

CALIFORNIA HORSE RACING BOARD
NOTIFICATION OF MODIFICATION OF THE FOLLOWING
TEXTS COMPRISING THE PROPOSED ADDITION OF
ARTICLE 27, EXCHANGE WAGERING

CHRB RULE 2086, DEFINITIONS; 2086.5, APPLICATION FOR LICENSE TO OPERATE EXCHANGE WAGERING; 2086.6, OPERATING PLAN REQUIRED; 2086.7, EXCHANGE WAGERING DATA; 2086.9, FINANCIAL AND SECURITY INTEGRITY AUDITS REQUIRED; 2087, SUSPENDING MARKETS; 2087.6, CANCELLATION OF MATCHED WAGERS; 2088.6, CANCELLATION OF UNMATCHED WAGERS; 2089, ERRORS IN PAYMENTS OF EXCHANGE WAGERS; 2089.5, REQUIREMENTS TO ESTABLISH AN EXCHANGE WAGERING ACCOUNT; 2091.5, SUSPENDING AN EXCHANGE WAGERING ACCOUNT; 2092.5, PROHIBITIONS ON WAGERS TO LAY A HORSE TO LOSE; 2092.6, SUSPENSION OF OCCUPATIONAL LICENSE.

Pursuant to the requirements of Government Code section 11346.8(c), and section 44 of Title 1 of the California Code of Regulations, the California Horse Racing Board (Board) is providing notice of changes that have been made to the texts of certain proposed regulations that comprise the proposed addition of Article 27, Exchange Wagering. The proposed regulations that have been modified are: Rule 2086, Definitions; 2086.5, Requirements to Establish an Exchange Wagering Account; 2086.6, Operating Plan Required; 2086.7, Exchange Wagering Data; 2086.9, Financial Integrity and Security Audits Required; 2087, Suspending Markets; 2087.6, Cancellation of Matched Wagers; 2088.6, Cancellation of Unmatched Wagers; 2089, Errors in Payments of Exchange Wagers; 2089.5, Requirements to Establish an Exchange Wagering Account; 2091.5, Suspending an Exchange Wagering Account; 2092.5, Prohibitions on Wagers to Lay a Horse to Lose; 2092.6, Suspension of Occupational License. The proposed addition of Article 27 is scheduled for a public hearing on **Thursday, June 20, 2013, at the Hollywood Park Race Track, 1050 South Prairie Avenue, Inglewood, California, at 9:30 a.m.**, or as soon thereafter as the business before the Board will permit.

The Board is providing notice of a 15-day public availability and comment period for a revised Initial Statement of Reasons (ISR). The revised ISR is accessible for public inspection during the 15-day availability period from **June 4, 2013** through **June 19, 2013**, at the Board's headquarters office, 1010 Hurley Way, suite 300, Sacramento, California 95825. Any interested person may submit a written statement relating to the revised ISR during the public comment period from **June 4, 2013** to **June 19, 2013**. The written comment period will close at 5:00 p.m. on June 19, 2013. Submit written comments to Harold Coburn, Policy and Regulations Unit, California Horse Racing Board, 1010 Hurley Way, Suite 300, Sacramento, California 95825. Email: HaroldC@chr.ca.gov.

The proposal to add Article 27 was originally noticed on May 11, 2012. A hearing for adoption was held on June 28, 2012 at the Hollywood Park Race Track in Inglewood, California; however, the hearing was continued to August 23, 2012 at the Del Mar Surfside Race Place, Del Mar, California. The August 23, 2012 hearing was continued until September 20, 2012, at the Sheraton Fairplex Conference Center, Pomona, California. At the September 2012 hearing for adoption changes to the texts of regulations comprising the proposed addition of Article 27 were discussed. In response to the suggested changes, a number of the proposed regulations were

modified. A 15-day public comment period was begun on September 28, 2012, but after it was determined an interested party did not receive notification of the comment period, a new 15-day public comment period was initiated on October 8, 2012, through October 22, 2012. A hearing for adoption of Article 27 was held at the November 15, 2012 Regular Board Meeting at the Hollywood Park Race Track in Inglewood, California. The exchange wagering rulemaking file was submitted to the Office of Administrative Law (OAL) on January 31, 2013. On March 20, 2013, the OAL disapproved the file. At its May 23, 2013 Regular Meeting at Cal-Expo Fair Grounds in Sacramento, California, the Board directed staff to initiate a 15-day public comment period regarding modifications to proposed regulations comprising the proposed addition of Article 27.

