013 resulting in net purse deductions of \$334,965. The purse deductions are supported by the following offsets as recognized by the OLA Special Report:

Export overpayment	2008 - 2012	\$201,081
Horsemen's benevolent insurance	2008 - 2014	\$137,232
		<u>\$338,313</u>
February net booked		\$334,965
Eligible offsets over amounts deducted		<u>\$3,348</u>

Based upon the OLA audit the handle underpayment calculation made and paid by us in February 2014 was \$1,899 under contributed.

February 2014 purse contribution deposited		\$434,965
OLA audit purse amount		(\$436,864)
Handle under contributed (not deposited)		<u>(\$1,899)</u>

Taking into account the to-date reconciliation itemized in the above tables, we have effectively over contributed into the horsemen's purse account \$1,449.

We look forward to promptly participating in the OLA's recommendation for a negotiation process initiated by the MRC to resolve any remaining issues.

Sincerely,



Robert Farinella
General Manager
Running Aces Harness Park