



Report of the Governor's Task Force on the Future of Horse Racing

December 2008

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December 15, 2008

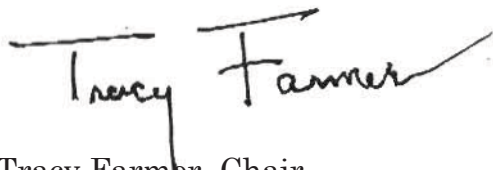
Dear Governor Beshear:

Six months ago you signed an executive order creating the Task Force on the Future of Horse Racing in Kentucky. You asked a number of highly qualified individuals to take a very close look at the current state of the horse industry and, in particular, the horse racing industry and how this group would recommend ensuring not only the viability of this signature industry, but ways in which horse racing in Kentucky can be competitive with other states.

In making the recommendations contained in this document, the Task Force members relied heavily upon those who work daily in this industry as owners, trainers, technicians, veterinarians, players and workers. Their input was valuable and gave us great insight into where Kentucky's horse industry should focus its attention in order to regain our competitive edge.

There are a number of recommendations in this report – recommendations that came from the four subcommittees following hours of discussion and testimony. We believe we have given you and those who read this report an excellent blueprint to begin the process of once again being able to proclaim Kentucky as “The Horse Capital of the World.” We strongly urge you to act swiftly in moving this report forward. Time is of the essence.

Sincerely,

A handwritten signature in black ink that reads "Tracy Farmer". The signature is written in a cursive style with a horizontal line above the first name.

Tracy Farmer, Chair
Governor's Task Force on the Future of Horse Racing

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Executive Summary

In his brief tenure as governor, Steve Beshear has moved forcefully to strengthen Kentucky's position as "The Horse Capital of the World." He reorganized the state's horse racing regulatory body into the Kentucky Horse Racing Commission (KHRC). The commission has made national news for its efforts to ensure the safety and integrity of horse racing, becoming among the first to ban anabolic steroids in competing horses. The governor also reconstituted the Equine Drug Research Council by appointing Dr. Jerry Yon as the new chair, and directing the council to examine and make recommendations on the complex issue of medications in racing.

In another example of his leadership, Governor Beshear announced in July 2008 the formation of a blue-ribbon Governor's Task Force on the Future of Horse Racing. The task force brought together leading figures in Kentucky's racing industry to analyze and make recommendations on some of the critical issues facing Kentucky horse racing today.

It is impossible to overstate the importance of the horse industry to Kentucky's economy and image. According to figures from the American Horse Council:

- Kentucky's horse industry has an annual economic impact of approximately \$4 billion.
- An estimated 80,000 to 100,000 Kentuckians owe their jobs to the horse industry.
- The horse industry is Kentucky's top agricultural cash crop.
- The Kentucky thoroughbred is the most sought after "brand" in the equine world. As proof of this, Kentucky breeders export horses worth in excess of \$127 million annually.

The public perception that horse racing is composed mostly of wealthy owners is inaccurate. There are horse farms in every county of the commonwealth, and the average income of those farm owners is \$50,000. In fact, most people in the horse business make their living producing hay, driving vans, grooming horses, and working in other support jobs. Still others are professionals such as veterinarians, equine accountants and attorneys, bloodstock consultants and race track officials.

Beyond the industry's direct impact on Kentucky's economy is the tourism value of horse racing. Hundreds of thousands of visitors travel to Kentucky each year to experience "the most exciting two minutes in sports" — the Kentucky Derby — attend races at the state's other outstanding tracks, visit a beautiful horse farm, attend sales at Keeneland and Fasig-Tipton, or enjoy the Kentucky Horse Park, the home of the 2010 Alltech FEI World Equestrian Games.

In assessing the importance of the horse industry to Kentucky's economy, it is important to understand the consequences of ignoring the difficulties facing it today and in the future. Citizens of the commonwealth need to reflect on how they would react if the thousands of jobs provided by Toyota, Ford and Kentucky's many auto-related industries were placed in jeopardy. There would be no question that Kentuckians would do everything necessary to save the state's vital automobile industry. The same mindset should prevail regarding the horse industry in Kentucky.

In creating the task force, Governor Beshear recognized that Kentucky's horse industry encompasses more than thoroughbred breeding and racing. The standardbred, quarter horse and numerous other breeds raised in Kentucky offer benefits to all 120 counties.

Governor Beshear has acknowledged that the horse racing industry in Kentucky faces unprecedented challenges. What competitive issues are Kentucky's race tracks facing? How can

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Kentucky maintain its position in horse racing with an inadequately funded regulatory body? Can the industry thrive if racing and betting integrity are not properly overseen? Is Kentucky well served by its laboratory testing services?

The task force was organized into four subcommittees: Industry Financial Matters, Proper Funding and Staffing Levels of the Kentucky Horse Racing Commission (KHRC), Integrity of Racing and All Pari-mutuel Activities, and Laboratory Facilities in Kentucky.

The task force, chaired by industry leader Tracy Farmer, promptly set about gathering information and conducting meetings. The task force invited a wide range of experts to provide their insight and expertise. Over the following four months, the subcommittees held numerous meetings and reviewed hundreds of pages of documents as part of their information-gathering process. The subcommittees then developed their recommendations.

Following is a summary of the work of these subcommittees, along with their recommendations to Governor Beshear.

Industry Financial Matters

Kentucky's horse industry faces significant and growing competition from other states. Purses and breeding programs in competing states have increased substantially, posing a threat to Kentucky's long-held position as the "The Horse Capital of the World."

The subcommittee noted that purses have grown nationwide at tracks that have alternative gaming revenue. Currently, 15 of the nation's top 20 tracks in total purses are now or will soon have purses subsidized with alternative gaming revenue.

For example, in Maryland, racetracks are projected to receive \$140 million annually from alternative gaming revenue, in the form of \$100 million more in purse money and \$40 million for capital expenditures.

Racetracks with alternative gambling are projected to see a combined increase in annual purses of 45.5 percent by 2013. This compares to an anticipated decline of 11.9 percent at tracks without such gaming revenue.

Two examples hit close to home. Hoosier Park and Indiana Downs in Indiana began operating slot machines in 2008. Projected purses at Hoosier Park for 2008 are estimated at \$8 million. That total is expected to double in 2009. At Indiana Downs, a total purse that now stands at \$4.6 million is expected to reach \$12 million next year.

The subcommittee also learned of challenges to Kentucky in breeding development funds. Pennsylvania is projected to pay \$23 million in 2008 to encourage breeding in that state. Standardbred award programs in other states also are increasing.

The subcommittee noted that the Kentucky Thoroughbred Development Fund and Kentucky Breeders' Incentive Fund have served the state well in providing incentives for owners to race and breed high-quality horses in Kentucky and recommends the expansion of both programs. In conclusion, the commonwealth needs to increase purses to remain The Horse Capital of the World.

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Industry Financial Matters Recommendations

1. Kentucky needs increased purses to remain The Horse Capital of the World.
2. Kentucky's Breeders' Incentive Fund must remain competitive in order to retain the best stallions and mares.
3. Kentucky needs to expand the Kentucky Thoroughbred Development Fund to retain high-quality racehorses.

Proper Funding and Staffing for KHRC

It has been well-established that the Kentucky Horse Racing Commission, the regulatory agency charged with overseeing racing in Kentucky, has been understaffed and underfunded. This conclusion was underscored in a 2006 audit by the Kentucky Auditor of Public Accounts. In the course of its work, the subcommittee learned that all other major racing states have more staff and more funding than Kentucky, according to testimony from Ed Martin, president of the Association of Racing Commissioners International.

The subcommittee also learned that the current pay scale of KHRC veterinarians is competitive but on the low end when compared to the potential compensation of local and national vets in private practice, thus hindering the commission's ability to hire and retain veterinarians. The subcommittee also noted that two out of three stewards are on the payroll of race tracks, creating a potential conflict of interest.

The state auditor's report also noted that KHRC lacks the staff to independently monitor and investigate pari-mutuel wagering activity.

The 2006 state audit pointed out that KHRC's total operating expenditures were generally lower than most other states surveyed.

The total budget for KHRC for the current fiscal year is approximately \$3 million. Its sources of funding are licensing fees and fines (\$1.5 million), track assessments (\$355,000) and General Fund (\$423,700). A carry-over from the prior fiscal year will permit KHRC to operate in the black through much of the current fiscal year, but these funds will not be available for the second year of the biennium.

The subcommittee examined many options for raising revenue, including increasing the takeout on wagers, increasing the pari-mutuel tax, dedicating the claiming tax to the KHRC, assessing the tracks, licensing tote companies and advanced deposit wagering companies, and imposing the cost of drug testing on winning owners. The actual proposals, however, are listed below.

Funding and Staffing Recommendations

1. Hire 10 new full-time staff members, consisting of two state stewards, two auditors, one paralegal, a staff attorney, two investigators, a racing veterinarian, and a veterinarian technician. Hire additional interim personnel as needed.
2. Put all three thoroughbred stewards and standardbred judges on the KHRC payroll.
3. Submit a budget request for a pari-mutuel information monitoring system as a capital project.
4. Require the various participants in the industry to share in funding the regulatory body.

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The following funding mechanisms are proposed:

1. Dedicate to the KHRC a specific dollar amount from the General Fund from the pari-mutuel tax.
2. Increase takeout on exotic bets and win-place-show bets, and dedicate the increase to funding the KHRC.
3. Require the owners of the top three finishers to contribute toward the cost of drug testing in any race in which the purse is \$10,000 or more.
4. Require the race tracks to continue to pay any cost of drug testing not covered by the owners.
5. Increase the pari-mutuel tax on race tracks with an average daily handle of \$1 million or more and dedicate the increase to funding the KHRC.
6. License tote companies and advance deposit wagering (ADWs) companies.
7. The subcommittee recommended that if other funding sources are not found, the amount of the reimbursements from tracks for the compensation of KHRC employees be increased and that tracks continue to pay for drug testing charges.

Integrity of Racing and All Pari-Mutuel Activities

Public confidence is essential to a vital racing industry. The racing enthusiast must be assured that wagering activity is closely monitored to ensure a level playing field for all players.

The 2006 state audit noted deficiencies in this area. The audit recommended additional investigatory staff to oversee wagering and to audit tote systems. The audit specifically recommended that the state hire a supervisor of pari-mutuel wagering.

The integrity subcommittee heard from several experts on wagering systems and on software used to detect betting anomalies. United Tote, the tote company for all of the Kentucky tracks, also provided information to the subcommittee.

The subcommittee learned details of a Comprehensive Horse Racing Information Management System (CHRIMS) used to gather and analyze tote information. The subcommittee also heard a presentation on a software system called Advanced Monitoring Systems designed to solve pari-mutuel problems such as account wagering fraud and odds manipulation. The subcommittee also heard from the Thoroughbred Racing Protective Bureau (TRPB) on the services it provides the tracks.

Integrity recommendations

Short-term (end of fiscal year 2010)

1. Fill current vacancies in the positions of pari-mutuel wagering supervisor, director of enforcement and investigator.
2. Obtain CHRIMS system.
3. Require all race tracks and off-track betting sites to notify KHRC of communications, reports or investigations by any state or federal regulatory agencies.
4. Require a track to record the exact time of races on all video feeds originating from Kentucky, require a tote company to certify the exact time of the closing of betting windows, require all tracks, tote companies and video providers to synchronize their time systems, and require tracks to provide a tote company with written permission for KHRC to receive handle and wagering information directly from the tote company.

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5. License and regulate tote companies.
6. Establish a Kentucky Horse Racing Integrity Hotline.
7. License and regulate advance deposit wagering companies.
8. Develop a method to license and supervise all vendors of products sold to trainers, veterinarians and grooms for use at tracks.
9. Hire and train additional security personnel to investigate alleged violations of Kentucky laws and regulations.

Long-term

1. Direct the pari-mutuel wagering supervisor to review available wagering monitoring systems and programs and obtain an appropriate system.
2. Develop career paths for investigators, auditors and stewards.
3. Continue efforts to verify and regulate wagering into Kentucky pools.
4. Monitor the progress of national efforts regarding the early closing of pools.
5. Establish regulations regarding past posting, cancel delay, late odds changes and unusually low payoffs.

Laboratory Facilities

Recent years have witnessed increased public concern regarding the use of illegal medications and overuse of permitted medications in all areas of horse racing. Within the industry, these concerns have led inevitably to an examination of existing equine drug testing facilities. The subcommittee specifically examined the advantages and disadvantages of establishing an equine drug testing lab in Kentucky.

The subcommittee consulted prominent experts to analyze the various methods of testing for medication, drugs and other substances. It learned that laboratories use substantially different methods of analysis, that labs are not standardized, and that with few exceptions, labs are not subject to strict quality control.

The subcommittee met with representatives of The Jockey Club and the Racing Medication and Testing Consortium (RMTC) to assess the volume of equine drug testing in the United States. The RMTC Drug Testing Initiative Task Force has noted that a number of cost efficiencies could be achieved by a reduction in the number of testing laboratories.

The subcommittee weighed other negative aspects of establishing a Kentucky laboratory, including the expense of building, outfitting and staffing the laboratory and the uncertain economic viability of the laboratory.

Several positive factors emerged from the examination. Among them would be more rapid test results, increased cooperation with the KHRC which should lead to higher quality testing and tighter controls, the potential for reduced costs, and the ability to organize research activities with university associated programs. In addition, the laboratory will create high-level, high-paying jobs in the commonwealth and may lead to the commercialization of research intellectual property.

Data obtained by the subcommittee indicated that a Kentucky lab would require from 12,000 to 17,500 square feet, that equipment would cost up to \$5 million, and that staffing and administrative costs would run up to \$3.5 million annually.

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The subcommittee examined several funding sources. The panel learned of state tax incentives for a profit-based facility. The subcommittee also learned of the interest of the city of Lexington and the University of Kentucky in facilitating a nonprofit research and drug testing facility. Several private organizations indicated their interest in either donating funds to or providing expertise to a world-class research and drug testing institute.

It was noted that the presence of a nonprofit facility could spin off for-profit entities that could provide funding to the institute through payment of royalties for intellectual property.

Laboratory Facilities Recommendations

1. Establish a nonprofit, world-class research and drug testing institute with a significant accreditation status.
2. Solidify, through further research, the cost estimates and identify potential additional revenue and funding sources.
3. Establish a foundation to begin raising a \$10 million endowment for operating expenses.
4. Establish an executive board of up to five members, including a chief executive officer, one member of the KHRC, and one member of the Equine Drug Research Council to guide the institute. The executive board would develop goals and a detailed business plan, collaborate with financing partners, work with the University of Kentucky on organization structure and facility development, and hire a lab director, among other functions.

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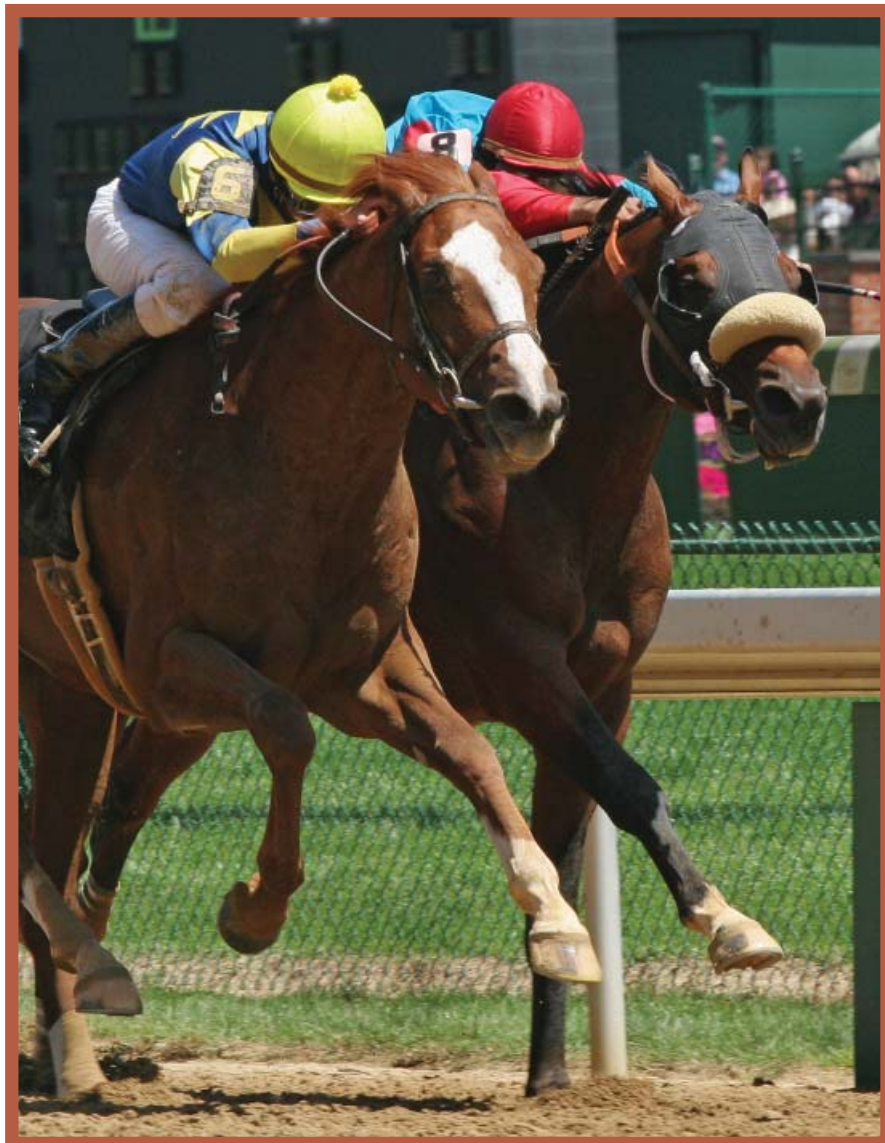


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Findings and Recommendations of the Subcommittee on Industry Financial Matters

Mission

The Industry Financial Matters Subcommittee was asked to study and make recommendations on the following aspects of Kentucky's horse industry:

- The current economic model for funding the purse structure;
- The competitiveness of Kentucky racing compared to other jurisdictions;
- The need and opportunity for alternative forms of gaming; and
- The success of the Kentucky Breeders' Incentive Fund in fulfilling its mission and purpose.

Subcommittee Members

Nick Nicholson, chair, Robert M. Beck Jr., Tracy Farmer, Robert D. Vance, Joe Costa, Ron Geary, Steve Sexton, Doug Cauthen (ex officio), Bob Elliston (ex officio), Dr. David Richardson (ex officio), and John Ward (ex officio).

Background and Summary

The horse industry is a leading cultural and economic contributor to the commonwealth of Kentucky.

As the state's signature industry and top agricultural cash crop, the horse industry provides a wealth of benefits and opportunities to Kentucky:

- It provides an estimated economic impact of \$4 billion spread among both rural and urban areas;
- It is a significant driver of tourism and business travel. Buyers from 48 different countries attended Keeneland sales in 2007, while fans in 29 countries wagered on the Kentucky Derby in 2008;
- It is a generator of 80,000 -100,000 direct and indirect jobs;
- It is a multi-level workforce employer, with positions ranging from low-skill to professional;
- It is an environmentally friendly industry which preserves green space throughout the state; and
- It provides a concentration of world-renowned expertise in all aspects of the horse industry, such as equine law and accounting, veterinary medicine, farm management, bloodstock consultant, and racetrack operation.

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Competitive Challenges to Kentucky’s Horse Racing and Breeding Industry

Kentucky faces significant challenges to its position as the “Horse Capital of the World.”

The advent of alternative gaming in other racing states has dramatically changed the landscape in recent years. Racetracks and state breeding programs that were historically noncompetitive with Kentucky, such as Pennsylvania, Louisiana and West Virginia, are now attracting Kentucky-based horsemen with enhanced purses and breeder incentive awards. New gaming initiatives created to significantly promote the horse industries in New York, Maryland and Indiana will further and substantially alter Kentucky racing in the next one to three years.