The Board proposes to modify the following regulations:

Rule 2086, Definitions. The Board proposes to modify the language of subsections 2086(h), (m), (p) and (s). Each subsection uses the term “*person*” in referring to an account holder. However, Business and Professions Code section 19604.5 states that only natural persons may establish an exchange wagering account and place wagers through the exchange (see subsections 19604.5 (a)(8) and (c)). For purposes of consistency the Board proposes to modify subsections 2086(h), (m), (p) and (s) to insert the word “*natural*” before “*person*”. This will bring Rule 2086 in line with the enabling statute, and make it clear that only natural persons may open an exchange wagering account, and place an exchange wager. In addition, the Board proposes to modify subsection 2086(k) to incorporate by reference the form CHRB-229 (New 5/13) Application for License to Operate Exchange Wagering. The form was previously incorporated by reference under Rule 2086.5, Application for License to Operate Exchange Wagering. However, subsection 2086(k) defines “*exchange wagering license application*” and it contains the first reference in Article 27 to the form CHRB-229; accordingly, subsection 2086(k) is where the incorporation by reference should occur.

Rule 2086.5, Application for License to Operate Exchange Wagering. The Board proposes to modify subsection 2086.5(b), which states the exchange wagering assessment fee is \$1,400,000 “*or an amount to be determined by the Board*”. However, it is not clear what factors would be examined for the Board to determine it would modify the amount of the assessment fee. To address this concern, the phrase “*or an amount to be determined by the Board*” was deleted. This means the total amount of the assessment fee is as provided in the regulation and cannot be modified outside of the Administrative Procedures Act. Subsection 2086.5(b) requires that the application for license to operate exchange wagering must be filed not later than 90 days in advance of the scheduled start of operation. This provides staff with time to vet the application, and to work with the applicant to present a complete document to the Board. For purposes of clarity, subsection 2086.5(b) has been modified to state the application must be filed not later than 90 *calendar* days in advance of the scheduled start of operation. This allows the applicant and staff to know exactly when an application must be submitted. Subsection 2086.5(b) requires that a certified check in the amount of \$1.4 million to accompany an application for license to operate exchange wagering. However, in the rulemaking record the Std. 399, Economic and Fiscal Impact Statement, shows the total annual estimate of program costs to regulate exchange wagering as \$510,000 which makes the \$1.4 million appear to exceed the reasonable costs of the program. Upon reexamination of estimated costs, the assessment fee for license to operate

exchange wagering has been modified to \$500,000 per fiscal year. This brings the regulation in line with the original estimates of the Std. 399, Economic and Fiscal Impact Statement, which is based on the State's fiscal year. The reference to the assessment fee amount was deleted from subsection 2086.5(b) and moved to a new subsection 2086.5(d). This was done for purposes of clarity, due to other changes in the regulation.

Subsection 2086.5(c) has been modified to state that the term of license to operate exchange wagering is a maximum of twelve months, commencing the first day of the month following approval. Rule 2086.5 originally provided for a license term of not more than two years, unless otherwise determined by the Board. However, it was not clear what criteria the Board may use when determining that the term of an exchange wagering license should be other than two years. To provide clarity and consistency, it was determined that the maximum term of license should be twelve months. Every exchange operator will know that subject to the provisions of Rule 2086.5, it will receive a maximum license term of one year. The 12 month term also provides the Board with the ability to regularly appraise and consider the effect of exchange wagering on California's horse racing industry. Subsection 2086.5(c) provides that the license period shall commence on the first day of the month following approval of the exchange wagering license. The exchange provider must pay its assessment fee on a month-to-month basis. Starting the term of license on the first day of the month following approval eliminates the need for the Board to prorate the new licensee's initial fee and to pay partial-month rebates to existing operators. It also provides sufficient time to notify existing exchange operators of the change to their monthly assessment.

