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From: Brian K. Murphy
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Re: Constitutionality of the Proposed Lottery Deal with Intralot

The proposed veterans lottery deal with Intralot (the "Proposed Deal") violates Ohio's constitution. Specifically, it disregards Article XV, Section 6, which mandates that the entire net proceeds of a state lottery be used solely for education. Because the Proposed Deal runs afoul of the Ohio Constitution, it should not be approved or funded.

I. Known Details of the Proposed Deal[1]

Just before a bill legalizing the existing veterans' machines was introduced, the Ohio Lottery Commission, at Gov. Kasich's request, announced its proposal to offer 1,200 next-generation machines to veterans posts and lodges.[2] The vendor for the new machines is Intralot, a Greek company.[3]

How exactly these new machines operate is unclear.[4] One source said the games will let players know instantly whether they have won by displaying a ticket and claimed the new machines "will not function like slot machines and video lottery terminals at casinos and horse tracks."[5] However, another source stated the machines "resemble and play somewhat like slot

[1] Currently the only information available to the general public is what the press has reported. However, the press has provided enough information to reveal that the Proposed Deal is unconstitutional.

[2] *See* Carr Smith, *Funding Request Delayed for Ohio Vets' Machines*, SFGate (Nov. 26, 2013), available at http://www.sfgate.com/news/article/Funding-request-delayed-for-Ohio-vets-machines-5013445.php.

[3] *See id.*

[4] Further details might reveal other legal issues, *i.e.*, whether the machines are really slot machines or video lottery terminals ("VLTs") and subject to other regulations. *See, e.g.*, R.C. 3770.21(A)(1) ("'Video lottery terminal' means any electronic device approved by the state lottery commission that provides immediate prize determinations for participants on an electronic display that is located at a facility owned by a holder of a permit as defined in rule 3769-1-05 of the Administrative Code.").

[5] Ott, *Ohio Lottery Offers Groups Substitutes for Machines DeWine Says Are Illegal*, The Plain Dealer (Oct. 28, 2013), available at http://www.cleveland.com/metro/index.ssf/2013/10/ohio_lottery_will_put_machines.html.

machines."[6] And, according to yet another source, the machines "would allow players to watch the game unfold on a video screen."[7]

Of greater concern, however, is how the revenue from the machines is to be allocated: "According to the lottery, a veterans post, its designated charity and the gambling vendor initially would split an estimated 85 percent of net revenues, with the lottery getting the rest."[8] This 85/15 split is consistent with an earlier report: "The groups, other charities and the manufacturer, Ohio Lottery vendor Intralot, will share 85 percent of the money generated by the machines, while the remaining 15 percent will go to the lottery, which funnels its profits to public schools."[9] Given the astoundingly high percentage and the fact that 85% of the money is to be split among three different groups, not including the lottery itself, the Proposed Deal is clearly an unconstitutional profit-sharing arrangement.

Moreover, in addition to its illegality, the Proposed Deal will not allow veterans organizations to continue to operate and maintain their same level of charitable giving. Indeed, veterans organizations have opposed the Proposed Deal because it will not provide enough funds to cover operating costs and allow them to continue their charitable contributions.[10] Under the agreement with Charitable Management and Capital Group, veterans groups retained 50% of the proceeds, and after 15 months, 60%.[11]

In sum, the Proposed Deal will not benefit veterans organizations and the charitable groups they support. Instead, the Proposed Deal is profit-sharing arrangement that violates Ohio's Constitution.

II. Ohio's Law Regarding Lotteries

A. *Ohio Constitution*

Article XV, Section 6 of the Ohio Constitution provides the following:

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[6] Johnson, *Bars, Truck Stops Want New Lottery Machines Veterans Spurn*, The Columbus Dispatch (Nov. 26, 2013), available at http://www.dispatch.com/content/stories/local/2013/11/25/1125-bowling-centers-would-welcome-gaming-machines.html.

[7] *Ohio Groups Reject Offer of New Gambling Machines*, Courier Electronic Edition (Nov. 22, 2013), available at http://www.thecourier.com/Issues/2013/Nov/22/ar_news_112213_story7.asp?d=112213_story7,2013,Nov,22&c=n.

[8] *See id.*

[9] Ott, *supra* note 5.

[10] Courier, *supra* note 7.

[11] Ott, *supra* note 5.

> Except as otherwise provided in this section, lotteries, and the sale of lottery tickets, for any purpose whatever, shall forever be prohibited in this State.
>
> The General Assembly may authorize an agency of the state to conduct lotteries, to sell rights to participate therein, and to award prizes by chance to participants, provided that the entire net proceeds of any such lottery are paid into a fund of the state treasury that shall consist solely of such proceeds and shall be used solely for the support of elementary, secondary, vocational, and special education programs as determined in appropriations made by the General Assembly.