Kentucky tracks do not compete with each other, but rather with tracks at various levels around the country:

- Turfway Park competes with W.Va., Pa., Ind., and La.
- Keeneland competes with N.Y., Calif., and Pa.
- Churchill Downs competes with Ill., N.Y., W.Va., Ind., Pa., and La.
- Ellis Park competes with Pa., W.Va., Ill., Ind., Ohio, Mich., and La.

Alternative gaming revenue is fueling substantial increases in purse money and breed incentive programs in other states, escalating competition for horses among racing jurisdictions. At the same time, racetracks are putting pressure on trainers to remain at their home track, resulting in fewer horses shipping between jurisdictions. As a result, Kentucky is experiencing a decline in both the quality of its racing and the number of horses available to fill race fields. These declines could lead to fewer race days and the potential loss of a viable year-round racing circuit in Kentucky.

Kentucky also competes with other jurisdictions in the export simulcast market, which comprises 85 to 90 percent of total wagering. Declines in racing compromise a track’s ability to promote its simulcast wagering product and negatively impacts off-track handle, a primary source of revenue for purses.

Current Economic Model for Funding Purses in Kentucky

In Kentucky, purse money is primarily funded through wagering, nominations, entry and starter fees, and KTDF funds. Revenue sources for purse money at Kentucky’s four major thoroughbred racetracks are as follows:

Keeneland	
Wagering	60.22%
KTDF	4.61%
Nominations, entry & starter fees	5.39%
Breeders’ Cup monies	1.88%
Payments in excess of requirements	27.90%
	<hr/>
	100.00%

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Churchill Downs

Wagering	87.16%
KTDF	5.59%
Nominations, entry & starter fees	6.39%
Breeders' Cup monies	0.86%
*Payments in excess of requirements	0.0%
	<hr/> 100.00%

Ellis Park

Wagering	82.53%
KTDF	14.28%
Nominations, entry & starter fees	1.11%
Breeders' Cup monies	0.84%
Payments in excess of requirements	1.24%
	<hr/> 100.00%

Turfway Park

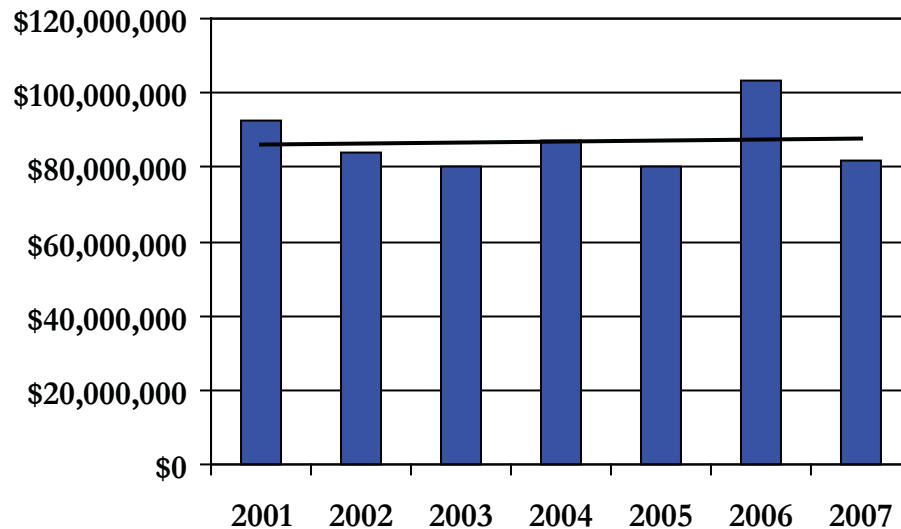
Wagering	83.82%
KTDF	13.28%
Nominations, entry & starter fees	2.06%
Breeders' Cup monies	0.84%
Payments in excess of requirements	0.0%
	<hr/> 100.00%

Purses Are Key Measure of Competitiveness

The connection between purse money and wagering is critical; one drives the other. Rich purses attract quality horses, jockeys and trainers. Competitive racing and full fields offer the betting public greater handicapping options. As a result, higher quality racing positively impacts on-track attendance and handle. It also promotes simulcast wagering by ensuring better product placement or "shelf space" among the many race signals vying for attention in today's simulcast market.

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Total Thoroughbred Purses — Kentucky for calendar year 2007 (Thoroughbred and standardbred purses for this same time period were \$95.6 million)



Note: The \$20 million Breeders' Cup World Championship was held at Churchill Downs in 2006.
Source: Kentucky Horse Racing Commission Biennial Reports

Subcommittee Findings

Competitiveness of Kentucky's Racing Industry

Virtually all growth in purses nationwide from 2000 – 2007 has occurred at racetracks with alternative gaming revenue.

Fifteen of the nation's top 20 racetracks ranked by 2007 total purses are currently, or will shortly be, subsidizing their purses with alternative gaming revenue.

Eight currently receive gaming revenues –

- Philadelphia Park (Pennsylvania)
- Charles Town and Mountaineer Park (West Virginia)
- Delaware Park (Delaware)
- Fair Grounds and Delta Downs (Louisiana)
- Monmouth Park (New Jersey)
- Gulfstream Park (Florida)

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Five others have approved alternative gaming and will begin receiving revenues within the next one to three years –

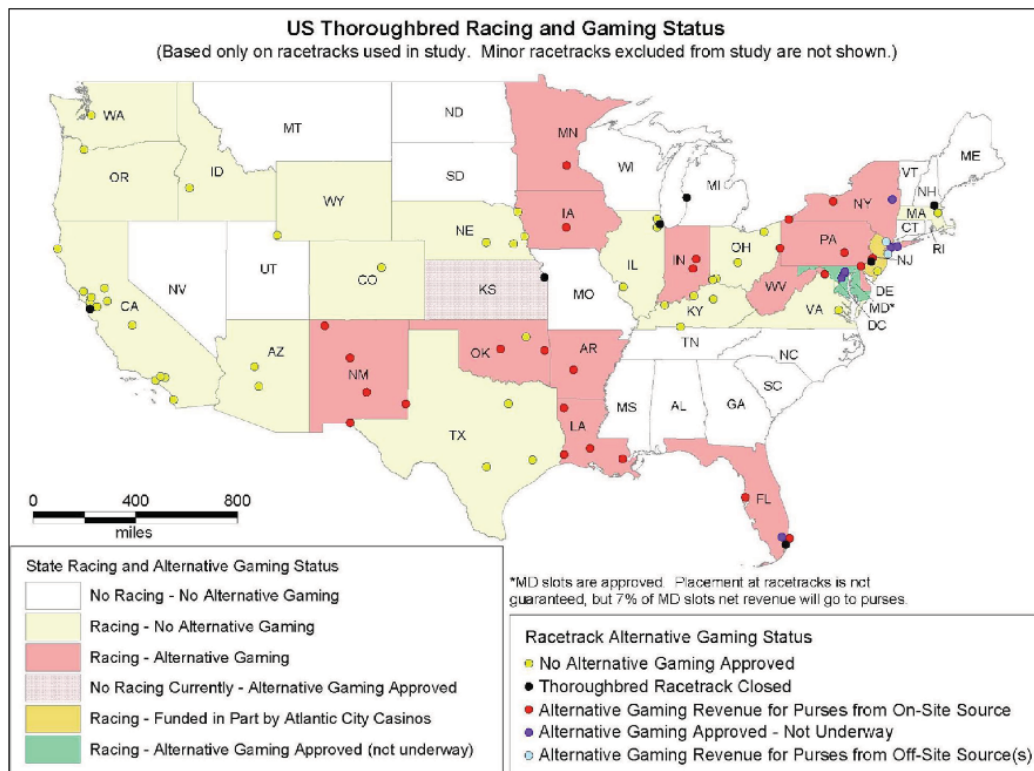
- Belmont, Aqueduct and Saratoga (New York)
- Calder Racecourse (Florida)
- Laurel (Maryland)*

Alternative gaming in Maryland, which was approved Nov. 4, 2008, is projected to provide \$140 million annually to state racetracks – \$100 million for purses and \$40 million for capital expenditures.

These changes will put Kentucky racetracks at a significant competitive disadvantage.

Illinois racetracks such as Arlington Park and Hawthorne will benefit from the immediate infusion of \$80 million in riverboat casino subsidies. Distribution of the fund has been delayed since 2006 due to pending litigation. It is anticipated that the fund will be distributed in the summer of 2009. Additionally, the Illinois legislature has approved a three-year extension (2009 – 2011) of the subsidy provision worth \$30 million annually to the state's horse industry.

Source: Thoroughbred Racing Associations, Comparative Study of Racing Jurisdictions per the Availability of Alternative Gaming Revenue for Purses, November 2008

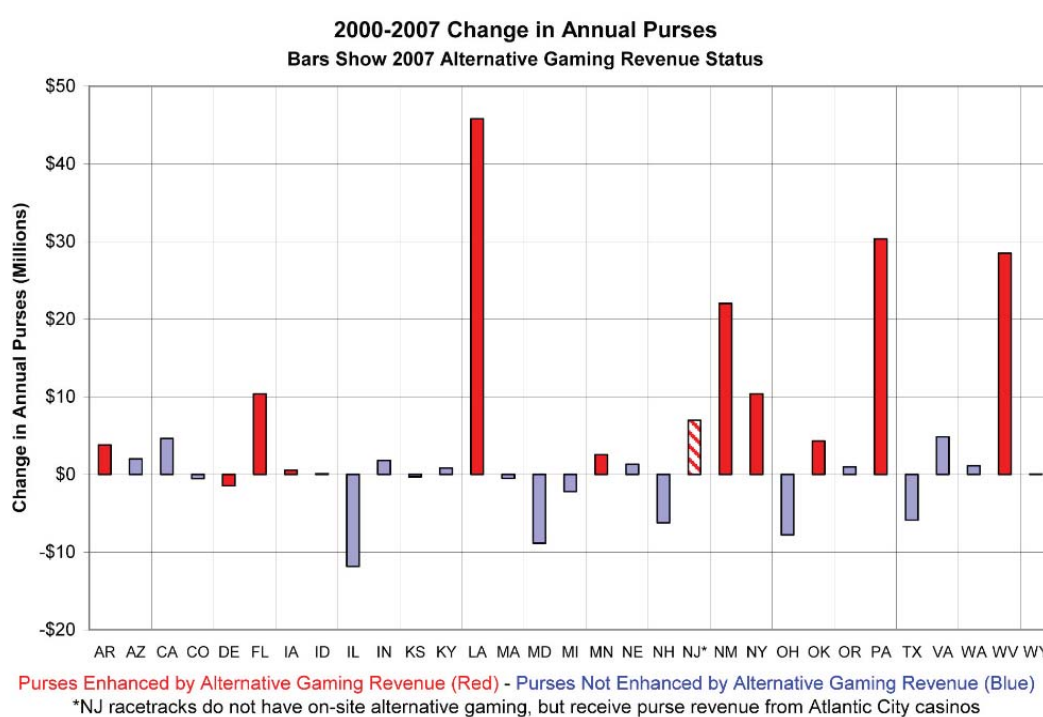


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Among racetracks with legalized alternative gaming as of November 2008, combined annual purses are forecast to increase by 45.5 percent by 2013, while combined annual purses at racetracks without legalized alternative gaming are expected to decline by 11.9 percent by 2013.

Within five years, the contribution of alternative gaming revenue to purses throughout the densely populated New York City – Washington, D.C. Corridor could elevate Northeast purses significantly above historically competitive states such as Kentucky. This Northeast purse advantage could accelerate the ongoing decline in purses and race dates in states without alternative gaming revenue for purses.

Source: Thoroughbred Racing Associations, Comparative Study of Racing Jurisdictions per the Availability of Alternative Gaming Revenue for Purses, November 2008



Nearly all growth in purses since 2000 came from alternative gaming revenue. The expansion of alternative gaming over the next five years will lead to purse increases in Maryland, New York and Pennsylvania that could well exceed purse increases in other states that have previously introduced alternative gaming.

States contributing alternative gaming revenue to purses by 2007 accounted for 48.6 percent of purses in 2000 and 57.4 percent in 2007, as purses in these states increased by \$164 million, or 35.2 percent. States without alternative gaming revenue by 2007 accounted for 51.4 percent of purses in 2000 and 42.6 percent in 2007, as purses in these states declined by \$27 million, or 5.4 percent.

Source: Thoroughbred Racing Associations, Comparative Study of Racing Jurisdictions per the Availability of Alternative Gaming Revenue for Purses, November 2008

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Kentucky's Breeding Industry

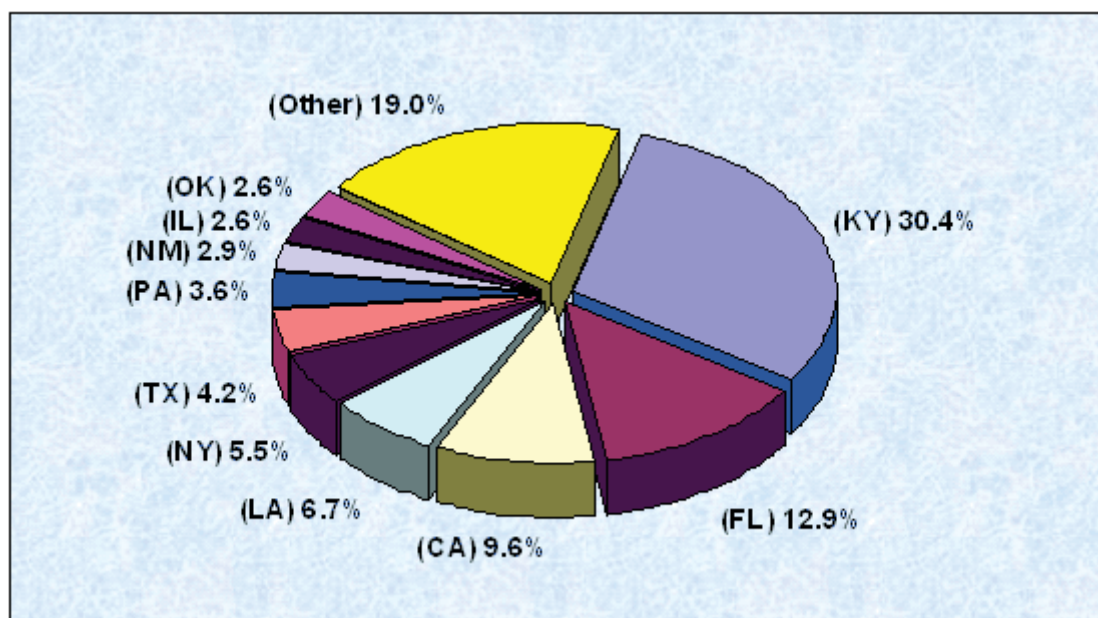
The Kentucky thoroughbred is the most sought after "brand" in the equine world.

Whereas the focus of other jurisdictions is to develop horses that are competitive against other state-bred horses, Kentucky "exports" horses that are competitive on a national and world stage.

Distribution of Registered U.S. Foal Crop by State

Kentucky, which annually produces more registered foals than any other state, yielded a record number of registered foals in 2006, exceeding its previous high-water mark of more than 10,100 registered foals in 2000. Other state's foal crops, however, are growing. New Mexico has more than doubled the size of its annual registered foal crop from 1996 to 2006 to pace the percentage growth in registered foal production experienced by seven of the top 10 foal-producing states. Three other states among the top 10 — Louisiana, New York and Pennsylvania — each increased their production by more than 40 percent during this time.

Distribution of 2006 Foal Crop



Source: Jockey Club Online Fact Book

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Kentucky-Bred Horses Dominate North American Racing

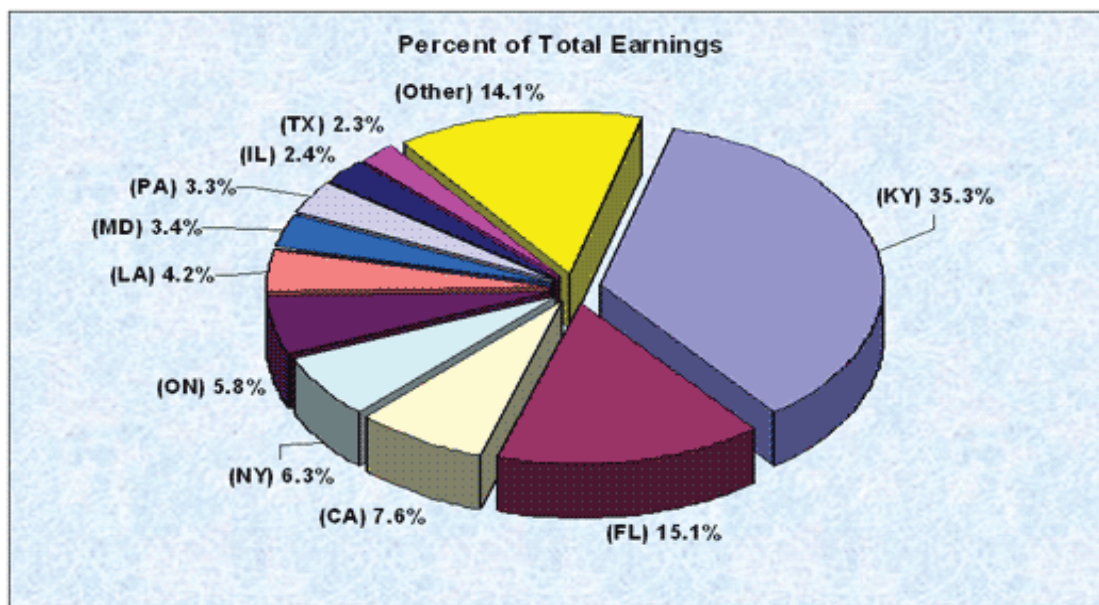
In 2007, Kentucky-bred horses:

- Won 69 of the 117 Grade 1 stakes
- Won 83 of the 169 Grade 2 stakes
- Won 110 of the 237 Grade 3 stakes

2007 Racing Statistics by Foaling Area (U.S. and Canada)

With nearly twice as many distinct starters as any other state or province, Kentucky-breds earned more than \$430 million at racetracks in the U.S. and Canada in 2007. Kentucky-breds constituted 26.5 percent of distinct starters and 35.3 percent of total purse money earned in 2007 by Thoroughbreds foaled in the U.S. and Canada.

2007 Earnings of Horses by State Where They Were Foaled



Source: Jockey Club Online Fact Book

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Kentucky Breeding Incentive Programs

Kentucky offers two breed development programs – the Kentucky Thoroughbred Development Fund (KTDF) and the Kentucky Breeders' Incentive Fund (KBIF).

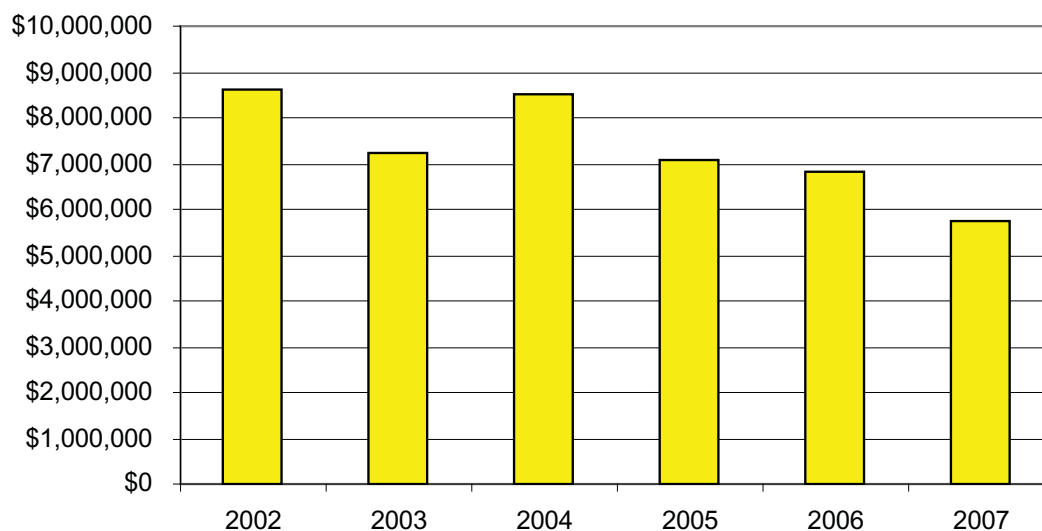
Kentucky Thoroughbred Development Fund

The KTDF was created in 1978 to encourage owners to buy, board, breed and race in Kentucky; only registered Kentucky-sired, Kentucky-foaled horses are eligible to participate.