Under subsection 2086.5(c), the word "*maximum*" is used to describe the 12 month term of license. This is because an original license to operate exchange wagering may be issued for less than 12 months. Subsection 2086.5(c)(1) provides that an original licenses to operate exchange wagering shall be issued to expire on the last day of the State of California's fiscal year in which it is issued. This means that the majority of *original* licenses will be issued for a period of less than 12 months. Only an *original* license approved in June to commence on July 1 will be issued for a maximum of 12 months. Subsection 2086.5(c)(1) states that subsequent approvals (renewals) of an exchange wagering license shall be for a period of 12 months beginning July 1 and ending June 30 to coincide with the State's fiscal year. This will bring all exchange wagering approvals in line with the State's fiscal year. Aligning the term of license with the State of California's fiscal year will provide clarity and consistency for the exchange operators, who will all know when applications for renewal must be submitted, and what the term of license will be. It will also aid in the Board's internal record keeping. The term of license was originally set at two years, on a calendar year basis, with the possibility that exchange wagering providers could enter or leave the market at any time. Additionally, exchange wagering providers would have to pay their portion of the assessment fee upon approval. This model created confusion regarding how the assessment fee would be apportioned amongst current and new exchange wagering providers. There was also a lack of clarity about how the Board would refund previously paid assessment fees to existing operators if a new operator was approved. The transition to a 12-month term of license with assessment fees paid on a monthly basis provided clarity. Approved operators would no longer have to pay on an annual basis. This allows for the modification of the fees as exchange operators enter or leave the market. The 12 month term also provides the Board with the ability to regularly appraise and consider the effect

of exchange wagering on California's horse racing industry. Under Business and Professions Code section 19604.5(e)(6) the Board may recover any costs associated with the licensing or regulation of exchange wagering. Justifying expenditures and validating revenue on a fiscal basis is more manageable than when a calendar year is used. Taking in revenue on a calendar year basis forces the Board to make assumptions. The audit trail for exchange wagering revenue paid on a State of California fiscal year basis will also be less cumbersome.

The new subsection 2086.5(d) provides that to fulfill Business and Professions Code section 19604.5(e)(6) the *total amount per fiscal year* to be assessed to operate exchange wagering is \$500,000. The Board originally estimated the assessment fee at \$1.4 million for a two-year license. This was based on initial consultations with the British Horse Racing Authority, a British entity with experience in regulating exchange wagering. However, after considering the needs of the Board and what it believes would be reasonable costs associated with the licensing and regulation of exchange wagering in California, the amount of the assessment fee was adjusted to the current estimate of \$500,000 per fiscal year. The assessment fee for license to operate exchange wagering shall be equally apportioned amongst the approved applicants and paid on a monthly basis. The assessment fees collected will be deposited into the Horse Racing Fund to enable the Board to recover costs associated with licensing, enforcing, auditing and regulating exchange wagering. The assessment fee will be collected in monthly payments throughout the State of California's fiscal year because the number of exchange wagering operators may vary. Collecting monthly payments, rather than a yearly lump sum, will eliminate the confusion of having to provide refunds or credits to existing exchange wagering operators if a new operator is approved. The monthly payments are simply adjusted for all parties. This provides clarity for exchange wagering operators, as monthly payments are easily calculated based on the number of licensees. Initially, the Board will conduct staff training and begin workload reassignments. A portion of the Board's existing resources may be redirected to absorb the costs associated with the launch of exchange wagering, but it cannot sustain the added expenses as the program progresses. As exchange wagering entities are licensed and assessment fees are collected, the Board anticipates staffing movement and system upgrades will be necessary to sustain the sophisticated bet monitoring platform needed. Enforcement assignments will change from traditional racing industry workload to more surveillance and analysis of wagering trends; more narcotic, vice and background investigations. The audits unit workload must adjust from traditional audit engagements to monitoring exchange wagering activity, using software tools to assist the investigative unit which will manage the racing intelligence system. Licensing activities will increase to include the vetting of exchange wagering provider applications. The result of this enforcement, auditing and licensing workload increase includes costs for equipment, staff office space movements, general office expense, increased racing official assignments, more hearing officer cases, staff training, and litigation due to increased investigations. The Board anticipates using independent contractors as hearing officers, bet monitors and high profile race day enforcement assistance.