As evidenced by this provision, Ohio embraces a public policy against gambling and lotteries. *See Ohio Roundtable v. Taft*, 119 Ohio Misc.2d 49, 2002-Ohio-3669, 773 N.E.2d 1113, ¶ 18 (C.P.). In fact, it was not until 1973 that an exception to the general constitutional prohibition against lotteries was permitted. *State ex rel. Ohio Roundtable v. Taft*, 10th Dist. No. 02AP-911, 2003-Ohio-3340, ¶ 15.[12] This exception allowed "the state to operate a state lottery on clearly and narrowly defined terms, including the restriction added in 1988 that all proceeds from the state lottery go to fund education in Ohio." *Id.* Indeed, the people of Ohio amended the constitution "to make sure that lottery proceeds would benefit public education and that those proceeds could be used for no other purpose."[13] *Ohio Roundtable*, 2002-Ohio-3669, ¶ 121. The state lottery has a sole purpose—to benefit public education.

B. *Ohio Revised Code*

Chapter 3770 of the Ohio Revised Code governs the state lottery. R.C. 3770.06 lays out a specific scheme that must be followed for lottery revenues. Pursuant to R.C. 3770.06(A), all gross revenues from lottery sales are to be deposited into the state lottery gross revenue fund. Then, all revenues in this fund "that are not paid to holders of winning lottery tickets, that are not required to meet short-term prize liabilities, that are not credited to lottery sales agents in the form of bonuses, commissions, or reimbursements … shall be transferred to the state lottery fund." *Id.* The director of the state lottery commission later transfers excess funds to the lottery profits education fund. R.C. 3770.06(B).

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[12] As both the Court of Common Pleas and appellate decisions are cited herein, the Ohio webcites will be provided hereinafter to avoid confusion.

[13] Given their disfavor regarding gambling and lotteries, the people of Ohio have only been open to them when it served an important social function, i.e. public education and charity. *See Ohio Roundtable*, 2002-Ohio-3669, ¶ 28. Accordingly, there are only two other exceptions provided in the Ohio Constitution: bingos conducted by charitable organizations for charitable purposes and casinos that create important funds for the state. *See* Ohio Constitution, Article XV, Section 6.

III. The Proposed Deal is an unconstitutional profit-sharing arrangement as any net proceeds from any lottery games are required to be used solely to support public education in Ohio, which the Proposed Deal blatantly disregards.

A. *Under the Proposed Deal, lottery proceeds will be used for reasons other than to support education.*

Article XV, Section 6 mandates that lottery funds go to education. As explained above, the only reason the people allowed the state lottery in Ohio was to secure "a net benefit to society through better funding for education in Ohio." *Ohio Roundtable*, 2003-Ohio-3340, ¶ 59.

Having the proceeds go elsewhere, no matter how noble the intention, is impermissible under Ohio's Constitution. For example, in *Ohio Roundtable*, 2003-Ohio-3340, a provision in H.B. 405 provided for a reduction in school funding from the general fund directly proportional to the anticipated increase in school funding from the multi-state lottery. *Id.* at ¶ 57. Though in form the provision appeared legitimate—lottery proceeds would go to education, the substance of the provision is what mattered. The proceeds were not being used solely to support education, but instead were used to free up money to be used elsewhere. The provision simply robbed Peter to pay Paul. Education would not get any additional money; the actual increase in revenue generated by the lottery funds would ultimately be used for purposes other then education.

Not surprisingly, the trial court found the provision to be unconstitutional because lottery net proceeds are to be used "solely" to support education. *Id.* at ¶ 57. *See also Ohio Roundtable*, 2002-Ohio-3669, ¶ 117 ("Proceeds from the multi-state lottery are not being used "*solely*" to support public education as required by the Ohio Constitution; they are *also* being used to facilitate the balancing of the state's general budget."). The Tenth District affirmed the trial court's determination that the provision was unconstitutional as it "renders fruitless the action of the people of Ohio in amending their constitution to specify that lottery proceeds go to public education." *Ohio Roundtable*, 2003-Ohio-3340, ¶ 61. Because the reallocation provision used lottery funds for purposes other than education, the provision violated Ohio's Constitution. *Id.*

Here, the Proposed Deal violates the Ohio Constitution because the lottery funds would be used for purposes other than education. Under the Proposed Deal, money goes not only to veterans organizations but also designated charities and Intralot. Then, just 15% is left for the lottery. Lottery proceeds are only to be used to benefit education, not charities, not veterans posts, and surely not private businesses. And, as the *Ohio Roundtable* case demonstrates, regardless of good intentions, the only constitutional use of state lottery proceeds is for education.[14] Because the Proposed Deal disregards this mandate and uses proceeds for purposes other than education, the Proposed Deal is unconstitutional.