The KTDF is funded from .75 percent of the total live thoroughbred racing handle and 2 percent of the total non-live racing handle. Money from KTDF is allocated to each licensed association in an amount equal to the association's contribution to fund. The KTDF supplements purses at all levels of racing in Kentucky.

The KTDF has been a successful program which has promoted quality racing in the state, and stimulated growth in Kentucky's foal crop, particularly at times when other state foal crops have shown declines.

Kentucky Thoroughbred Development Fund



The KTDF contributed \$6.8 million to purses at Kentucky tracks in 2006 and \$5.7 million in 2007.

Source: Kentucky Horse Racing Commission Biennial Reports

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Kentucky Breeders' Incentive Fund

The Kentucky Breeders' Incentive Fund is funded through the dedication of the 6 percent sales tax paid on stud fees, which generated a total of \$19.2 million for the program in 2007. The Kentucky Breeders' Incentive Fund was created in 2005 to ensure the growth of all breeds that comprise Kentucky's horse industry. Thoroughbred breeders receive 80 percent of the Incentive Fund; Standardbred breeders receive 13 percent; while other qualified breeds, such as Quarter Horses, receive 7 percent.

The KBIF is off to a good start, particularly with regard to the incentives paid to Thoroughbred horsemen. The fund is also demonstrating a positive impact on Kentucky's Standardbred and Quarter Horse industries by enticing a return of breeding stock to the state.

Kentucky Thoroughbred Breeders' Incentive Fund (KTBF)

In 2007, thoroughbred awards totaled \$15,487,462. Awards are distributed to Kentucky-bred winners of races at various levels throughout the United States, Canada, England, Ireland and France.

Kentucky Standardbred Breeders' Incentive Fund (KSBIF)

In 2007, standardbred awards totaled \$2,364,340. The KSBIF primarily funds enhancements to the Kentucky Sire Stakes Program (KYSS). In 2008, the KYSS held the second annual "Unbridled Evening of Champions" at the Red Mile where there was a record \$3.6 million in purses offered.

Kentucky Horse Breeders' Incentive Fund (KHBIF)

In 2007, the non-race breed awards totaled \$1,370,006. The KHBIF was created to enhance qualified, non-racing breeds, including the Kentucky Quarter Horse, Kentucky Appaloosa, South Central Hackney, Kentucky Morgan Horse, Kentucky Mountain Horse, Kentucky Paint, Kentucky Paso Fino, Kentucky Saddlebred and Kentucky Walking Horse.

Source: Kentucky Horse Racing Commission Biennial Reports

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Kentucky Breeding Industry Faces Challenges

While Kentucky has enjoyed an undisputed position as the Horse Capital of the World, other states are striving to lure away Kentucky's top stallions and breeding stock by offering rich incentives to owners and breeders.

Revenues from alternative gaming have spurred growth trends in other states' breed development programs. Pennsylvania and Louisiana each increased their state foal production by more than 40 percent from 1996-2006. In 2007, Pennsylvania-breds experienced the greatest increase in average earnings per starter, advancing 38.5 percent.

Thoroughbred breeding activity in Kentucky traditionally paces North America. During 2008, Kentucky's 318 reported stallions covered 21,317 mares, or 40.7 percent of all of the mares reported bred in North America. The number of mares bred to Kentucky stallions declined 1.9 percent against the 21,724 reported at this time last year.

Of the top 10 states and provinces by number of mares reported bred in 2008 through Oct. 10, 2008, only Ontario and Pennsylvania stallions covered more mares in 2008 than in 2007, as reported at this time last year. The top 10 states and provinces, ranked by number of mares reported bred through Oct. 10, 2008, are:

Jockey Club 2008 Report of Mares Bred

State/Province	2007 Stallions	2008 Stallions	Pct. Change	2007 Mares Bred	2008 Mares Bred	Pct Change
Kentucky	333	318	-4.5	21,724	21,317	-1.9
Florida	211	202	-4.3	6,376	5,316	-16.6
California	255	233	-8.6	4,447	3,817	-14.2
Louisiana	238	230	-3.4	3,780	3,515	-7.0
New York	92	85	-7.6	1,967	1,839	-6.5
Texas	205	191	-6.8	1,935	1,722	-11.0
New Mexico	137	128	-6.6	1,775	1,456	-18.0
Oklahoma	120	126	+5.0	1,381	1,335	-3.3
Ontario	66	77	+16.7	1,257	1,272	+1.2
Pennsylvania	72	89	+23.6	941	1,237	+31.5

Source: The Jockey Club

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Subcommittee Conclusions

The Industry Financial Matters Subcommittee has reviewed those issues requested and submits the following conclusions:

The Success of the Kentucky Thoroughbred Development Fund and Kentucky Breeders' Incentive Fund

The Kentucky Thoroughbred Development Fund (KTDF) has served Kentucky very well. Among its strengths is the fact that the incentive award is paid to the current owner who pays the bills. The funds provide an incentive for owners to race quality horses in Kentucky, thereby enhancing the overall racing program at each of Kentucky's racetracks. Better quality racing promotes attendance and wagering, which in turn creates economic activity and more jobs across the state.

The subcommittee recommends that the KTDF should be expanded if possible.

The Kentucky Breeders' Incentive Fund is a much newer program than the KTDF, and our initial opinion is that the KBIF is off to a good start, and that the administrative structure put in place by the Kentucky Horse Racing Commission is performing well. The fund appears to have already begun to have the intended effect of incenting breeders to keep their mares in Kentucky year-round. When owners keep or move their mares and stallions here, they keep or buy farms in Kentucky. Once they have farms, they buy equipment and supplies locally, employ citizens of the commonwealth and contribute to the state's economy.

The KBIF also has stimulated economic development, particularly with regard to Kentucky's quarter horse industry. Since 2006, more than 600 quarter horse stallions have relocated to Kentucky from Oklahoma, Texas and other prominent quarter horse states. More than 2,100 mares have followed and now are boarded on Kentucky farms. The Kentucky quarter horse population now numbers more than 37,000, and membership in KYQHA has increased from 240 in 2006 to more than 663 in 2007.

Both the KTDF and the KBIF offer legitimate and different functions – the KTDF provides incentives to those paying bills on the racing side while the KBIF helps promote and support the breeding and agricultural side of the industry.

The Current Economic Model for Funding the Purse Structure The Competitiveness of Kentucky Racing Compared to Other Jurisdictions The Need and Opportunity for Alternative Forms of Gaming

It is the subcommittee's belief that these three aspects must be discussed together.

It is our opinion that Kentucky's horse industry faces the most competitively challenging environment in its storied history. Due to the dramatic growth of alternative gaming in both regional and major racing states, Kentucky is at a far greater disadvantage than ever before.

The reality is that if other states were not supplementing their horse industries with expanded gaming revenue, Kentucky could compete very easily. Kentucky has long been the preeminent state because our horses have, for decades, proven themselves at the racetrack in their athletic accomplishments and in the breeding shed. If we were competing horse-to-horse, we would be confident of our abilities.

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However, other state governments are investing staggering amounts of revenue in their horse industries through their expanded gaming programs; amounts with which we cannot begin to compete.

Inevitably, with 100 percent certainty, Kentucky is on the verge of being overtaken by these other racing states. Given the realities of the General Fund and the commonwealth of Kentucky, the state cannot afford to invest the amounts other states are investing unless a new source of revenue is created.

The subcommittee is confident in its expertise in the horse industry, however, we firmly believe that we cannot retain the status quo when faced with the reality of today's environment. Kentucky must identify a new source of revenue that is competitive with other states or the Kentucky thoroughbred industry will soon be in crisis.

Why is that? Because the horse industry is an attractive state industry on several levels.

- It is an environmentally responsible industry. It leaves the landscape in a healthy condition. It is inexpensive to regulate; there is little regulatory cost on the racing side and virtually no cost to regulate the breeding aspect;
- It is a net importer of capital and churns that capital inside the state; and
- It is unique in that it enhances both rural and urban parts of a state's economy.

It is no wonder other states want an industry that Kentucky has been so blessed to have.

It is an industry worth fighting for.

Note: See Appendix A for additional comparative analysis of the U.S. horse racing industry and see Appendix B for additional comparative analysis of thoroughbred and standardbred development and breeding programs.

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Findings and Recommendations of the Subcommittee on the Proper Funding and Staffing Levels of the Kentucky Horse Racing Commission (KHRC)

Mission

The governor asked the task force to review the staffing and funding levels of the KHRC.

Subcommittee Members

Members of the Subcommittee on the Proper Funding and Staffing Levels for the KHRC included: Ellen M. Hesen, chair; Robert M. Beck Jr., Edward S. Bonnie, Tracy Farmer, Dr. Robert Lawrence, Nick Nicholson, Robert D. Vance, Wade Houston (ex officio) and Michael Pitino (ex officio).

Background and Summary

A 2006 audit by the Auditor of Public Accounts illustrated that the KHRC has been chronically understaffed and underfunded. The KHRC is the entity charged with protecting the integrity of horse racing in Kentucky. However, it has not been fully provided the financial resources to hire the staff necessary to fulfill that statutory mandate. The governor directed the task force to make a recommendation on the proper levels of staffing.

Presentations were made by various industry experts on the responsibilities of the KHRC and the staffing levels in other racing jurisdictions.

The subcommittee met on three occasions, gathered information and took testimony from various sources to carry out its mission. Presentations were made by the following people:

- Lisa E. Underwood, executive director of the Kentucky Horse Racing Commission
- John Hicks, Office of the Governor, Office of Budget and Policy, deputy budget director
- Bryan Lykins, Office of Auditor of Public Accounts, director of Special Exams
- Jim Bondurant, Office of Auditor of Public Accounts, Performance Audit Division
- Mike Helton, Office of Auditor of Public Accounts, Performance Audit Division
- David Pitts, Office of Auditor of Public Accounts, Financial Audit Division
- Ed Martin, president, Association of Racing Commissioners International
- Richard Riedel, director for the Health and Welfare Fund
- Leesa Moorman, director of Licensing, Kentucky Horse Racing Commission
- John Mountjoy, director of Policy and Research for the Council of State Governments
- Rick Masters, special counsel for Interstate Compacts for the Council of State Governments
- Keith Scott, Council of State Governments

Findings

Staffing

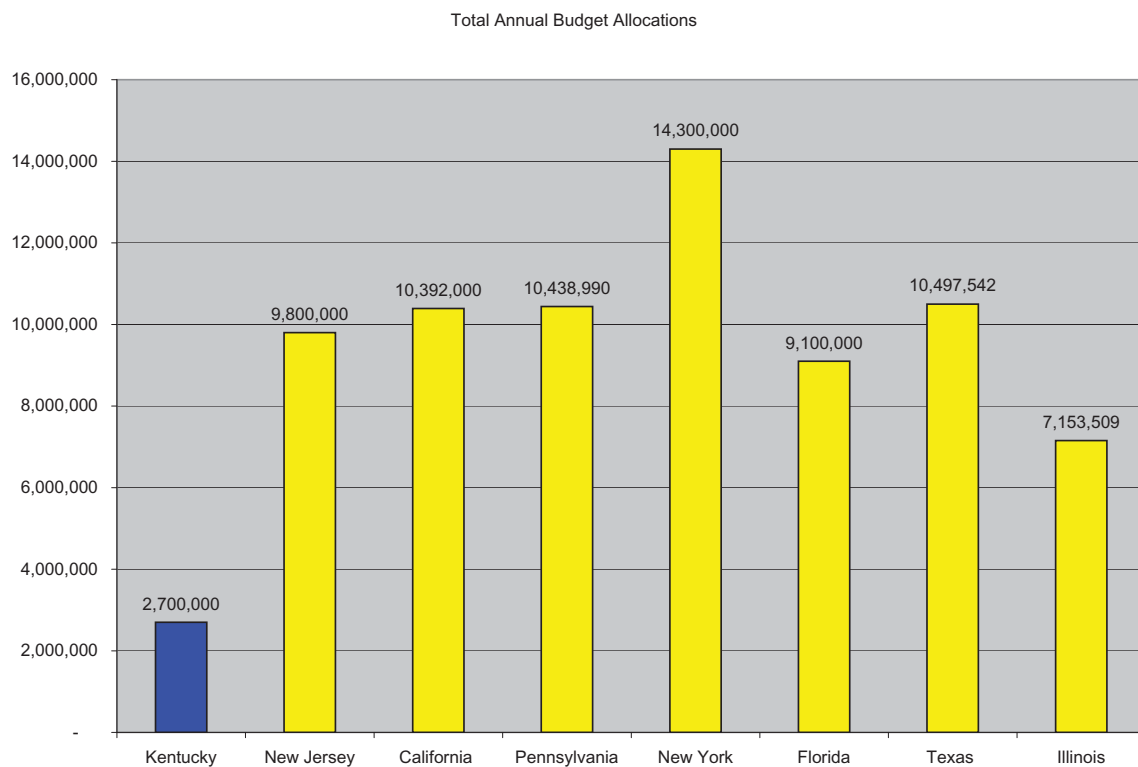
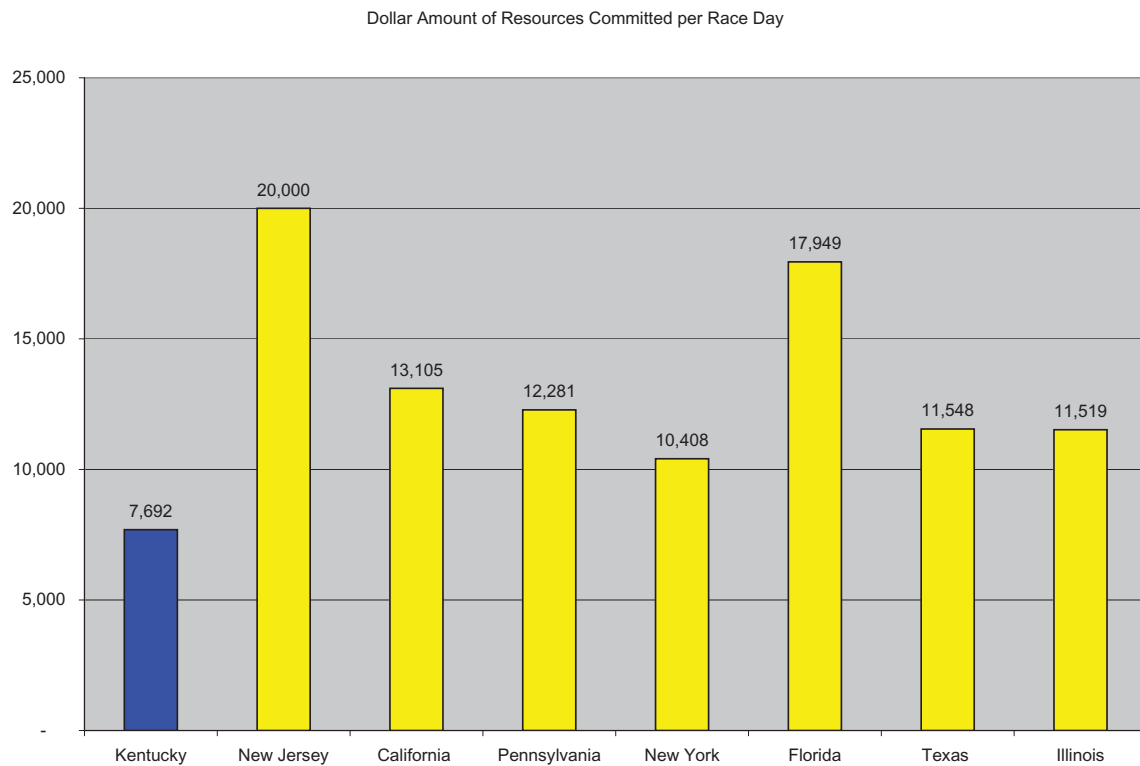
“In comparing the resources on a per-race day basis to ensure integrity of other major racing jurisdictions—New York, California, Florida, Pennsylvania and New Jersey—we find that Kentucky, instead of being first is last.”... “While some states have committed as many as six people to wagering security and made arrangements for independent monitoring, Kentucky has yet to commit one.” *Ed Martin, testimony on Sept. 18, 2008, in front of the Subcommittee on Funding and Staffing.*

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COMPARISON OF REGULATORY RESOURCES Prepared by the Association of Racing Commissioners International Amounts represent most recent calendar or fiscal year as reported by relevant jurisdiction

	Kentucky	New York	California	Pennsylvania	New Jersey	Florida
Race Days						
Total	351	1374	793	850	490	507
Thoroughbred	271	402	444	415	147	349
Standardbred	78	972	141	435	343	148
Quarterhorse	2		208			
Handle	\$1,413,316,709.00	\$ 3,054,560,741.00	\$ 4,378,778,214.00	\$ 934,200,853.00	\$1,400,000,000.00	\$ 1,480,427,370.00
Purses	\$ 95,682,401.00	\$ 229,687,871.00	\$ 170,038,461.00	\$ 127,344,002.00	\$ 80,000,000.00	\$ 73,018,769.00
Breeder Incentives	calendar year '07 for KY	separate agency	\$ 16,286,236.00	\$ 61,126,678.00		
Functionality: (# of employees by function)						
Administrative	6	3 racing + 15 shared	18	15	10	15
Wagering Security	0	6	3	1	4 ft/ 4 pt	5 + monitoring system
Investigators	2	14	18	15	4	17
Licensing	6	15	10	25	7	13
Legal	1	7	1 plus AG		AG (\$330,000)	3 lawyers/ 1 legal asst
Horse ID	provided by track	TB tracks provide	provided by track	provided by track	provided by track	provided by track
Equine Med Director	1 (UK contract)	1 (Cornell Contract)	1 (U of C contract)	1		1
Veterinarians	4 + 1 Vet tech	9 per diem	6-8 daily/ 5 hourly		7 ft/ 11 pt	5 hourly
Funding: (Racing Regulation Only)						
General Funds	\$ 504,000.00					
Assessments				Tax on Handle	\$ 8,300,000.00	\$ 22,960,118.00
License Fees	\$ 1,141,000.00				\$ 500,000.00	\$ 4,419,400.00
Other	\$ 1,055,000.00	Reg fee on handle			\$ 1,000,000.00	\$ 179,877.00
Racing Commission Budget Allocation:						
Total: FY08 for KY	\$ 2,700,000.00	\$ 14,300,000.00	\$ 10,392,000.00	\$ 10,438,990.54	\$ 9,800,000.00	\$ 9,100,000.00
PER RACE DAY						
Resources Committed	\$ 7,692.31	\$ 10,407.57	\$ 13,104.67	\$ 12,281.17	\$ 20,000.00	\$ 17,948.72

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Source: Compiled by the Association of Racing Commissioners International (ARCI)

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Veterinarians

There is concern that the current pay scale has limited the KHRC's ability to attract and retain veterinarians. After comparing veterinarian salaries of local and national veterinarians in private practice, as well as federal and state employees, the salary levels for KHRC veterinarians are competitive but on the low end. It was the consensus of the subcommittee that KHRC should have an appropriate number of veterinarians who are paid an adequate salary and have a developed career path.

Stewards

The KHRC has requested that all three stewards be state employees. Currently, two of the three stewards are on the payroll of the racing association conducting the live meet. The potential for conflicts of interest is a constant problem. A representative of one of the racing associations suggested that only one steward be added to the state payroll; under this arrangement, two stewards including the chief would be state employees and one steward would be an employee of the racing association.

Security

Testimony was presented that additional investigators are necessary to increase the security and enforcement efforts of the KHRC. During six months of the year, the KHRC is responsible for regulatory matters at two live meets running at the same time. Additional enforcement personnel are needed in order to adequately staff the racing circuit in Kentucky.