New subsections 2086.5(d)(1) and (d)(2) provide for assessment fee payment timelines and the amounts to be paid monthly – dependent on the number of approved applicants. The payment timelines and the listing of possible monthly assessment fees are necessary so that applicants and licensees will know when payments are due, and that assessment fees will be based on the number of approved applicants. A new subsection 2086.5(d)(3) requires the Board to notify

existing exchange wagering operators of an adjustment to the monthly assessment fees within seven business days. This gives the Board enough time to calculate the correct assessment fee based on the number of operators and to ensure all parties are properly notified.

Subsection 2086.5(e), has been modified to delete the word “*may*” and the word “*shall*” had been inserted. The subsection originally stated the Board “*may approve*” an application, but it did not provide the reasons why the Board may or may not take such action. For purposes of clarity the subsection was modified to state the Board shall approve an application if it determines the applicant meets the criteria identified in its regulations and the enabling statute.

The form CHRB-299 (New 05/13) Application for License to Operate Exchange Wagering (form 229), which is incorporated by reference in Rule 2086, Definitions, was also amended – where appropriate - to reflect the changes made to Rule 2086.5. The changes were necessary to achieve consistency. On page 1 of the form 229 the information regarding the total dollar amount of the assessment fee for license to operate exchange wagering, as well as the timeframe for making payments, was changed to reflect the changes in Rule 2086.5. Item five of the form 229 was changed to reflect the amended term of license, which is now a maximum of 12 months versus two years. Item 6C of the form 229 was redacted, as the operating plan is no longer exempt from disclosure. Additional changes to the form 229 include punctuation, changing the date of the form, and inserting the word “*natural*” before “*person*”. Business and Professions Code section 19604.5(a)(8) provides that only a natural person may establish an exchange wagering account.

Rule 2086.6, Operating Plan Required. The rule currently requires the exchange wagering license applicant to submit a detailed operating plan in a format and including such information as required by the Board, and which at a minimum must address a list of items, as specified. However, the regulation does not provide guidance as to the format required by the Board. It is also unclear what additional information beyond the “*minimum*” listed might be required or in what instance the Board might require any additional information. To provide clarity the Board proposes to modify subsection 2086.6 to require that the exchange wagering license applicant provide an operating plan, and that the operating plan only needs to address the items required under subsections 2086.6(a) through (h). Subsection 2086.6(h) has also been modified for clarity and consistency to insert the word “*natural*” before “*persons*”. This is in keeping with the enabling statute which provides that only natural persons may open an exchange wagering account and place an exchange wager. Subsection 2086(i) has been deleted for purposes of consistency, as the OAL denial letter of March 20, 2013 stated it was not in harmony with Government Code section 6254(k).

Rule 2086.7, Exchange Wagering Data. The Board proposes to modify Rule 2086.7 for purposes of clarity. The regulation requires the exchange provider to furnish nonprofit horse racing data base with a data interface. However, it was not clear what organization was the nonprofit data base. Subsection 2086.7(a) has been modified to identify CHRIMS Inc. as the nonprofit data base. CHRIMS Inc. currently acts in this capacity for California’s horse racing industry. Subsection 2086.7(a) also did not require the exchange wagering operator to provide data; it only required a data interface. The subsection has been modified to make it clear that both a data interface and data are to be provided. Subsections 2086.7(a)(1)(F) and (a)(1)(I) have been modified to add the phrase “*if any*”. This was done for purposes of clarity as under subsection

(a)(1)(F) there may or may not be any cancellations of wagers, and under subsection (a)(1)(I) there may or may not be a percentage or flat fee rebated to customers.