[14] Generating money for charities through limited forms of gaming is permitted under the Ohio Constitution. *See* Article XV, Section 6(B). However, the lottery is not the proper avenue for doing so and these separate constitutional provisions should not be blurred.

B. *Manipulating what constitutes "entire net proceeds" is simply an end run; if allowed, the Proposed Deal would flout Ohio's Constitution.*

Labels and technicalities cannot be used to circumvent Ohio's constitutional mandate:

> It is not reasonable to suppose that the people of Ohio went to the trouble of amending their Constitution in 1987, changing the allocation of lottery proceeds from the state's general revenue fund to a special fund for public education, and requiring that that fund be used 'solely for the support' of public education, merely for the purpose of requiring a formal accounting procedure that would not materially benefit public education. *Ohio Roundtable*, 2002-Ohio-3369, ¶ 115.

The Ohio Constitution requires that the "entire net proceeds" of the lottery be used solely for education.[15] Article XV, Section 6. The phrase, "net proceeds," was at issue in *Ohio Roundtable*, 2003-Ohio-3340, ¶¶ 38-40. The Tenth District noted that "net proceeds" were what remained after overhead and expenses were deducted. *Id.* at ¶ 40 ("Applying this reasoning uniformly to in-state and multi-state lottery games, we conclude that the 'entire net proceeds' from lottery sales, multi-state or Ohio only, are retained in the state after the deduction of overhead and expenses of all description…."). It concluded that prize payouts to lottery winners for tickets sold in other states were proper expenses—promotional expenses to foster ticket sales, and as such, the multi-state lottery game did not violate the constitutional provision.[16] *Id.*

Interestingly, the dissent in *Ohio Roundtable*, 2003-Ohio-3340, criticized the majority's determination. Judge Tyack remarked that "the efforts of the majority to avoid the remaining mandates of Section 6, Article XV by manipulating the definition of 'net proceeds' to allow other states and their citizens to receive most or all of the funds generated by the multi-state lottery before the public schools of Ohio are entitled to any funds I find to be, at best, unconvincing." *Id.* at ¶ 75 (Tyack, J., dissenting).

The Proposed Deal is not simply a prize payout or a promotional expense; it is a profit-sharing arrangement that retains 85% of the net revenues. It is not an expense, much less an authorized one. Administrative agencies only have as much power as the General Assembly grants them.[17] *See Ohio Roundtable*, 2002-Ohio-3669, ¶ 52. Under R.C. 3770.03(B)(3), the

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[15] The provision logically acknowledges that there are expenses associated with operating a lottery and that such expenses should be taken into account.

[16] The trial court had taken a similar position. *See Ohio Roundtable*, 2002-Ohio-3669, ¶ 103 ("[I]f Ohio must allow the other states to retain a portion of the multi-state revenues as a condition of there being a multi-state lottery, then those funds provided to the other states constitute an expense for the state of Ohio.").

[17] And it goes without saying, the General Assembly only has as much authority as the Ohio Constitution grants it. *See, e.g., City of Columbus v. Barr*, 160 Ohio St. 209, 111 N.E.2d 391 (1953), paragraph one of the syllabus ("By

state lottery commission has the authority to determine "the amount of compensation to be paid licensed lottery sales agents."[18] The commission's determination must be reasonable. *See Northwestern Ohio Bldg. & Constr. Trades Council v. Conrad*, 92 Ohio St.3d 282, 287, 750 N.E.2d 130 (2001) ("It is axiomatic that if a statute provides the authority for an administrative agency to perform a specified act, but does not provide the details by which the act should be performed, the agency is to perform the act in a reasonable manner based upon a reasonable construction of the statutory scheme.").[19]