Integrity

The members of the Auditor of Public Accounts staff suggested that the KHRC should have its own independent method for conducting an investigation of pari-mutuel wagering activity, including a system to ensure that the financial amounts that are being reported to the state and the amounts being returned to the players are correct. Wagering reports should be provided directly by the totalizator companies to the KHRC rather than being provided by the racing association. KHRC staff has also had concerns that it does not have the resources to independently monitor the tote system. There are national and international trends to focus on the integrity of the pari-mutuel system. The pari-mutuel supervisor should research available technology and make a recommendation regarding the technology to the KHRC.

KHRC Staffing

Documentation was prepared on critical staffing levels, the funding necessary to operate the KHRC at the critical level, and potential sources of funding, taking into account the comments from the members of the subcommittee.

The KHRC currently has 24 full-time employees on its payroll (not including breeders' incentive fund or the equine medical director) and four interim employees. Three full-time vacancies have been budgeted. The Breeders' Incentive Fund has four full-time employees. The Breeders' Incentive Fund is able to fund its operations through registration fees paid by persons registering thoroughbred mares.

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Recommendations

At the request of the subcommittee, the KHRC staff proposed the following 10 full-time positions be added to fulfill its statutory mandate:

2 State Stewards positions
2 Auditor I positions
1 Paralegal I position
1 Staff Attorney position
2 Investigator I positions
1 Racing Veterinarian II position
1 Veterinarian Technician I position

Rationale for Additional Staff

KHRC proposes the addition of 10 full-time staff members. In order to save resources but be able to fulfill the KHRC's statutory mandate, the KHRC is also proposing adding interim (part-time) staff members who would work only during live race meets or during peak work volume periods as part-time employees. Interim staff members may work as few as one or two days and up to a maximum of nine months. This hiring model is designed to assure that the tracks have adequate coverage and that the KHRC's limited funding is being wisely used to only pay for staff at the times staff is needed to perform job duties at that track, rather than having full-time staff who are underused throughout the year. Interim employees are not eligible for most state benefits, including health insurance and state retirement, further reducing the personnel costs to KHRC. Also, the use of interim employees who live in the same county or vicinity as the live track would substantially reduce the travel costs to the agency. The compensation and overhead for those additional full-time employees and additional interim employees to assist on a seasonal basis will add \$1,747,033 to the KHRC payroll.

2--Associate State Steward-Thoroughbred

- Currently, the associate stewards are employees of the tracks, and this status has presented issues because these stewards are attempting to regulate their own employers.
- Conflicts of interest have arisen in the past when the stewards have been in the position of determining whether a track has violated the laws.
- In addition, if a licensee is thought of as a good client of the track (because he runs a lot of horses there, is on the board of directors, etc), this creates a potential conflict of interest for the stewards who are paid by the tracks.
- KHRC could create a career path to develop stewards and a chief state steward for the future.
- Hiring the two associate state stewards would eliminate the above issues at no new costs to the tracks. The tracks are required to pay the salaries of the personnel at the tracks pursuant to KRS 230.240.

2--Auditor I

- The supervisor of pari-mutuel wagering will need to have a support staff. The Auditor I will assist the supervisor of pari-mutuel wagering in monitoring tote activity, reviewing whether the payoff to players and the distribution to the commonwealth is correct, assisting in investigations of pari-mutuel activity and assisting in verifying that the tote is preparing correct calculations.
- This position has not existed in the past in Kentucky. Ed Martin suggested that the supervisor of pari-mutuel wagering will need assistance and his chart (*on Page 20*) illustrates that in other states an auditing team is utilized, rather than just one person.

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1--Paralegal I

- The KHRC currently has one attorney on the payroll. That attorney has a workload that is too high.
- A paralegal could assist the attorney in managing his workload, organizational matters, preparing filings for court and the Legislative Research Commission and research activity.

1--Staff Attorney

- The KHRC currently has one attorney on the payroll. That attorney has a workload that is too high.
- With increased enforcement efforts there will be additional legal work.
- With increased work from the Safety and Welfare Committee of the KHRC and the Equine Drug Research Council as well as efforts to license tote companies and advanced deposit wagering companies, there will be many regulations in process requiring legal expertise.

2--Investigator I

- An additional investigator is required for increased enforcement of existing programs, including license compliance checks and investigations related to drugs and other racing violations.
- The KHRC would like to perform more barn and vehicle searches, and this is difficult with the limited number of personnel.
- During six months of the year, KHRC is responsible for regulating two race tracks that are running simultaneously. This is very difficult with the current staffing levels.

1--Racing Veterinarian II

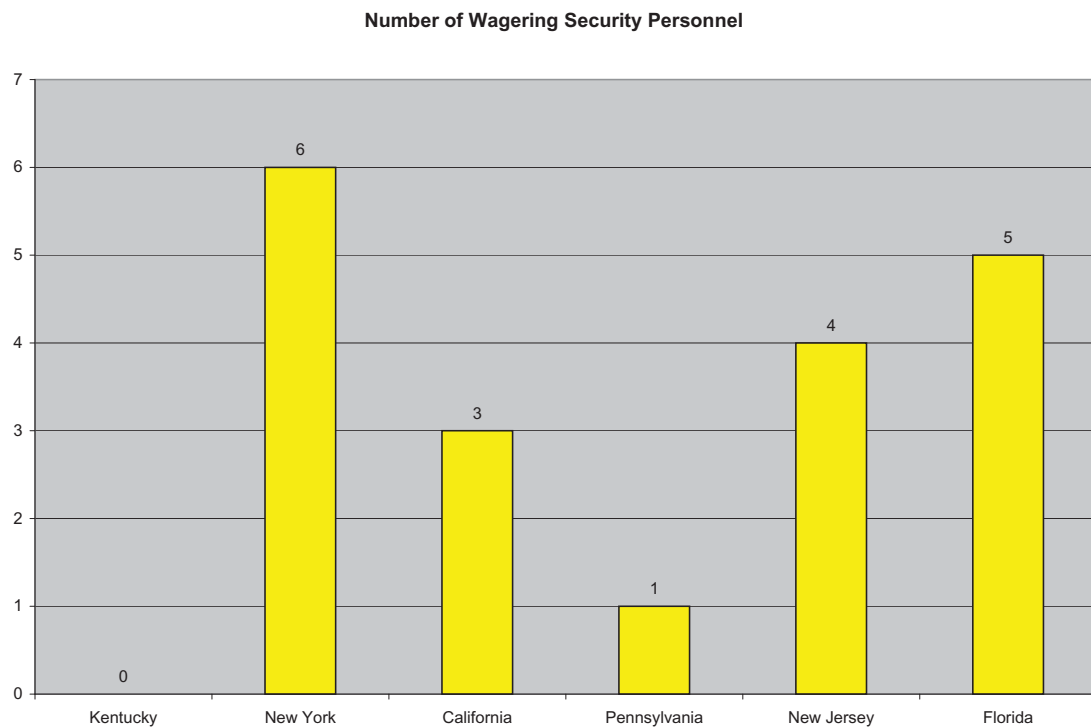
- Critical for implementation of enforcement of additional drug testing initiatives, especially for anabolic steroids and TCO2.
- Enhance soundness checks, by enabling our veterinarians to spend more time on prerace examinations.
- In order to promote safety and integrity, there is a trend in the industry towards increased emphasis on post-race examinations and out-of-competition testing.
- With the addition of one veterinarian, a full-time state veterinarian would be assigned to oversee the standardbred drug testing program. The drug testing at the standardbred tracks is currently being performed by veterinarians under personal service contracts, and the addition of veterinary staff would eliminate the need for these contracts and would result in a net cost savings to the KHRC.

1--Veterinarian Technician I

- A veterinarian technician can draw blood, catch urine and assist with paperwork in the test barn.
- The KHRC has recently hired an interim veterinarian technician and has been very pleased with her ability to perform the above services. Since a veterinarian technician can draw blood, this frees the veterinarian to perform other duties requiring the skills of a veterinarian.
- The addition of a veterinarian technician is an inexpensive way to increase the level of expertise and professionalism in the test barn.

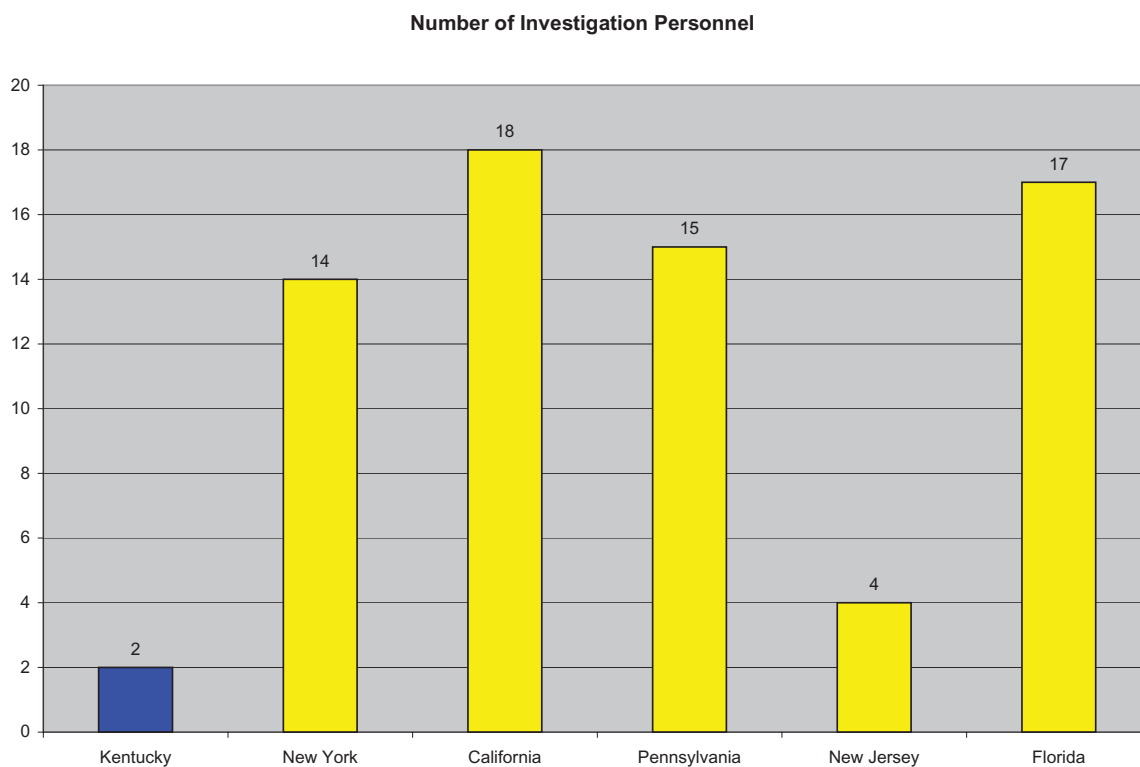
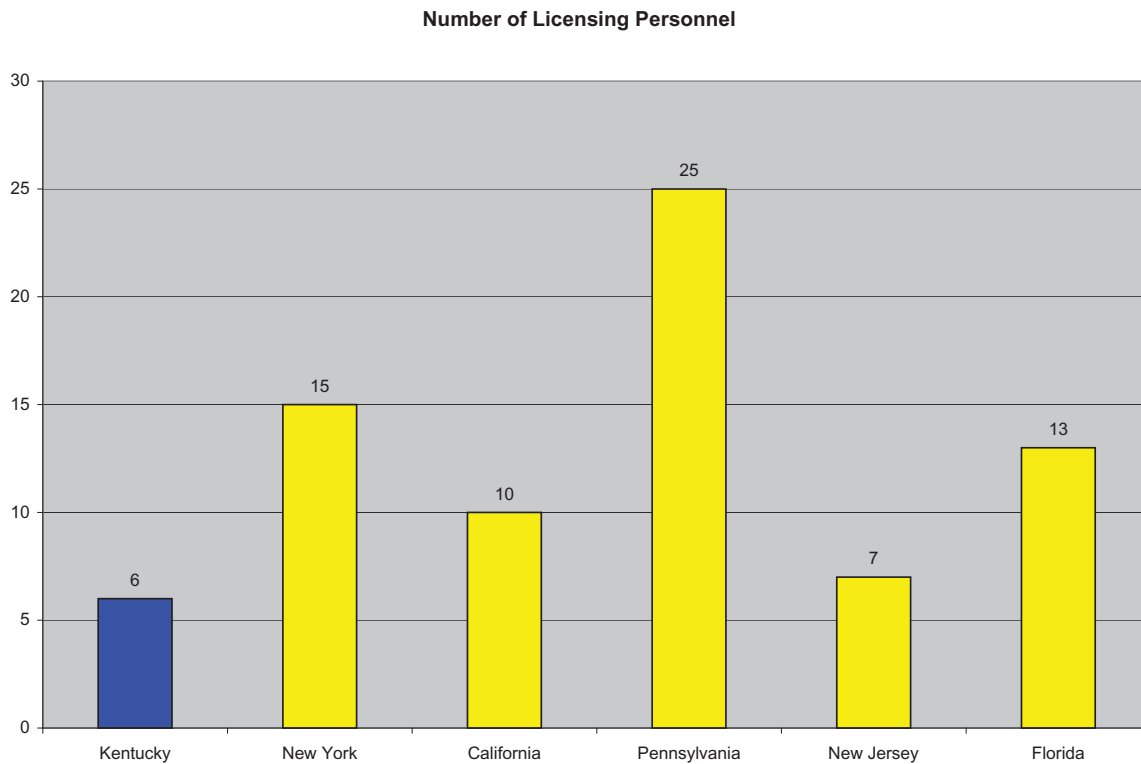
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The following charts illustrate the KHRC’s lack of staff in the following areas as compared to the staffs of other major racing jurisdictions.



Source: Compiled by the Association of Racing Commissioners International (ARCI)

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Source: Compiled by the Association of Racing Commissioners International (ARCI)

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Findings

Funding

The 2006 audit found that “the total operating expenditures for KHRC are lower, on average, than most of the other states surveyed.” P. 34

The agency receives funding from three sources:

- Licensing fees and fines (approximately \$1.5 million for FY 2009 and FY 2010)
- Track assessments (\$355,000 for FY 2009 and at least \$478,000 for FY 2010)
- General Fund allocation (\$423,700 for FY 2009 and \$423,700 for FY 2010).

For a historical perspective, the KHRC received \$1,509,620 from the General Fund in FY 2007 and \$504,200 from the General Fund in FY 2008. The budget for the agency for FY 2009 is approximately \$3 million. The KHRC will be able to continue operations through FY 2009 through the use of reserves from the prior fiscal year in the amount of \$758,000. These reserves will be depleted and unavailable in FY 2010 resulting in a deficit of at least \$939,754 in fiscal year 2010 even without adding additional staff. This deficit may be offset by increasing track assessments unless another source of funding is obtained.

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Kentucky Horse Racing Commission Projected Revenue, Expenditures, and differences based on Status Quo and Critical Staffing

Fiscal Year	FY09 Status Quo	FY10 Status Quo	FY10 CRITICAL TEAM	FY11 CRITICAL TEAM
Licensing fees and fines	\$1,500,000	\$1,500,000	\$1,500,000	\$1,500,000
General fund	423,700	423,700	423,000	-
Track assessments	355,000	478,000	478,000	-
Balance carryforward	758,000	-	-	-
Projected Revenue	3,036,700 (1)	2,401,700 (2)	2,401,000 (2)	1,500,000 (3)
Projected Expenditures (4)	\$3,052,546	\$3,341,454	\$5,088,487	\$5,207,155
Difference	(\$15,846)	(\$939,754)	(\$2,687,487)	\$3,707,155

Note: In FY09, there might be a budget reduction of 4.0% or (\$423,700 x .04) \$16,948. So, the difference in FY09 would be approximately \$32,794 (15,846 + 16,948). The difference in the deficit for FY 10 would go from approximately \$939,000 to \$956,000.

Footnotes

- (1) Projected Revenue for FY09 includes a balance carryforward of approximately \$758,000 that is not available in FY10 or FY11.
- (2) Projected revenue includes funding from three sources: Licensing fees and fines (approx. \$1.5M), General Funds (\$423,000), and assessments from the track (\$355,000 in FY09 and \$478,000 in FY10).
- (3) The only existing source of funding that is both relatively stable and secure (dedicated to the KHRC) is the licensing fees that the KHRC collects from industry participants. This amount is projected to be approximately \$1.5 million for the next three fiscal years (09,10,11), respectively. There is no guarantee that the KHRC will receive funding from the General Fund or the tracks in FY11.
- (4) Projected Expenditures are based on detailed personnel and operating expenditure projections and includes non-revenue receipts.

Source: Compiled by the Association of Racing Commissioners International (ARCI)

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The following is an outline of the funding alternatives discussed by the subcommittee. Although not all of these are recommendations, they are mentioned to be remembered for future consideration. The subcommittee considered the idea that the industry participant with an interest in a particular area of regulation should provide the funding for that area. As an example, the players could pay for pari-mutuel security matters, including monitoring the tote company. The tracks and owners could pay for drug testing. The tracks could pay for backside security and enforcement. The consensus of the subcommittee was that the KHRC should be funded by a combination of sources, with the sources coming from the various participants in the industry. The various funding sources reviewed included:

- Dedicating all or a portion of the undedicated pari-mutuel tax to the KHRC. Subcommittee members discussed whether this should be a fixed dollar amount or a percentage of the undedicated portion. The undedicated portion of the pari-mutuel tax currently goes to the General Fund, which supports many projects in the commonwealth such as teachers' salaries, police salaries, health care, roads and prisons and will generate approximately \$4.9 million annually thus providing a benefit to all Kentuckians.
- Increasing the pari-mutuel tax and dedicating the increase to the operations of the KHRC. The pari-mutuel tax is paid by the race tracks. This estimate is based on a .327 percent increase in the pari-mutuel tax paid for calendar year 2007 by tracks adjusted for a 15 percent decrease in handle to reflect the national trend of declining handle.
 - \$ 781,558 Total for Keeneland and Churchill Downs
 - \$ 366,641 Total for other tracks
 - \$1,148,199 Total impact of increase of .327 percent in pari-mutuel tax
- Increasing the takeout on wagers and dedicating that increase to the KHRC. Ranges from 0.125 to 0.5 percent were discussed. Whether to only increase the takeout on either exotics or win-place-show bets was also discussed. An increase in takeout may have an adverse impact on handle, which will reduce the pari-mutuel tax received by the commonwealth and have other negative ramifications. The dollar amount of the reduction in handle has not been estimated. In addition, the increase in wagering as a result of patrons' increased confidence in the integrity of the industry has not been estimated either. Such an increase in confidence may offset, all or in part, any decrease caused by the minimal increase in the takeout.
 - a. An increase in takeout on exotic bets would provide the following revenue based on an assumption of \$776 million in exotic bets on Kentucky races:
 - .125 percent = \$ 970,574
 - .245 percent = \$1,902,325
 - .50 percent = \$3,882,296
 - b. An increase in takeout on win-place-show bets (WPS) would provide the following revenue based on an assumption of \$430 million in WPS bets on Kentucky races:
 - .125 percent = \$ 537,339
 - .245 percent = \$1,053,185
 - .5 percent = \$2,149,356

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- Dedicating the sales tax on claimed horses to the KHRC. The claiming tax currently goes into the General Fund. The claiming tax should remain as an alternative funding source for KHRC operations. The claiming tax would generate approximately \$1 million. There is precedent for this type of dedication. The stud fee tax is dedicated to fund the Breeders' Incentive Funds.
- A per start fee on the owners. This would allocate some of the financial burden to the owners. It should be noted that the owners have recently received an increase in the licensing fee. A \$10 fee per start would generate \$300,000.
- Impose a fee on horses sold at auction or impose a fee based on the number of mares bred.
- Require licensing stables separately.
- A fee for drug testing could be deducted from the purse to be given to the owners of the top three finishers in each race. The winning horse, plus at least one other horse, are tested in every race. For stakes races, the top four horses are tested. If the owners of the top three finishers make a payment toward the cost of testing for those finishers, the tracks could pay the remaining cost of drug testing. This allocates the cost among the various participants.
- Licensing advanced deposit wagering companies (ADWs).
- Licensing tote companies.
- Taxing the ADWs. At least two states are taxing ADWs currently. This could be a significant source of revenue but more research is needed relative to this funding source.
- Track assessments. Track assessments are one method for receiving a contribution from the racing association toward regulation. The subcommittee noted that pursuant to KRS 230.240 the tracks are required to pay the compensation of the employees at the tracks and the salary of the executive director, as well as the cost of drug testing. It can also be argued the tracks should be paying the expenses of the KHRC employees while they are "on location." The race tracks are presently paying a fixed amount that is arguably less than the amount they would be required to pay by statute. The governor established the task force to provide recommendations on the proper method to use to fund the operations of the KHRC. There was a general consensus that all of the participants, including the tracks, should pay some amount toward regulation. There was also a recognition by the members of the task force that some of the tracks are struggling financially and the full amount due under KRS 230.240 would be burdensome and might jeopardize the ability to maintain a full racing circuit in the commonwealth.
- Dedicating the breakage to the KHRC. The breakage is arguably the players' money; however, it has historically been retained by the racing associations to support operations. Breakage is approximately \$2 million per year.