Rule 2086.9, Financial Security and Integrity Audits Required, has been modified to create a subsection (c). The sentence that constitutes the new subsection (c) was previously part of subsection 2086.9(b)(2). While the text is original, the creation of the new subsection provides clarity. The Board proposes to adopt section 2086.9, which requires that exchange providers submit an annual audited financial statement, including the Service Organization Controls I (SOC I) and Service Organization Controls II (SOC II) reports of the Statement on Standards for Attestation Engagements 16 (SSAE 16) audit. *In accordance with Government Code section 11346.3(d) the Board has found that it is necessary for the health, safety, or welfare of the people of the state that the regulation applies to exchange provider businesses.*

Rule 2087, Suspending Markets, subsection (a), has been modified for the purpose of clarity and consistency to insert the word “*natural*” before “*persons*”. This is in keeping with Business and Professions Code section 19604.5(a)(8), which provides that only natural persons may open an exchange wagering account and place an exchange wager.

Rule 2087.6, Cancellation of Matched Wagers, sets the circumstances under which a matched wager may be canceled, and requires the exchange provider to notify the Board of such cancellations as specified. Subsection 2087.6(a)(2) has been modified for purposes of consistency and clarity to insert the word “*natural*” before “*person*”. Business and Professions Code section 19604.5(a)(8) provides that only a natural person may establish an exchange wagering account. Subsection 2087.6(c) provides that if an account holder believes a payout was “*inappropriately disrupted*” due to the cancellation of a matched wager, he or she may submit a claim. However, it is not clear what an inappropriate disruption might be; therefore, for purposes of clarity, subsection 2087.6(c) has been modified to state that if an account holder believes a payout was “*not made*” due to the cancellation of a matched wager, he or she may make a claim.

Rule 2088.6, Cancellation of Unmatched Wagers, allows the exchange provider to cancel an unmatched wager at any time. The regulation has been modified for purposes of clarity and grammar. A new subsection 2088.6(a) provides that the exchange provider may cancel an unmatched wager at any time, without cause, before it is matched to form one or more identically opposing wagers. This makes it clear that the exchange provider may cancel an unmatched wager if it believes it is in its best interests. A new subsection 2088.6(b) states the account holder who offers an unmatched wager may cancel that unmatched wager at any time before it is matched to form one or more identically opposing wagers. This makes it clear that an account holder may withdraw an unmatched wager, and it is necessary to provide the account holder with a means of managing his account should he change his mind before his wager is matched.

Rule 2089, Errors in Payments of Exchange Wagers, sets the procedures for the exchange provider to remedy errors in payment of exchange wagers. Subsection 2089(a) has been modified for purposes of clarity. The subsection required the exchange provider to “*immediately*” notify the account holder of overpayment. However, it was not clear what would constitute immediate notification. The Board changed subsection 2089(a) to state that the exchange provider shall “*within one business day*” notify the account holder of an overpayment.

This gives a clear time frame in which the exchange provider must notify the account holder. Subsection 2089(a)(1) was also modified to state that the exchange provider must notify the account holder within one business day of any underpayment. This is consistent with notification of an overpayment and it provides a clear time frame for such notification. Subsection 2089(b)(4) was modified for purposes of consistency and clarity to insert the word “*natural*” before “*person*”. Business and Professions Code section 19604.5(a)(8) provides that only a natural person may establish an exchange wagering account. Subsection 2089(b)(5) was modified for purposes of grammar; the word “*T*”, which did not make sense in context, was replaced with the word “*in*”.