Currently, there is a case pending in the Ohio Supreme Court that challenges an arrangement similar to the Proposed Deal with regard to VLTs at racetracks.[20] *See State ex rel. Walgate v. Kasich*, Case No. 13-0656. VLT operators, per O.A.C. 3770:2-3-08(A), receive a commission of 66.5% of VLT proceeds. This number has been attacked as being arbitrary, as it bears no relation to the actual expenses of VLT games. *See Walgate*, Case No. 11-CV-013126, Am. Compl., ¶ 44. Additionally, VLT opponents maintain that even if deference is given to the General Assembly and the commission, Ohio courts also have the responsibility of interpreting the provisions of the Ohio Constitution in accordance with the intent of its framers. *See Walgate*, Case No. 11-CV-013126, Memo Contra to Mot. to Dismiss of Def. Ohio lottery Comm., p. 22. They point out that lottery revenues cannot simply be labeled as "commissions" and treated as such without question: "Such an approach would render meaningless the 'net proceeds'

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reason of the provisions of Section 6, Article XV of the Ohio Constitution, the General Assembly is without power to legalize, either directly or indirectly, 'lotteries, and the sale of lottery tickets, for any purpose.'").

[18] The Proposed Deal arguably also exceeds statutory authority. The commission can determine what can be paid to licensed lottery sales agents. R.C. 3770.03(B)(3). While the term "lottery sales agent" is not defined, it is unclear how the veterans organizations, their designated charities, and Intralot would all be licensed lottery sales agents. The commission is not expressly authorized to pay persons other than sales agents—likely because allowing the commission to give money to whomever it chooses is unconstitutional. Though R.C. 3770.03(A) & (B) suggest that the commission can establish rules not limited to the subjects listed therein, this cannot include the power to reallocate proceeds away from education. *See* Article XV, Section 6. *See also Std. Tote Inc. v. Ohio State Racing Comm.*, 68 Ohio Law Abs. 19, 121 N.E.2d 463, 470 (C.P. 1954) ("Statutory provisions which authorize the carrying on of a gambling business should be strictly construed and every reasonable doubt so resolved as to limit the powers and rights claimed under its authority." (citing 24 Am.Jur. 404, Sec. 9)); *Ohio Roundtable*, 2002-Ohio-3669, ¶ 53 ("Such grant of power, by virtue of a statute, may be either express or implied, but the limitation put upon the implied power is that it is only such as may be reasonably necessary to make the express power effective. In short, the implied power is only incidental or ancillary to an express power, and, if there be no express grant, it follows, as a matter of course, that there can be no implied grant."). Moreover, payments are supposed to be tied to performance. *See* O.A.C. 3770-4-09(A) ("Each sales agent shall receive a commission based upon the sales agent's gross game sales at the rate specified by the director for each license.").

[19] In *Northwestern*, the Ohio Supreme Court held that the State Insurance Fund, a trust fund for injured Ohio workers and their families, could be used to pay administrative and performance-incentive fees to managed care organizations (MCOs) without violating the constitution. *Id.* at 294. Notably, the most an MCO could earn was six percent of premiums paid by enrolled employers. *Id.* at 285.

[20] The case is in the Supreme Court based upon a standing issue. Because standing is a threshold issue, no court has had the opportunity to determine the merits of the case. The case is being held for the decision in Supreme Court Case No. 2012-1272, *ProgressOhio.org, Inc. v. JobsOhio*, a case that involves a similar standing issue.

limitation intended by the framers." *Id.* There must be a meaningful distinction between expenses and profits in determining what constitutes "net proceeds." *Id.* at 24. As explained by VLT opponents, "A determination must be made whether the racinos' VLT operations are services which represented expenses to the state in conducting the lottery, or whether racinos are conducting a business for profit, splitting net revenue as partners with the state." *Id.* After all, the people of Ohio consented to lotteries so all of its profits could be used for education, not for private business interests. *Id.*

Such an approach must be adopted. Otherwise, if the General Assembly or commission can label whatever it wants as commissions or expenses, either could give away as much as it wanted to whomever it wishes, leaving zero profit for the lottery. Indeed, the exception would swallow the rule and render the constitutional mandate meaningless. Form cannot be elevated over substance. *See Ohio Roundtable*, 2002-Ohio-3669, ¶ 129 ("For this court now to interpret that amendment as requiring only an accounting formality, which in no way prevents the General Assembly from using lottery proceeds to accomplish whatever purposes it chooses, would render the action of the people of Ohio fruitless.").

Like the pending VLT case, the Proposed Deal requires payment of an arbitrary figure—in fact, a significantly higher percentage—that bears no relationship to the actual expenses. Furthermore, the 85% of net revenues that are retained cannot be reasonably viewed as an authorized expense. If that were the case, the constitutional mandate that the entire net proceeds of the state lottery go to education could be easily circumvented. Because the Proposed Deal does not allow for the entire net proceeds to go to education in Ohio, it violates the Ohio Constitution.

In conclusion, since the Proposed Deal is unconstitutional, it should not be approved or funded.