Several concepts for reducing operating costs of the KHRC and the costs to the tracks were discussed throughout the meetings. Though these are not being proposed at this time, they should be remembered for future consideration.

- The idea of utilizing an interstate compact with other racing jurisdictions for pari-mutuel security was discussed as a possible long-term opportunity.

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- Various members of the subcommittee also discussed using the concepts promoted in the 1991 McKinsey Report regarding drug testing. The McKinsey Report advocated taking samples from horses but not actually conducting the testing on all of the samples collected. The samples would be retained for future testing. This would reduce testing costs, but drawing the samples would continue to have a deterrent effect from a law enforcement perspective.

Recommendations

Staffing

It was the consensus of the subcommittee that the staffing levels recommended should be pursued. This results in an increase in 10 full-time staff positions and interim staff positions as needed.

It was also the consensus of the subcommittee that KHRC veterinarian salaries should be increased by \$3 per hour for the racing veterinarian I and racing veterinarian II. The proposed salary for the chief racing veterinarian should be increased up to \$125,000 per year. The subcommittee also recommends that all three stewards and judges be placed on the KHRC payroll.

The KHRC working with the Finance Facilities Department, is to identify in the next agency six-year capital plan, the need for a pari-mutuel information monitoring system.

The KHRC working with the Finance Facilities Department is to request funding in the 2010-2012 budget.

Access to the information provided by the CHRIMS system should be acquired immediately.

The KHRC should submit a budget request for a pari-mutuel information monitoring systems capital project.

Employing the optimum staff will require a budget of \$5,088,487 in FY 2010 and \$5,207,155 in FY 2011. Assuming licensing provides \$1.5 million in revenue the remainder must be obtained from other sources. The difference is \$2,687,487 in FY 2010 and \$3,707,155 in FY 2011. This assumes the tracks continue to pay for drug testing and pay an assessment in FY 2010, but not in FY 2011.

Funding

It was the consensus of the subcommittee that the KHRC should have a secure and dedicated funding source.

It was the consensus of the subcommittee that the various participants in the industry should share in the funding of the regulatory body. Everyone in the industry has an interest in promoting the integrity of the sport.

The following sources of funding were identified, which spreads the impact among the various participants in the industry.

1. Players. Increase the takeout on the exotics and win-place-show bets .245 percent and dedicate the increase to funding the KHRC. The players will be the constituency paying the increase and the increase should raise approximately \$2.9 million per year.

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2. Owners. For any race in which the purse is \$10,000 or more, the owners of the top three finishers will contribute toward the cost of the drug testing. The charge will be deducted from the purse prior to distribution of earnings to the owner. The winning owner will pay 100 percent of the cost of testing the winning horse. The owner of the second place and third place horse will each pay 50 percent and 25 percent, respectively, of the cost of testing for one horse in the race.
3. Race Tracks. Increase the pari-mutuel tax on race tracks with an average daily handle of \$1 million or more by .327 percent and dedicate the increase to funding the KHRC. Keeneland and Churchill Downs will be the constituency paying the increase and the increase should raise approximately \$781,558. The other race tracks will not incur an increase in the pari-mutuel tax under this scenario. All race tracks will continue to be responsible for paying for drug testing costs not covered by the owners. It is estimated that the tracks would be paying one-fourth of the cost of drug testing rather than the full amount which they are currently paying.
4. Commonwealth of Kentucky. The KHRC has historically received a small amount of funding from the General Fund. The task force recommends that a specific dollar amount be dedicated from the pari-mutuel tax. For FY 2011 and forward, the task force recommends that \$600,000 with a cost of living escalator, be dedicated to the KHRC from the pari-mutuel tax.
5. Tote Company. Any tote company operating in Kentucky should be required to be licensed by the KHRC and pay the cost of a background check and to provide access to the tote data through the CHRIMS system, at the tote company's cost. The regulation will state that the licensing fee for the tote company will be \$10,000. We recommend this regulation be enacted with all due speed so that tote companies can be licensed and the CHRIMS system can be purchased quickly.
6. Advanced Deposit Wagering Companies. ADWs doing business with Kentucky residents should be required to be licensed by the KHRC. The regulation will state that the licensing fee for the ADW will be \$10,000 and the applicant will pay the cost of any background check. We should also consider receiving tax revenue dedicated to KHRC operations for wagers placed by Kentucky residents on Kentucky races through an ADW. Once we have acquired the CHRIMS system, we will have an estimate of the dollar amount of that wagering activity and the level of taxation to recommend. Any such tax would not be recommended until the next biennium. We recommend this regulation be enacted with all due speed so that ADWs can be licensed quickly.
7. Cost cutting Strategy. Various cost cutting strategies have been employed by the KHRC and need to continue. The KHRC intends to consider reducing the costs of drug testing. The concepts advocated in the McKinsey Report will be explored.
8. Another source of revenue. If another source of revenue is dedicated to fund the KHRC, then the increase in takeout rate, increase in pari-mutuel tax and the responsibility for the payment of drug testing charges will be revisited in order to reduce the financial burden placed on those participants by this funding proposal.

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Findings and Recommendations of the Subcommittee on Integrity of Racing and Pari-mutuel Activities

Mission

The governor asked the task force to study and recommend improvements the Kentucky Horse Racing Commission (KHRC) can make to maintain and improve the confidence of the public in the integrity of racing and all pari-mutuel betting activities.

Subcommittee Members

Members of the Subcommittee on the Integrity of Racing and all Pari-mutuel Activities include: Edward S. Bonnie, chair; Robert M. Beck Jr., Tracy Farmer, Robert D. Vance, Brian Lavin, J. Duncan Pithchford, Ed Ashcraft, Gary Biszantz (ex officio), Tom Conway (ex officio), Frank Kling (ex officio), Tom Ludt (ex officio) and Mike Maloney (ex officio).

Background and Summary

The KHRC is the entity charged with protecting the integrity of horse racing in Kentucky. In the past, however, it has not been provided the financial resources to hire the investigatory staff necessary to fulfill that statutory mandate. Additionally, this subcommittee was asked to review methods for the KHRC to be able to accumulate and retain data and independently monitor tote activity. Presentations were made by various industry experts regarding racing and pari-mutual integrity.

NOTE: The focus of this subcommittee is on general and pari-mutuel security issues. All matters related to medication issues are being addressed by the Equine Drug Research Council. The KHRC should continue to improve Kentucky's equine drug testing rules and ensure that these rules are enforced to the fullest extent possible. This will be the best way to place Kentucky as a leader in drug testing policy in the horse racing industry.

In 2006, the Auditor of Public Accounts (APA) recommended that the KHRA (reconstituted as the KHRC since the Audit):

- Take immediate action to hire a supervisor of pari-mutuel wagering as required by KRS 138.530 and conduct audits of tote systems.
- Review staffing levels in comparison with other states.
- Consider and incorporate model rules from the RCI where beneficial in Kentucky administrative regulations.
- Acquire software access to racetrack tote systems in order to perform pari-mutuel analyses and facilitate checks and audits of wagering.
- Work in conjunction with the Kentucky Department of Revenue to define responsibilities of pari-mutuel and tote system auditing.

In response to these recommendations, the KHRC commented:

We agree with the need to hire a supervisor of pari-mutuel wagering. The KHRC was trying to implement a reorganization that would have added a supervisor of pari-mutuel wagering when HB 380 was enacted, which effectively ended the KHRC's ability to hire new personnel, even if they were required by statute.

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The KHRC and the subcommittee also recommend that each race track install a system in which the tote information is provided directly to the KHRC. This will allow for daily monitoring of the tote and tax and licensing information as well as balances that should be accruing to the funds KHRC is charged with monitoring. Keeneland and the Red Mile currently have the Comprehensive Horse Racing Information Management System (CHRIMS) noted in the APA's report. Churchill Downs has developed its own system. The KHRC would prefer a situation in which: (1) all race tracks use the same system and (2) the information is downloaded daily to the KHRC directly from the tote.

The subcommittee met on one occasion, gathered information, requested and received comments from licensees on materials sent them and took testimony from various sources to carry out its mission. Presentations were made by the following people during a public meeting held on Oct. 6, 2008:

- Isidore Sobkowski and Denny Oelschlager, representatives of Advanced Monitoring Systems
- Frank Kling, member of the subcommittee
- Mike Maloney, member of the subcommittee
- Frank Fabian, president of the Thoroughbred Racing Protective Bureau (TRPB)
- J. Curtis Linnell, director of Wagering and Analysis, TRPB

The Advanced Monitoring Systems presentation indicated the system was designed to specifically solve pari-mutuel problems, such as account wagering fraud, past/posting, cancel delay, odds manipulation, win pool odds manipulation, arbitrage, performance enhancement, money laundering and dead contender scenario. Mr. Kling spoke about methods to obtain direct access to the tote system and data from United Tote. Mr. Maloney presented a white paper he had written on past posting and wagering security. Mr. Maloney presented several ideas to improve integrity in the pari-mutuel system. Several of those ideas are included in the recommendations in this report. Mr. Fabian noted that the TRPB has a Betting Analysis Project for identifying wagering anomalies. The TRPB is also performing due diligence reviews of off-shore entities that are wagering in the U.S. pools. Mr. Fabian noted that KHRC needs additional trained and seasoned investigators who have spent time on the racetracks. These investigators could work with TRPB investigators on backside investigations.

In addition to the public meeting, information was obtained from the race tracks as described below and discussions were held with the following people:

- David Ruffra, United Tote
- Jeff True, president, United Tote
- Mark Thurman, president, and Yolanda Aguilar, executive administrator, Comprehensive Horse Racing Information Management System (CHRIMS)
- Sammy Jackson, deputy director of the Division of Finance and Regulatory Controls, Texas Horse Racing Commission.

Mr. Bonnie toured the Eastern Operations of United Tote located in Louisville, Ky., and the tote room at Churchill Downs. Mr. Bonnie sent letters to the race tracks asking for information about their security systems generally and their pari-mutuel wagering systems and the security of the pari-mutuel systems. Jeff True held multiple conversations with staff of the KHRC and certain subcommittee members regarding various issues related to the tote company being licensed by the KHRC, tote security, access to handle data and internal control review. Representatives of CHRIMS presented representatives of the KHRC with a webinar describing the functions and capabilities

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of the CHRIMS system and how it could be used by the KHRC. A conversation was conducted with KHRC staff and Mr. Jackson from the Texas Horse Racing Commission regarding the policies and procedures Texas uses for pari-mutuel auditing and accounting.

Recommendations from the Integrity Subcommittee

Short-Term (by the end of FY2010)

1. Fill the following current vacancies.
 - Supervisor of Pari-mutuel Wagering
 - Division Director of Enforcement
 - Investigator II
2. Improve the efficiency and effectiveness of KHRC reporting.
 - Obtain the CHRIMS system that will provide KHRC with reports for each of the Kentucky tracks. The proposed initial start-up charge is \$7,500. The proposed annual fee is \$24,000.
 - CHRIMS will enable the KHRC to verify payments to the commonwealth for taxes and the various funds. For example a calculation will be run on payments due to the following accounts: pari-mutuel tax, KTDF, Equine Drug Research Council, Backside Improvement Fund, Kentucky Equine Industry Fund and the Higher Education Equine Fund.
 - CHRIMS will also enable the KHRC to verify that the payments to the players are accurate and will independently reconcile track amounts, such as handle and breakage.
3. Safety and integrity improvements.
 - Each race track and OTB shall promptly notify the KHRC in writing of any communication, report or investigation conducted by the TRA or TRPB or any state or federal regulatory agency that relates to the safety, integrity or security of the race track or OTB, and its participants, or that would reasonably be deemed to affect public confidence in the race track or OTB. Each race track and OTB shall further send a copy of any TRA or TRPB communications, correspondence or reports relating to any such report or investigation to the KHRC promptly upon receipt by the racing association or OTB.
 - Each race track shall send a copy of any correspondence to the KHRC at the same time it is filed with the TRA or TRPB relating to the safety, integrity or security of the race track or OTB, with the exception of any information that is proprietary to the race track or OTB.
 - The KHRC director of enforcement should work with TRPB and security personnel in other states for training and investigations.
 - Obtain Secondary Pari-mutuel Organization (SPMO) due diligence reports from TRPB after the supervisor of pari-mutuel wagering is hired.
 - Participate in the Association of Racing Commissioner's International (RCI) certification of Secondary Pari-mutuel Organizations (SPMOs) program.
4. Conditions of licensure for tracks.
 - Require tracks to record the date and time (down to the second) on all live video feeds originating from a Kentucky track.
 - Require the tote company to certify the time for the closing of the betting windows down to the second.

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- Require all Kentucky tracks, tote companies and video providers to synchronize their time system with U.S. Naval Observatory Clock, Network Time Protocol (NTP), Atomic Clock Sync or such other clock synchronization tool as the tote company may use, at the beginning of each day, down to the second.
 - Require tracks to provide the tote company with written permission for the KHRC or a designated representative of the KHRC to receive handle and wagering information directly from the tote company.
 - One subcommittee member recommended establishing a retention period for the live video feeds and requiring tracks to record the exact time (down to the second) when the gate opens.
5. Tote company.
- License the tote company and promulgate regulations.
 - Require the approved tote company to complete the GLI or a SAS 70 review.
 - Require all Kentucky tracks, tote companies and wagering locations that take bets on Kentucky races to synchronize their time system (hopefully this becomes the industry standard).
 - Consider requiring the tote company to bring the longest wager transmission cycle to 15 seconds or less.
6. Establish Kentucky Horse Racing Integrity Hotline with both a phone number and Web link. Publicize this hotline at the tracks. Potentially work with current crime-stoppers program.
7. License the advance deposit wagering companies and promulgate regulations.
8. Develop a method for licensing and supervising all vendors of products (drugs, etc.) being sold to trainers, veterinarians, grooms, etc. for use and/or consumption on licensed premises in Kentucky.
9. Hire and train additional security personnel to investigate alleged violations of Kentucky Revised Statutes and Regulations.
10. Provide the KHRC with sufficient, dedicated funding to maintain and improve the confidence of the public in the integrity of racing and all pari-mutuel betting activities.

Long-term

1. The supervisor of pari-mutuel wagering will review available wagering monitoring systems and programs. Obtain system that will identify wagering anomalies.
2. Develop career paths for both investigators and pari-mutuel auditors.
3. Continue efforts to verify and regulate who is wagering into Kentucky pools.
4. Subcommittee members mentioned that early closing of the pools should be considered an option if wagering security issues could not be resolved technologically. The KHRC will continue to monitor the progress of industry technology in determining the correct course of action in the future.
5. Establish regulations eliminating the opportunity for incidents related to past postings, cancel delays, late odds changes and unusually low payoffs.

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Findings and Recommendations of the Subcommittee on the Laboratory Facilities in Kentucky

Mission

This subcommittee was asked to review the industry needs for a testing, research and laboratory facility in Kentucky. The subcommittee discussed the possible methods of organizing and funding a laboratory. In addition the subcommittee analyzed the benefits of having a laboratory in Kentucky.

Subcommittee Members

Members of the Subcommittee on Laboratory Facilities in Kentucky included Robert M., Beck Jr., chair; Tracy Farmer, Robert D. Vance, Edward S. Bonnie, Steve Sexton, Dr. Jerry Yon (ex officio), Daisy Phipps (ex officio), Dr. Foster Northrop (ex officio) and Craig Bendoroff (ex officio).

Background and Summary

In recent years there has been increased public awareness of the use of illegal and overuse of legal medications in all areas of horse racing. Due to increased publicity and increasing focus on integrity issues in horse racing, industry leaders and stakeholders have focused more of their attention and resources on the issues of drug testing and research and the facilities that provide these services. In order to gain a better understanding of these issues, the subcommittee received presentations, conducted personal interviews and accessed available information from sources knowledgeable in the equine drug testing and research laboratory area.

The subcommittee met on two occasions and heard presentations from the following:

- Dr. Mary Scollay – Equine medical director of the Kentucky Horse Racing Commission
- Dr. Nancy Cox – University of Kentucky associate dean for research and director of the Agricultural Experiment Station
- Leonard Heller – University of Kentucky vice president, commercialization and economic development, and president and CEO for Kentucky Technologies Inc.
- Warren Nash –deputy commissioner, Department for Commercialization and Innovation, Kentucky Cabinet for Economic Development

The subcommittee, through its members and the staff of the Kentucky Horse Racing Commission, conducted interviews of individuals with knowledge and experience. These individuals contributed to the information analysed by the subcommittee concerning equine drug testing and research. This group included:

- Dr. Terence Wan – lab director for the lab owned by the Hong Kong Jockey Club
- Dr. Scott Smith – dean, College of Agriculture, University of Kentucky
- Dan Fick – executive director of the Jockey Club and chief executive officer of the Racing Medication and Testing Consortium (RMTC)

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- Deborah Clayton – Commissioner, Department for Commercialization and Innovation, Kentucky Cabinet for Economic Development

The subcommittee also utilized information provided in connection with KHRC's development of an anabolic steroid rule. The subcommittee included KHRC staff and commission members who helped develop the anabolic steroid rule. The earlier testimony was provided by:

- Dr. Don Catlin – director of the UCLA Olympic Analytical Laboratory
- Dr. Scot Waterman – executive director, RMTC
- Dr. Richard Sams – Professor Racing Laboratory, Department of Physiological Sciences University of Florida
- Dr. Rick Arthur – equine medical director, California Horse Racing Board

The subcommittee's work was directed toward:

- Developing an understanding of the current landscape of drug testing and research laboratories in the United States.
- Assessing the need for and advantages and disadvantages of developing a drug testing and research laboratory in Kentucky.
- Investigating the costs of the building, equipment, ongoing operating costs, capital expenditures and human resources necessary to develop the laboratory.
- Investigating the availability of financing for a laboratory project.
- Researching the feasibility of establishing an equine drug and research laboratory in Kentucky.

Findings

Current Status of Testing and Research

The subcommittee was advised that there are currently 18 drug testing and research laboratories in the U.S. Two of the laboratories are for-profit commercial labs. The rest of the laboratories are affiliated with universities and are presumably not-for-profit laboratories. ISO 17025 is a certification as a quality control indicator for drug testing laboratories. Only four of the current labs are ISO 17025 certified. Several lab directors interviewed by the subcommittee noted that financial problems for state governments and universities directly and adversely impact funding for the university-affiliated laboratories' operating budgets. See Page 38 for a listing of the laboratories and the jurisdictions they service. The RMTC Drug Testing Initiative Task Force has noted that a number of cost efficiencies could be achieved by a reduction in the number of testing laboratories. Requiring laboratories to be accredited may result in a reduction of the number of laboratories. Accreditation will require a significant capital infusion. Some laboratories may decide not to make a capital investment to obtain the accreditation, and therefore the number of labs providing testing services may decline.

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Currently, nationwide approximately 200,000 paired samples are tested yearly in equine drug testing programs. Kentucky racing generates approximately 5,000 paired samples per year.

In addition to ISO 17025 there is another quality assurance standard established and monitored by the World Anti-doping Agency Quality Assurance Program (WADA). At the Jockey Club's request, the RMTC established a drug testing initiative aimed at developing laboratory and drug testing standards comparable to WADA standards. Additionally, the RMTC task force is reviewing the Association of Official Racing Chemists standards.

The RMTC project sponsored by the Jockey Club is in process. The RMTC Drug Testing Initiative Task Force working on the project is reviewing laboratory standards, formulating a business plan for laboratories, mapping accreditation requirements and other issues. It is anticipated that at least part of the report regarding equine drug testing and research laboratories will be available in six months.

Advantages and Disadvantages of a Kentucky Laboratory

The subcommittee discussed a number of advantages to establishing an equine drug testing and research laboratory in Kentucky. The advantages include the following:

- The closer proximity to KHRC offices and Kentucky racetracks would allow for quicker turnaround time for testing results. This is a distinct advantage in an era of more significant testing.
- Better opportunity to accommodate special testing circumstances and associated costs.
- Closer proximity to KHRC offices and Kentucky racetracks could increase cooperation among the testing laboratory, the Kentucky Horse Racing Commission, the racetracks and the horsemen.
- Proximity to a large number of horses available for research.
- More input into the process for the Kentucky Horse Racing Commission.
- More cooperation should lead to higher quality testing, tighter controls, and a possible reduction in costs.
- Creation of strategic alliances with graduate schools of chemistry and pharmacology which will help in developing the next generation of equine drug testing laboratory directors and chemists, including post-doctoral and graduate student programs.
- Allow Kentucky to replicate its leadership in the breeding and racing areas with leadership in the equine drug testing and research area.
- The creation of high-level, high-paying jobs in the commonwealth allowing Kentucky to provide good opportunities for its bright young professionals in the state.
- Increase capital investment in the commonwealth.
- Commercialization of research intellectual property could stimulate the growth of new companies and create additional jobs.

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- The intangible benefits all lead to better quality testing, which helps maintain the integrity of the industry.

Disadvantages

The subcommittee also considered the disadvantages of locating a laboratory in Kentucky. The disadvantages include:

- Expense of building, outfitting and staffing the laboratory.
- Economic viability of the laboratory.

Costs

It was difficult for the subcommittee to develop accurate cost estimates without a specific list of necessary equipment and a set of plans for a building. However, the subcommittee was able to develop some estimates by assembling information from various sources. Any decision to proceed would require in-depth study of the numbers and estimates.

The types of necessary items and projected costs are as follows. Some items are presented in ranges where the subcommittee had multiple estimates. The sources include proposals for a research and reference laboratory prepared for the RMTTC, an interview with Dr. Don Catlin, interviews with the University of Kentucky staff and presentation materials prepared by Dr. Scott Stanley for a national racing chemistry research and reference laboratory.

Start-up costs for instruments, equipment computers and supplies	\$2,500,000 -- \$5,000,000
Staffing	\$1,300,000 -- \$3,500,000
Program administration Costs per year	\$ 175,000 -- \$ 335,000
Testing costs per year (supplies, disposables)	\$ 126,000 -- \$ 984,000

Initial estimates indicate the need for a facility of 12,000 to 17,500 square feet with a cost of \$5,700,000 to \$10,500,000.

Costs can vary significantly based on such factors as whether the equipment is purchased or leased and whether a new building is constructed or existing space is used. Costs also varied depending on the extent of research component of the project.

Ongoing maintenance costs are also an issue. Revenue sources identified to finance operating expenses include fees from testing services, interest from an endowment, research funding supplied by the Equine Drug Research Council or other industry organizations and commercialization of intellectual property generated by a for-profit research arm.

Financing

The subcommittee gathered information about financing possibilities from a number of sources. Warren Nash, Deputy Commissioner of the Office of Economic Development, and Deborah Clayton,

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with the same department, provided information regarding various tax incentives available for annual health projects. It appears that the laboratory could qualify for some of these incentives

The subcommittee discussed the structure of the project on a number of occasions. Both for-profit and non-profit structures were considered. Based on testimony of Mr. Leonard Heller, the optimum structure would be a non-profit organization with a for-profit affiliate dedicated to commercializing any intellectual property produced by the research laboratory. The benefit of the structure would be the availability of state and local issues to finance a building and equipment costs.

Feasibility

Kentucky racing currently generates 5,000 paired test samples a year. The financial feasibility of a drug testing and research laboratory will require attracting additional business. Some states require equine drug testing to be conducted at in-state laboratories, which might limit the ability to attract business from those other jurisdictions. The subcommittee was advised of certain states and equine organizations that would entertain the possibility of using a Kentucky laboratory for their drug testing needs. The possibility also exists of providing non-equine testing in the laboratory. Some labs currently provide both equine and human testing. A guideline for the Kentucky lab would be 10,000 paired samples a year. It is anticipated that the project may take four or five years to complete.

Conclusions

1. There is substantial support for building an equine drug testing and research laboratory in Kentucky. This support includes the Office of Governor Steven L. Beshear, the office of Lexington Mayor Jim Newbury, University of Kentucky President Lee Todd and a number of equine organizations that have indicated a willingness to provide economic or other support.
2. The laboratory must be a high-class, accredited laboratory with WADA, ISO 17025 or other significant accreditation. There is no reason to proceed with a laboratory project unless the quality of the laboratory allows for accreditation.
3. There are substantial tangible and intangible benefits to be gained from a Kentucky drug testing and research laboratory project. The industry, the participants in racing and the Commonwealth of Kentucky can all benefit from such a program.
4. A laboratory project should include cooperation with The Jockey Club, the Racing Medication and Testing Consortium and other industry stakeholders to develop a viable business plan for a laboratory in Kentucky.
5. Further research is needed to solidify the cost estimates and to identify potential additional revenue and funding sources.
6. A proposed equine drug testing and research laboratory will require sufficient initial funding to develop a business plan and to hire a consultant to provide technical advice regarding laboratory equipment and space requirements.

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Recommendations

1. Establish a world class equine drug research and testing laboratory in the Commonwealth of Kentucky.
2. Organize a non-profit and qualify the entity as a section 501(c) charitable organization for Internal Revenue purposes.
3. Develop a business plan to address structure, equipment and facility requirements, cost structure, financing and other relevant items.
4. Incorporate industry recommended standards for quality assurance standards, accreditation and best practices into the business plan.
5. Establish an executive board of no more than five members, one of whom should be a chief executive officer; one a member of the KHRC and one a member of the EDRC. This board will immediately pursue the following:
 - Provide the foundation board its goals.
 - Develop a detailed business plan and timeline for building and organizing the nonprofit institute.
 - Collaborate with Lexington and state bonding agency, legislature and state Finance Cabinet.
 - Seek cooperation with UK for organizing the structure of the research facility and a possible land donation.
 - Hire laboratory director or consultant to oversee planning of and building of the laboratory.
 - Explore collaboration with FEI on laboratory with aim to do drug testing for FEI.
 - Explore possible drug testing for surrounding states.
 - Explore possible human drug testing, as well as equine, in the new laboratory.
 - Continue cooperation with The Jockey Club and the RMTC Drug Testing Initiative Task Force.

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Forensic Testing Laboratories in Existence and the Jurisdictions That Use Each as of December 1, 2008

Labs that are bold and underlined are ISO 17025 certified - highest level of accreditation.

Jurisdictions that are in bold and italics do not use a laboratory that is located in their jurisdiction.

Laboratory	Jurisdictions	Laboratory	Jurisdictions
Truesdail Laboratories located in Tustin, California	<i>Idaho</i> <i>Indiana</i> <i>Minnesota</i> <i>Oklahoma</i> <i>Oregon</i> <i>Washington</i>	LSU Equine Medication Surveillance Laboratory Maine Health & Environmental Testing Lab Maryland Racing Commission Laboratory New Jersey State Police Ohio State Racing Commission Laboratory	Louisiana Maine Maryland New Jersey Ohio
Center for Tox Services located in Tempe, Arizona	<i>Kansas</i> <i>South Dakota</i>	<u>Pennsylvania Race Horse Testing Laboratory</u> Texas Veterinary Medical Diagnostic Laboratory Cornell University University of Illinois Animal Forensic Toxicology Lab	Pennsylvania Texas New York Illinois
Dalare Associates located in Philadelphia, Pennsylvania	<i>Delaware</i> <i>West Virginia</i>	<u>University of Florida</u> Massachusetts State Racing Laboratory Michigan Department of Agriculture	Florida New Hampshire Massachusetts Michigan
<u>Industrial Laboratories</u> located in Denver, Colorado	<i>Arkansas</i> <i>Arizona</i> <i>Colorado</i> <i>Montana</i> <i>Nebraska</i> <i>North Dakota</i> <i>Utah</i> <i>Wyoming</i>	<u>Ken Maddy Equine Analytical Lab</u> located in David, California	California
Iowa Racing Chemistry Veterinary Diagnostic Lab	<i>Iowa</i> <i>Kentucky</i> <i>New Mexico</i> <i>Virginia</i>		

Appendix A

Purses at Major Race Tracks in the U.S.

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Appendix A

Annual U.S. Purses

Racetracks experiencing the greatest growth in annual purses from 2000 to 2007 were those that contributed alternative gaming revenue to purses.

Among the top 20 racetracks ranked by 2007 total purses, eight tracks – Philadelphia Park (Pennsylvania) Charles Town and Mountaineer (West Virginia), Delaware Park (Delaware), Monmouth Park (New Jersey), Fair Grounds and Delta Downs (Louisiana), and Gulfstream Park (Florida) – have alternative gaming revenue.

Five other tracks – Belmont Park, Aqueduct, and Saratoga (New York), Calder Race Course (Florida) and Laurel Park (Maryland) — have state approval and are preparing to incorporate alternative gaming into their operations.

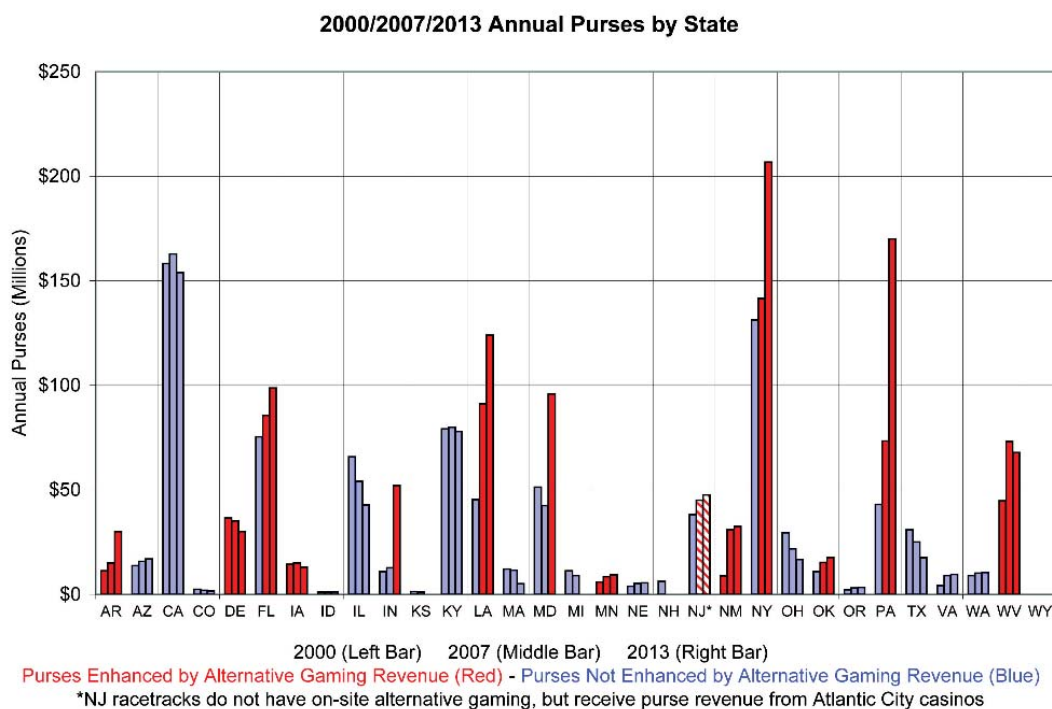
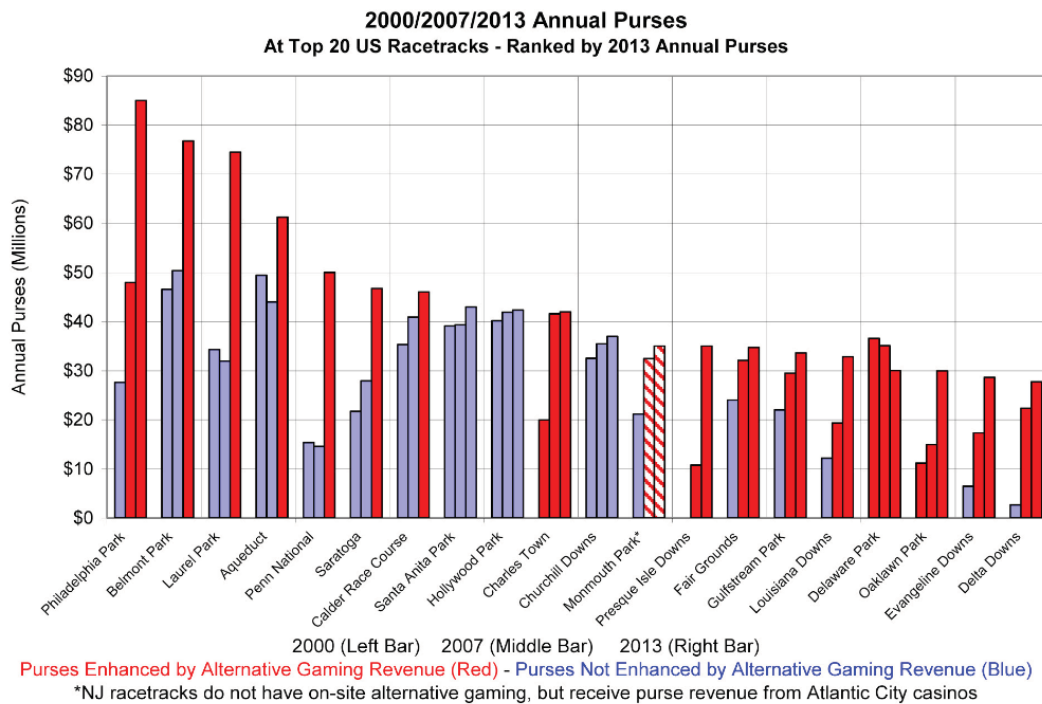
Several racetracks that recently introduced alternative gaming will likely soon join the top 20 rankings, including Presque Isle Downs and Penn National (Pennsylvania), and Hoosier Park (Indiana).

Major expansion of alternative gaming during the next five years will result in a change in rankings and scale favoring Maryland, New York, Pennsylvania and Indiana. In other states, by 2013, annual purses at racetracks with alternative gaming will begin to approach levels at premier Kentucky and California racetracks, which historically maintained distinctly higher annual purses than most racetracks.

Source: Thoroughbred Racing Associations, Comparative Study of Racing Jurisdictions per the Availability of Alternative Gaming Revenue for Purses, November 2008

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Source: Thoroughbred Racing Associations, Comparative Study of Racing Jurisdictions per the availability of Alternative Gaming Revenue for Purses, November 2008

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Average Daily U.S. Purses

Among racetracks that contributed alternative gaming revenue to purses by 2007, combined average daily purses increased from \$127,783 in 2000 to \$191,957 in 2007 (50.2 percent increase), while live race dates increased 3.6 percent.

Among racetracks that did not contribute alternative gaming revenue to purses by 2007, combined average daily purses increased from \$180,397 in 2000 to \$197,382 in 2007 (9.4 percent increase), while live race dates declined by 12.5 percent.

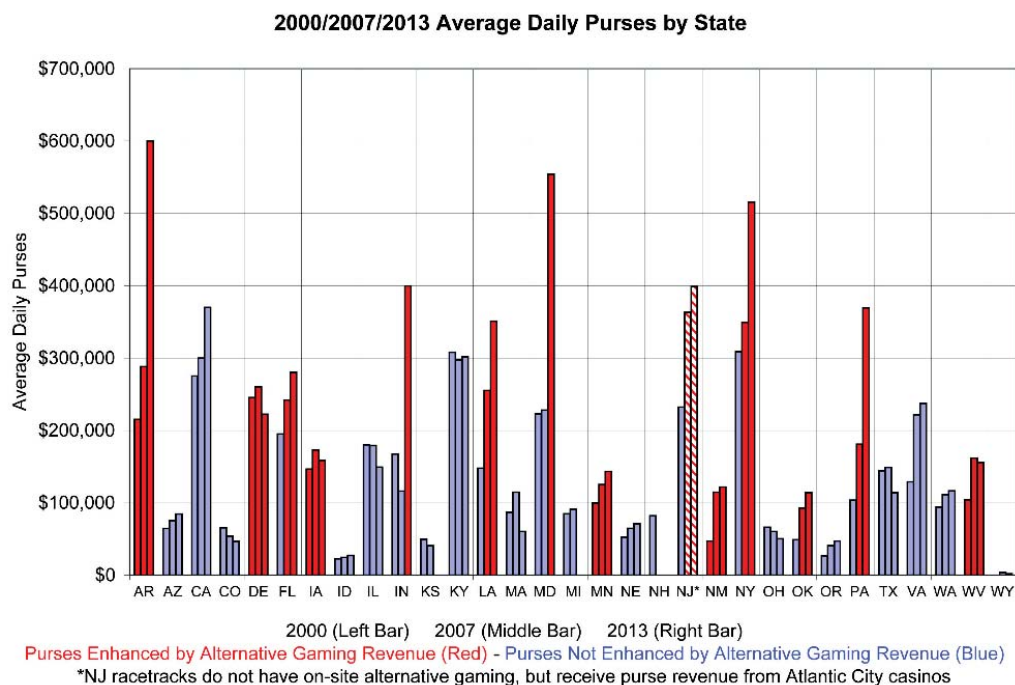
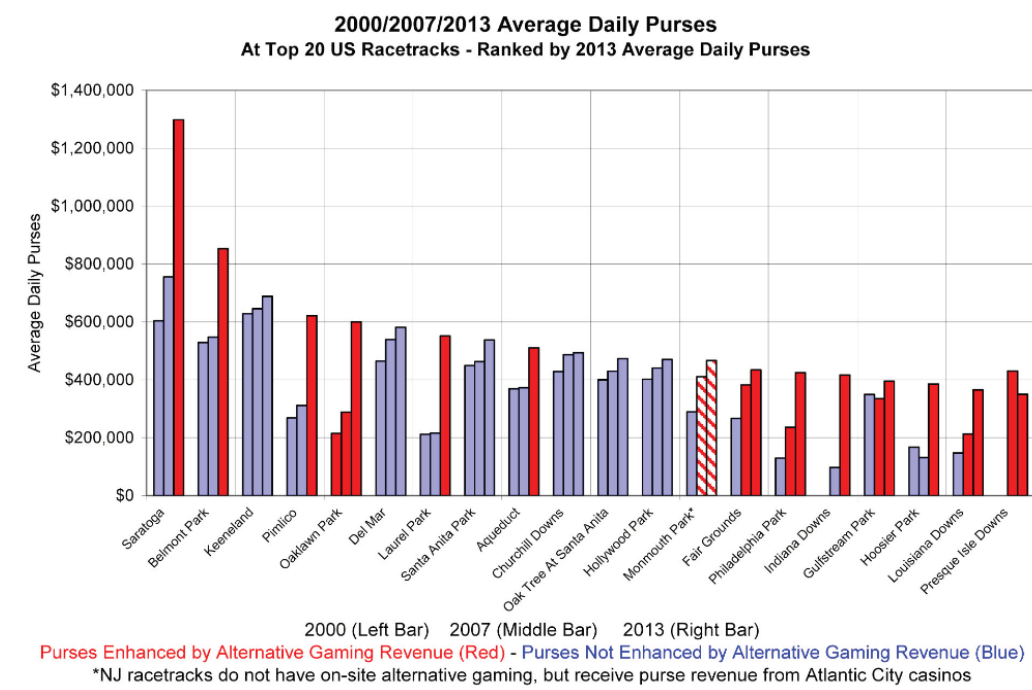
The strongest growth in average daily purses through 2013 will come from alternative gaming revenue. Between 2000 and 2007, major racetracks maintained their comparative ranking, although the gap between premier racetracks and historically less competitive racetracks narrowed due to alternative gaming revenue.

By 2013, New York and Pennsylvania average daily purses are projected to far exceed those of other traditionally premier racing states, such as Kentucky and California. The concentration of superior purses on the East Coast could accelerate the impact on annual purses and live race days elsewhere.

Source: Thoroughbred Racing Associations, Comparative Study of Racing Jurisdictions per the Availability of Alternative Gaming Revenue for Purses, November 2008

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Source: Thoroughbred Racing Associations, *Comparative Study of Racing Jurisdictions per the Availability of Alternative Gaming Revenue for Purses*, November 2008

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Summary of Thoroughbred Racing States In Which Purses Are Enhanced by Alternative Gaming Revenue

ARKANSAS – Thoroughbred racing is conducted at Oaklawn Park, which introduced electronic gaming in January 2000. Oaklawn Park has 500 machines and will have 900 to 1,000 machines once its \$20 million expansion is completed.

DELAWARE – Slot machines were introduced at Delaware Park in December 1995. The track currently operates 3,191 machines. Thoroughbred purses increased from \$10 million in 1995 to \$36.3 million in 2007; average daily purses increased from \$77,842 in 1995 to \$269,011 in 2007.

FLORIDA – Florida's major Thoroughbred racetracks are Calder, Gulfstream Park and Tampa Bay Downs. Calder has been approved for card games and up to 2,000 slot machines, which are in the planning stages. Gulfstream offers card games and opened slot operations in November 2006. The track currently has 825 machines and is permitted up to 2,000. Gulfstream's purses increased from \$24.4 million in 2005 to \$28.2 million in 2007. Tampa Bay Downs has offered card games since December 2003, but is not approved for slot machines.

ILLINOIS – Illinois' Thoroughbred racetracks are Arlington Park, Fairmount Park and Hawthorne. In 2006, the Illinois General Assembly passed legislation creating the "Horse Racing Equity Trust" to fund a portion of Illinois purses with a surcharge on riverboat casinos meeting a certain threshold. The fund now totals \$80 million. The riverboats filed a complaint to stop collection of the surcharge. In June 2008, the Illinois Supreme Court ruled that the surcharge was constitutional. The decision was appealed, and in October 2008 the state Supreme Court denied a rehearing. The matter will likely be appealed to the U.S. Supreme Court. If a hearing is denied, distribution of the fund is anticipated in the summer of 2009.

INDIANA – Indiana's Thoroughbred racetracks are Hoosier Park and Indiana Downs. Hoosier Park and Indiana Downs both opened casinos in June 2008. Hoosier Park has 1,973 gaming machines, while Indiana Downs has 1,889 machines.

IOWA – Iowa has one Thoroughbred racetrack, Prairie Meadows, which has conducted alternative gaming since 1995. The track currently operates 1,900 machines.

LOUISIANA – Louisiana's Thoroughbred racetracks are Delta Downs, Evangeline Downs, Fair Grounds and Louisiana Downs, all of which offer casino gaming. Delta Downs opened its casino in February 2002 and operates 1,600 machines; Evangeline Downs opened a casino in December 2003 and operates 1,627 machines; and Louisiana Downs opened a casino in May 2003 and has 1,300 slots. Fair Grounds opened its permanent facility with 606 machines in November 2008.

MARYLAND – Maryland's Thoroughbred racetracks are Laurel, Pimlico and Timonium. Maryland voters approved slots in November 2008, allowing up to 15,000 machines statewide. Laurel is a potential casino site. Regardless of where casinos are located in Maryland, 7 percent of all gaming revenue is earmarked for purses and breeders' awards.

NEW JERSEY – New Jersey's Thoroughbred racetracks are Atlantic City, the Meadowlands and Monmouth Park. During 2004 – 2007, New Jersey casinos provided \$84 million in subsidies for Thoroughbred and Standardbred purses. During 2008 – 2010, casinos will provide \$90 million in purse subsidies.

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NEW MEXICO – New Mexico's Thoroughbred racetracks are The Downs at Albuquerque, which operates 330 machines; Ruidoso Downs, which has 325 machines; Sunland Park, with 700 machines; Sunray Park, which operates 510 machines; and Zia Park, with 750 machines.

NEW YORK -- New York's Thoroughbred racetracks are Aqueduct, Belmont and Saratoga, operated by the New York Racing Association (NYRA), and Finger Lakes. Finger Lakes has conducted gaming since February 2004 and operates 1,199 slot machines. Aqueduct's casino operator was named in October 2008, and construction is expected to begin soon on a 4,500 slot machine facility.

OKLAHOMA – Oklahoma's Thoroughbred racetracks are Blue Ribbon Downs, Fair Meadows Tulsa and Remington Park. Blue Ribbon and Remington offer casino gaming, operating 250 and 700 machines, respectively.

PENNSYLVANIA – Pennsylvania's Thoroughbred racetracks are Penn National, Philadelphia Park and Presque Isle Downs. Philadelphia Park's casino opened in December 2006 and operates 2,912 machines; Presque Isle Downs opened its casino in February 2007 and has 1,997 machines; and Penn National opened its casino in February 2008 with 2,201 machines.

WEST VIRGINIA – West Virginia's Thoroughbred racetracks are Charles Town and Mountaineer Park. Charles Town opened a casino in 1997 and operates 5,000 machines. Mountaineer's casino opened in 1992 and features 3,200 machines and 95 table games.

Source: Thoroughbred Racing Associations, Comparative Study of Racing Jurisdictions Per the Availability of Alternative Gaming Revenue for Purses, November 2008

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Projected Thoroughbred Purses in Pennsylvania

<u>Racetrack</u>	<u>2006</u>	<u>2007</u>	<u>2009</u>
Penn National	\$12,272,225	\$14,590,641	\$47,272,225
Philadelphia Park	\$28,599,655	\$47,961,998	\$83,599,655
Presque Isle Downs	N/A	\$10,756,500	\$35,000,000
Total	\$40,871,880	\$73,309,139	\$165,871,880

After one year with a limited number of gaming machines during 2007, Philadelphia Park's total purses were ranked second-highest nationally, up from 13th place in 2006. They will be ranked first in 2008. Purse money generated solely from slot machines at Philadelphia Park likely will reach \$60 million within a few years.

Source: Thoroughbred Racing Associations, Comparative Study of Racing Jurisdictions per the Availability of Alternative Gaming Revenue for Purses, November 2008

Projected Thoroughbred Purses in New York

<u>Racetrack</u>	<u>2007</u>	<u>2009</u>	<u>2013</u>
Aqueduct	\$44,007,510	\$44,134,695	\$62,000,000
Belmont	\$50,373,128	\$50,518,710	\$77,000,000
Saratoga	\$27,952,797	\$28,033,582	\$46,000,000
Total	\$122,333,435	\$122,686,987	\$185,000,000

A 4,500-slot machine casino is anticipated to open at Aqueduct by 2010 and could boost combined purses at Aqueduct, Belmont Park and Saratoga by more than \$60 million (50%). Alternative gaming revenues for New York tracks will dramatically alter Kentucky racing, particularly Keeneland's spring and fall race meets.

Source: Thoroughbred Racing Associations, Comparative Study of Racing Jurisdictions per the Availability of Alternative Gaming Revenue for Purses, November 2008

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Projected Thoroughbred Purses in Indiana

<u>Racetrack</u>	<u>2006</u>	<u>2007</u>	<u>2009</u>
Hoosier Park	\$8,786,013	\$8,019,548	\$16,186,013
Indiana Downs	\$4,699,002	\$4,647,888	\$12,099,002
Total	\$13,485,015	\$12,667,436	\$28,285,015

Hoosier Park and Indiana Downs began operating slot machines in 2008. Ellis Park will overlap race dates with Indiana tracks for the majority of its 2009 race meet, competing head-to-head with Indiana's more attractive purses and incentives. Indiana's lucrative purse programs will have a potentially devastating impact on Ellis Park, Turfway, and the lower levels of racing at Churchill Downs.

Source: Thoroughbred Racing Associations, Comparative Study of Racing Jurisdictions per the Availability of Alternative Gaming Revenue for Purses, November 2008

Kentucky-Based Trainers Shipping to Other Racetracks

<u>Track</u>	<u>2006 Trainers/Starts</u>	<u>2008 Trainers/Starts</u>
Aqueduct	12 / 371	30 / 674
Belmont	16 / 536	24 / 488
Hoosier Park	132 / 2,236	162 / 1,891
Indiana Downs	66 / 1,350	126 / 1,045
Mountaineer	98 / 1,718	135 / 1,476
Presque Isle Downs	N/A	109 / 1,185
Total Starts	6,211	6,759

Purses enhanced by alternative gaming revenue have attracted a growing number of Kentucky-based trainers to out-of-state racetracks, particularly in Indiana and Pennsylvania.

Source: Equibase

Appendix B

Challenges Facing Kentucky's Breed Development Program

Report of the Governor's Task Force on the Future of Horse Racing

Appendix B

Pennsylvania Thoroughbred Development Awards

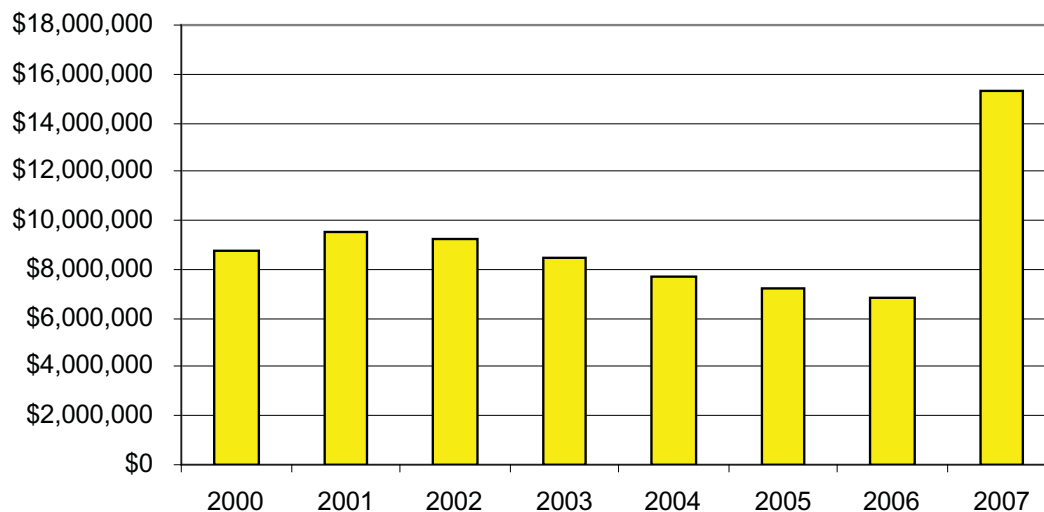
Pennsylvania is publicly taking aim at Kentucky, enriching its state breed development program to improve the quality of its breeding and racing stock.

In 2006, year before racetrack gaming, Pennsylvania's breeding fund paid about \$7.8 million. In 2008, the fund is projected to pay \$23 million.

"Two years ago, we had an excellent breeding fund program. Today, Pennsylvania's breeding program is absolutely the best in America."

-- Mark McDermott, executive director of the Pennsylvania Horse Breeders Association, "PA-Bred Program Sets Sights on KY," *Blood-Horse*, February 25, 2008

Pennsylvania Thoroughbred Development Awards



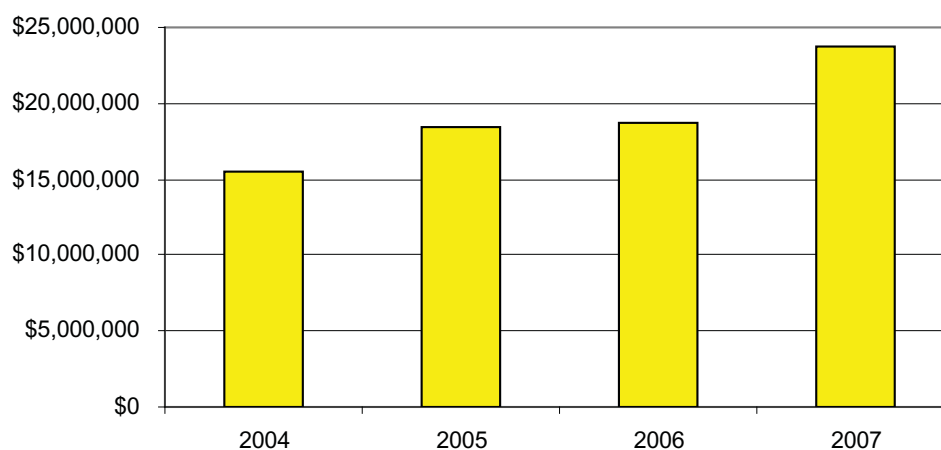
Source: Pennsylvania Horse Breeders Association

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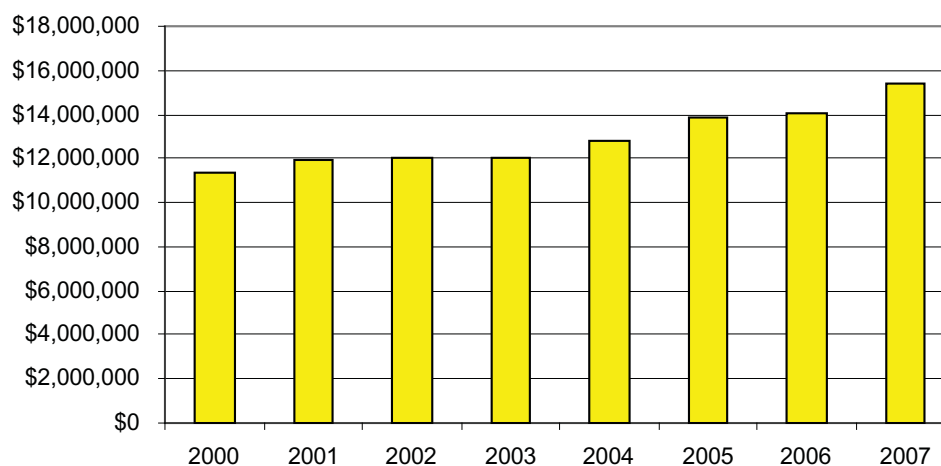
Other states are also positively improving their trend lines by pumping significant new revenue into their owner, breeder and stallion incentive award programs.

Louisiana Thoroughbred Development Awards (Gaming Revenue)



Source: Louisiana Thoroughbred Breeders Association

New York Thoroughbred Development Awards (Gaming Approved)

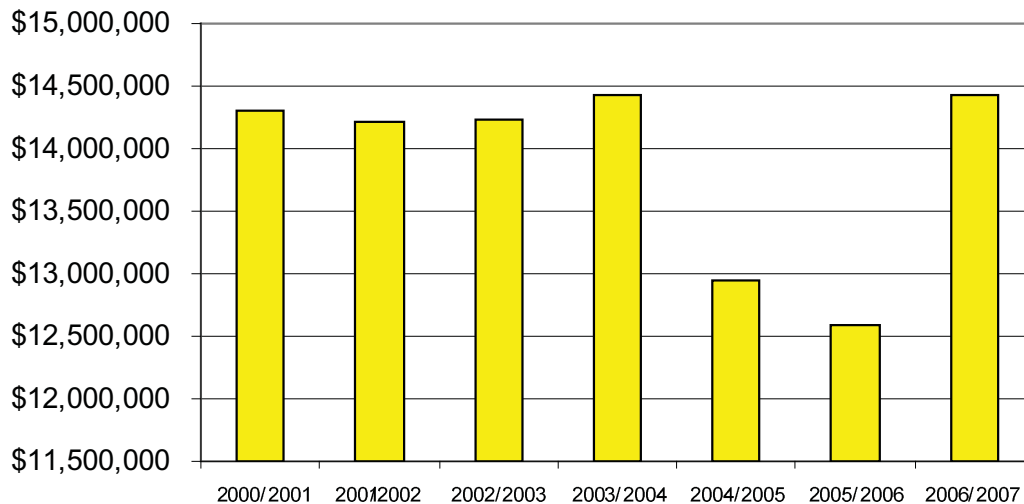


Source: New York Thoroughbred Breeding and Development Fund

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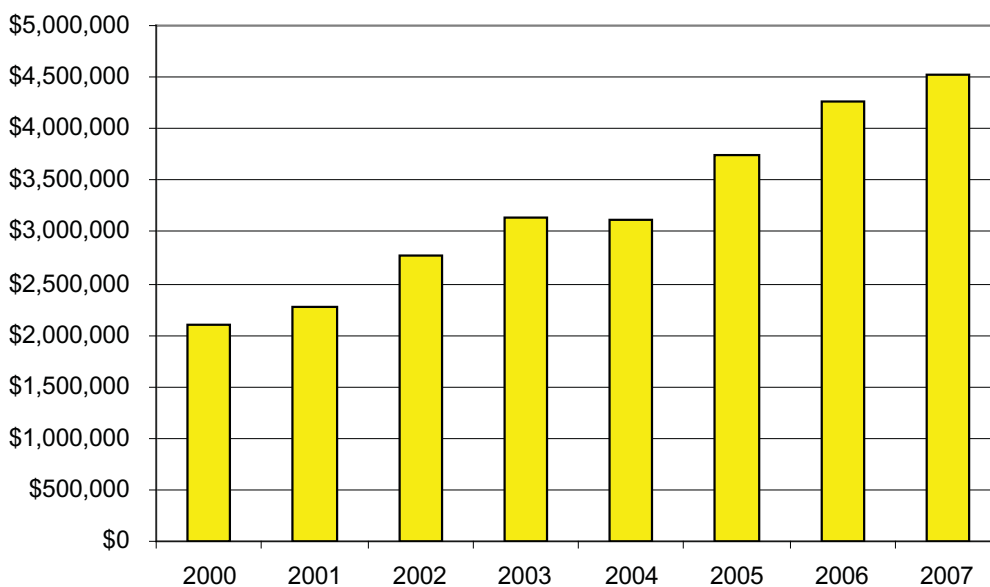
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California Thoroughbred Development Awards



Source: California Horse Racing Board

New Mexico Breed* Development Awards (Gaming Revenues)

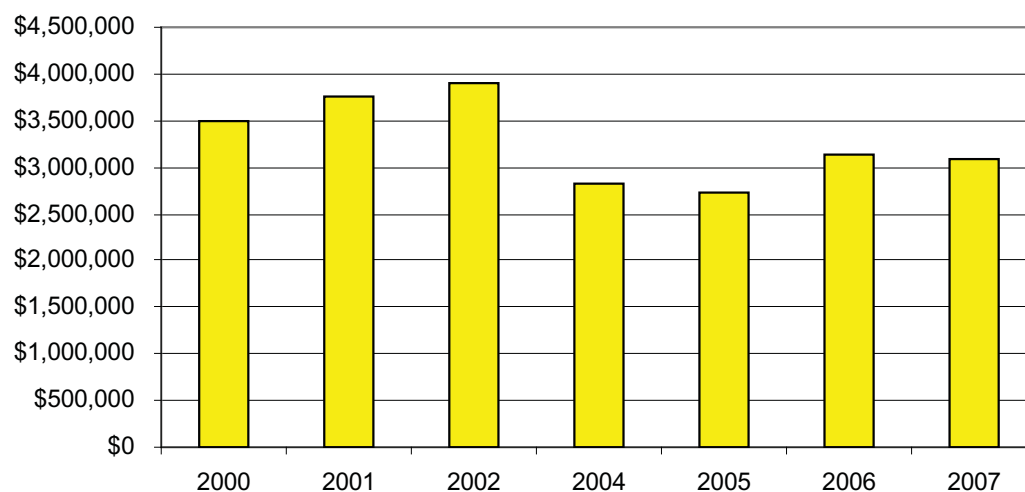


* Figures include all breeds Source: New Mexico Breeders Association

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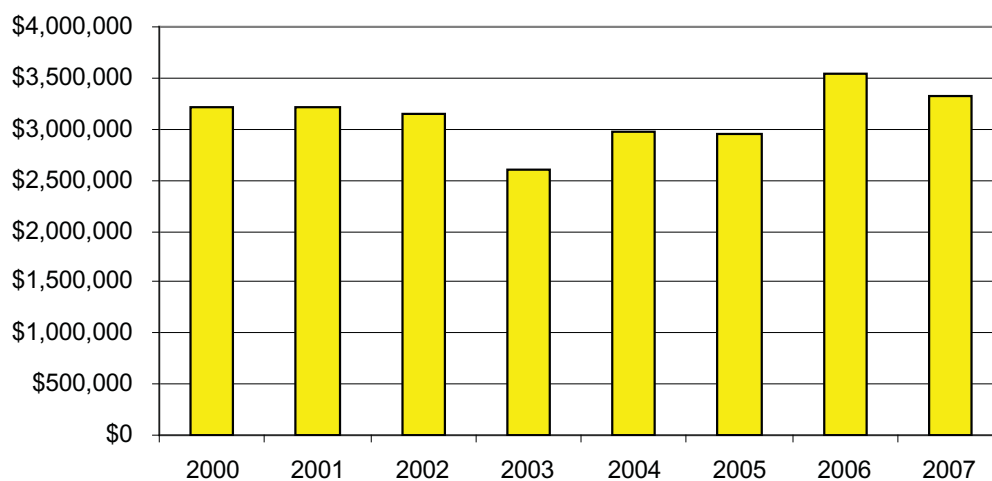
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Indiana Thoroughbred Development Awards (Gaming Revenues)



Source: Indiana Horse Racing Commission

New Jersey Thoroughbred Development Awards (Gaming Revenues)

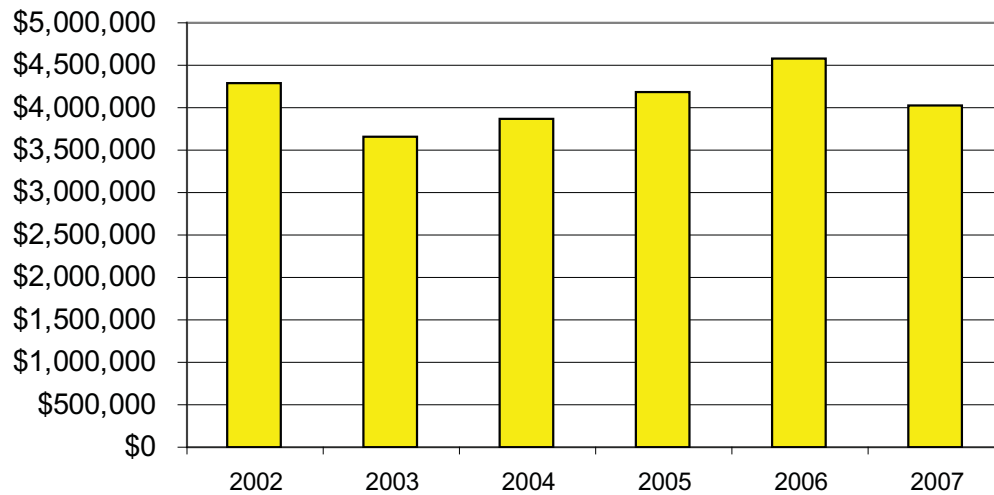


Source: Thoroughbred Breeders Association of New Jersey

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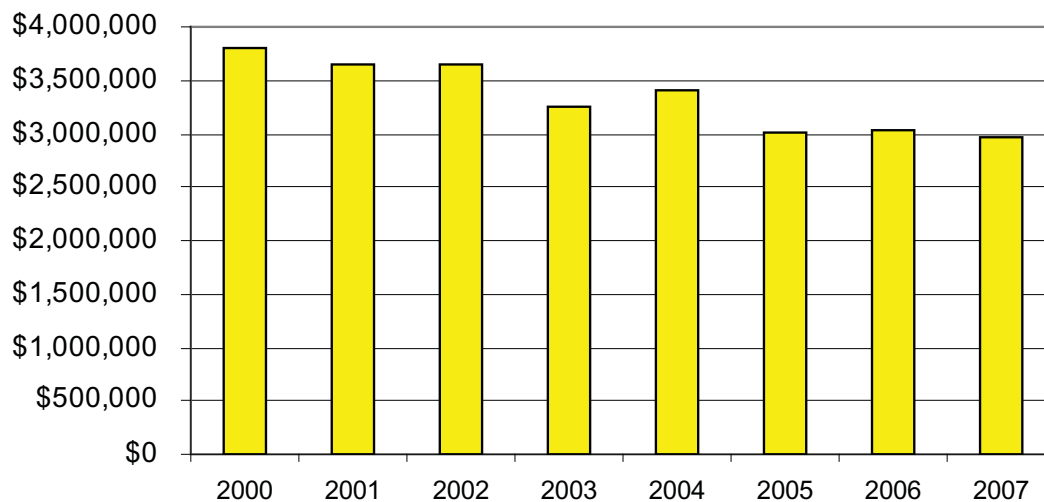
Appendix B

Illinois Thoroughbred Development Awards (Gaming Subsidy Approved)



Source: Illinois Racing Board

Texas Thoroughbred Development Awards

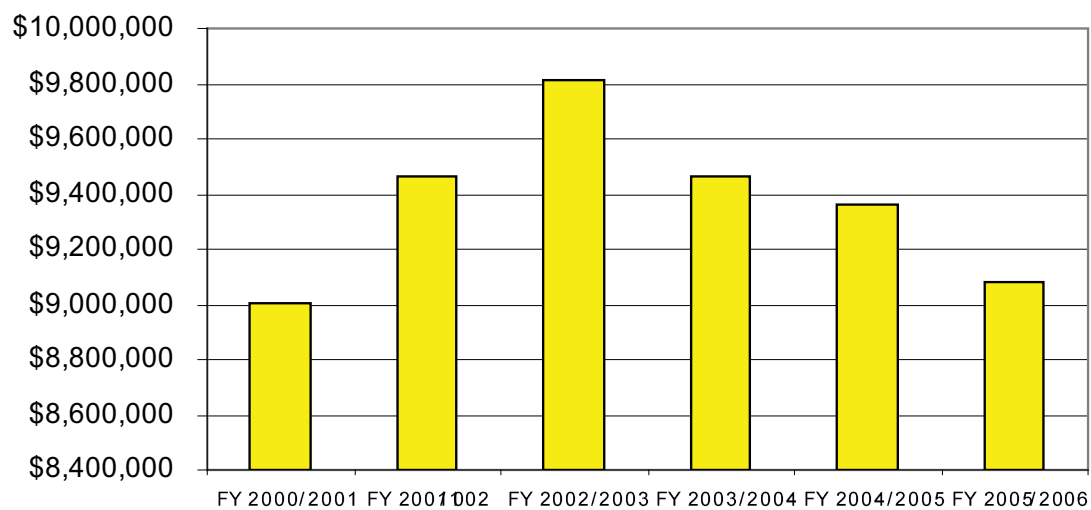


Source: Texas Racing Commission

Report of the Governor's Task Force on the Future of Horse Racing

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Florida Thoroughbred Development Awards (Gaming Approved and Being Implemented)



Source: Florida Thoroughbred Breeders & Owners Association

Report of the Governor’s Task Force on the Future of Horse Racing

Appendix B

Kentucky Standardbred Breeding Industry

Kentucky’s once-prominent standardbred breeding, which boasted the world-renown Castleton and Walnut Hill Farms, has been devastated by out-of-state competition.

In 1986, 95 standardbred stallions bred 2,270 mares in Kentucky. In 2004, 30 stallions bred 680 mares.

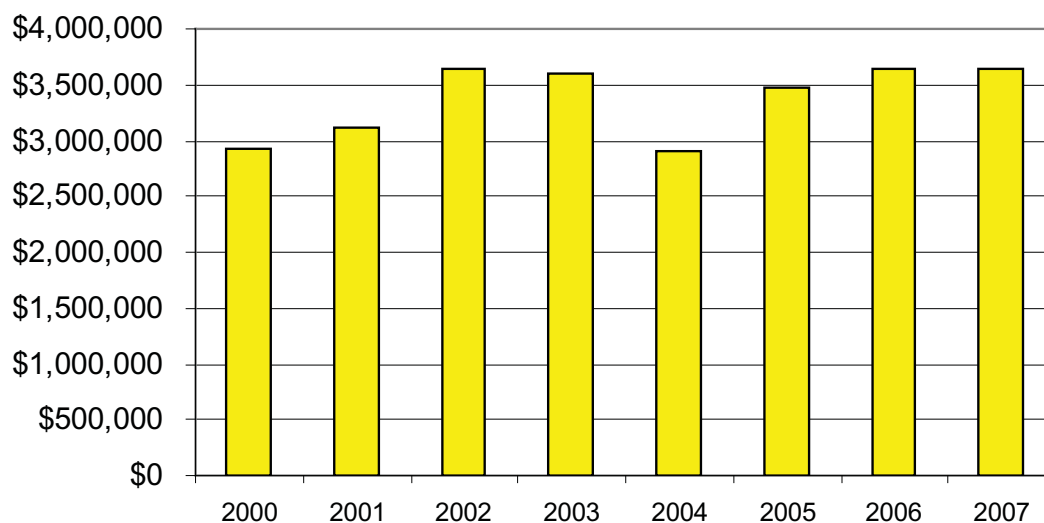
New Jersey Standardbred Development Awards (Gaming Subsidy)

The New Jersey Sires Stakes Program, which offered \$10.3 million in purse money in 2006, played a large role in the decline of Kentucky’s Standardbred breeding industry.

“New Jersey has gained a wide reputation as the premier breeding ground for Standardbred horses (some call us “the Kentucky of Standardbreds) ...”

-- *New Jersey Sire Stakes, State of New Jersey Department of Agriculture website*

Indiana Standardbred Development Awards (Gaming Revenue)

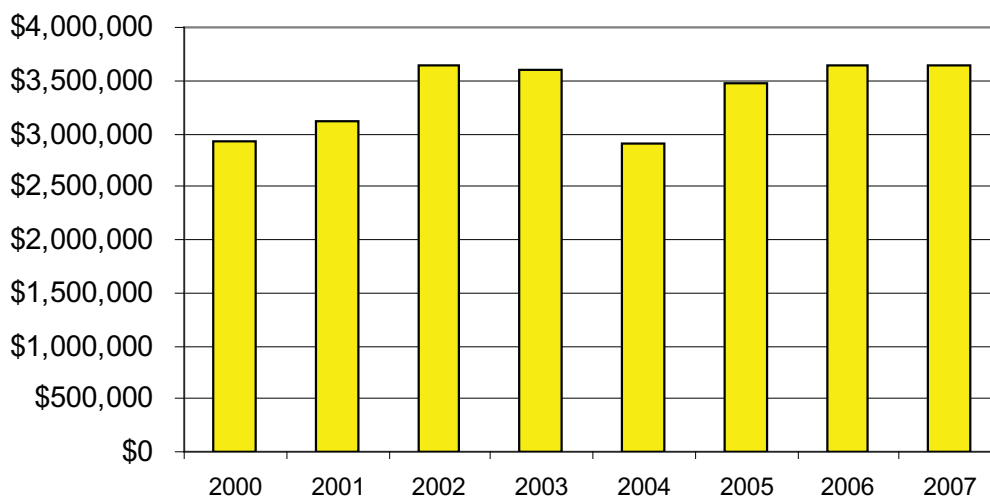


Source: Indiana Horse Racing Commission

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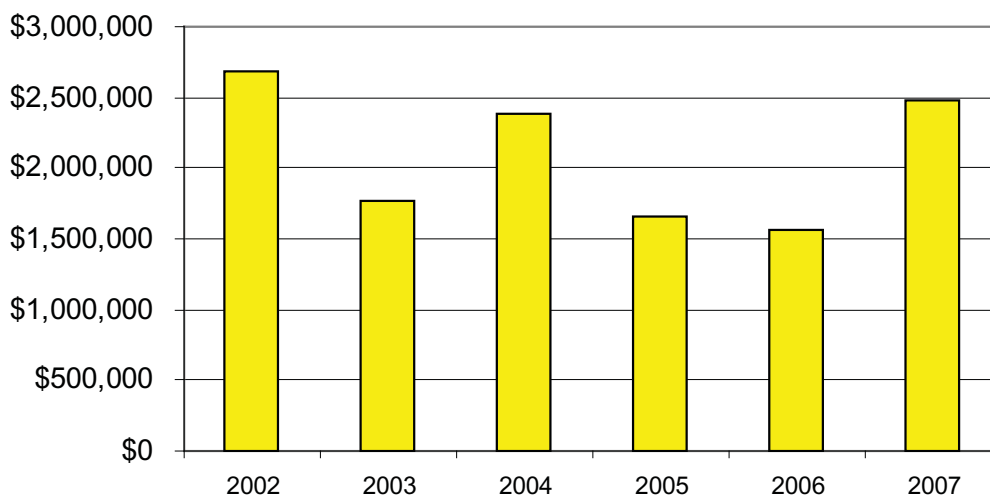
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California Standardbred Development Awards



Source: California Horse Racing Board

Illinois Standardbred Development Awards (Gaming Subsidy Approved)

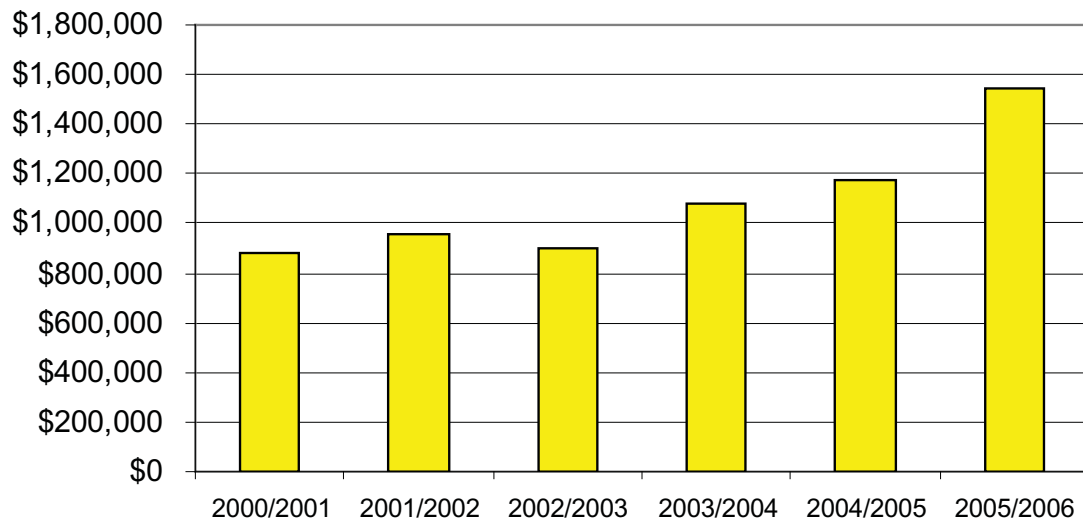


Source: Illinois Horse Racing Board

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Florida Standardbred Development Awards (Gaming Approved and Being Implemented)



Source: Florida Standardbred Breeders & Owners Association

Appendix C

Executive Order Creating the Governor's Task Force

Report of the Governor's Task Force on the Future of Horse Racing



STEVEN L. BESHEAR
GOVERNOR

EXECUTIVE ORDER

Secretary of State
Frankfort
Kentucky

2008-768
July 24, 2008

RELATING TO THE ESTABLISHMENT OF THE THE GOVERNOR'S TASK FORCE ON THE FUTURE OF HORSE RACING

WHEREAS, horse racing long has been the signature industry of the Commonwealth of Kentucky, and, because of the quality and tradition of the industry, the Commonwealth is widely known as "The Horse Capital of the World"; and

WHEREAS, to maintain that lofty and prestigious stature, the Commonwealth must ensure the long-term health, integrity, and competitiveness of the industry, and state government should lead efforts to do so; and

WHEREAS, the Commonwealth should convene an expert panel representing interests throughout the industry, including large and small tracks, trainers, owners, and breeders, as well as the general public, to examine all aspects of the horse racing industry in Kentucky and to assist the Kentucky Horse Racing Commission in its mission; and

WHEREAS, this panel should study the economic soundness of the industry (including the source of revenues for owners and breeders and the competitiveness of purses), measures to maintain the confidence of the wagering and spectating public, drug testing and other measures for the health and welfare of horses, the funding and oversight role of the Kentucky Horse Racing Commission, and the adequacy of current state laws and regulations, and should consider thoroughbreds, standardbreds, and quarterhorses on these matters; and

WHEREAS, this panel should assist the Governor of the Commonwealth in recommending and formulating policy to sustain the state's international leadership in horse racing;

Report of the Governor's Task Force on the Future of Horse Racing



STEVEN L. BESHEAR
GOVERNOR

EXECUTIVE ORDER

Secretary of State
Frankfort
Kentucky

2008-768
July 24, 2008

NOW, THEREFORE, I, Steven L. Beshear, Governor of the Commonwealth of Kentucky, by virtue of the authority vested in me by the Kentucky Constitution and KRS 12.029, do hereby direct and order the following:

I. There is hereby established the Governor's Task Force on the Future of Horse Racing ("the Governor's Task Force"), which shall be composed of the following members:

- A. Tracy Farmer, Midway, who shall serve as Chair;
- B. Robert M. Beck, Jr., Lexington;
- C. Robert D. Vance, Maysville;
- D. Nick Nicholson, Lexington;
- E. Brian Lavin, Louisville;
- F. Ron Geary, Louisville;
- G. Steve Sexton, Louisville;
- H. Dr. Robert Lawrence, Louisville;
- I. Joe Costa, Lexington;
- J. Edward S. Bonnie, Prospect;
- K. J. Duncan Pitchford, Paducah; and
- L. Ellen M. Hesen, Louisville.

II. The Chair shall have full authority to establish any subcommittees, including the membership, purpose, and composition thereof, as deemed necessary to successfully carry out the mission of the Governor's Task Force.

III. Professional, clerical, and other administrative staffing needs of the Governor's Task Force shall be provided by the Kentucky Horse Racing Commission.

Report of the Governor's Task Force on the Future of Horse Racing



STEVEN L. BESHEAR
GOVERNOR

EXECUTIVE ORDER

2008-768
July 24, 2008

Secretary of State
Frankfort
Kentucky

IV. The Governor's Task Force shall be charged with a comprehensive review of all aspects of the horse racing industry in Kentucky, including without limitation:

- A. the current economic model for funding the purse structure;
- B. the industry needs and funding for testing, research, and laboratory facilities in Kentucky;
- C. the competitiveness of Kentucky racing compared to other jurisdictions;
- D. the need and opportunity for alternative forms of gaming;
- E. the confidence of the public in the integrity of racing and all pari-mutuel betting activities;
- F. the funding and staffing levels of the Kentucky Horse Racing Commission; and
- G. the success of the Kentucky Breeders' Incentive Fund in fulfilling its mission and purpose.

V. Non-state employee members of the Governor's Task Force shall be reimbursed for actual and necessary expenses incurred in performing their duties.

VI. The Governor's Task Force shall complete its work and submit a report to the Governor on or before December 1, 2008.

VII. This order shall be effective July 24, 2008.


STEVEN L. BESHEAR, GOVERNOR
Commonwealth of Kentucky


TREY GRAYSON
Secretary of State

Report of the Governor's Task Force on the Future of Horse Racing

RECEIVED AND FILED
DATE 7/24/08

TREY GRAYSON
SECRETARY OF STATE
COMMONWEALTH OF KENTUCKY
BY R. Adler