Rule 2089.5, Requirements to Establish an Exchange Wagering Account, provides the requirements for a person to establish an exchange wagering account. The regulation also requires the exchange provider to comply with Internal Revenue Service reporting requirements, and to record and retain specified transactions and conversations. Subsection 2089.5(j) requires the records of communications recorded by the exchange provider to be kept by the entity for at least 180 day, unless otherwise directed by the Board. However, it was not clear what circumstances would prompt the Board to require the entity to keep the records past 180 days. To provide clarity, subsection 2089(j) was modified to state that the reasons for retaining the records may include, but are not limited to, conducting an investigation, an audit or an ongoing wagering inquiry. Subsection 2089(j) has been modified to provide that the Board may direct the entity to retain such records for an additional period of one year past the 180 days. This provides a clear period of time over which the Board might require retention of records.

Rule 2091.5, Suspending an Exchange Wagering Account, states that the exchange provider may suspend an account if it has reason to believe the account holder committed acts of fraud in connection with exchange wagering or any other action or inaction that threatened the integrity or fairness of exchange wagering. Rule 2091.5 also requires the exchange provider to notify the Board when it suspends an account under such circumstances. Subsection 2091.5(b)(1) has been modified for purposes of consistency and clarity to insert the word “*natural*” before “*person*”. Business and Professions Code section 19604.5(a)(8) provides that only a natural person may establish an exchange wagering account.

The Board proposes to modify Rule 2092.5, Prohibitions on Wagers to Lay a Horse to Lose. The regulation prohibits specified classes of licensees from placing wagers to lay a horse to lose, prohibits others from making such wagers on behalf of such licensees, and provides that only the account holder may use his account to place such a wager. Subsections 2092.5(a) and (b) have been modified for purposes of consistency and clarity to insert the word “*natural*” before “*person*”. Business and Professions Code section 19604.5(a)(8) provides that only a natural person may establish an exchange wagering account.

Rule 2092.6, Suspension of Occupational License, provides that the Board of Stewards may suspend the license of any person if after a hearing it determines there is probable cause to believe that such person may have committed acts of fraud in connection with exchange wagering or any other action or inaction which threatens the integrity or fairness of any exchange wagering. Rule 2092.6 also provides that the licensee may make an appeal to the Board by complying with the provisions of Rule 1761, Appeal from Decision of Stewards. Subsection

2092.6(a) has been modified for purposes of consistency and clarity to insert the word “*natural*” before “*person*”. Business and Professions Code section 19604.5(a)(8) provides that only a natural person may establish an exchange wagering account.

IDENTIFICATION OF RELIED UPON DOCUMENTS

Pursuant to the requirements of Government Code section 11347.1 the Board is providing notice of materials added to the record after the close of the initial 45-day public comment period. In proposing the addition of Article 27, the Board has relied on the results of a revised economic impact assessment (EIA) prepared pursuant to Government Code section 11346.3(b), as a technical, theoretical, and/or empirical study, report or document relied upon. This document is accessible for public inspection during the 15 day availability period from **June 4, 2013** through **June 19, 2013** at the Board’s headquarters office, 1010 Hurley Way, suite 300, Sacramento, California 95825. Any interested person may submit a written statement relating to the revised EIA during the public comment period from **June 4, 2013** to **June 19, 2013**. The written comment period will close at 5:00 p.m. on June 19, 2013

Copies of the full texts of the regulations with the proposed changes indicated are attached for your review. Additions to the originally proposed language appear as *italicized with bolded underlined text* and deletions are shown in ~~*italicized double strikethrough text*~~.

Any interested person may submit a written statement relating to the modified language during the public comment period from **June 4, 2013** to **June 19, 2013**. The written comment period will close at **5:00 p.m. on June 19, 2013**. The Board will only consider comments regarding the amendments to the 13 modified regulations identified in this notice, the revised Initial Statement of Reasons, the Economic Impact Assessment and other documents relied upon and added to this rulemaking. Submit written comments to:

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All written comments received by the CHRB by **5:00 p.m. on June 19, 2013**, which pertain to the indicated changes will be reviewed and responded to by the Board staff as part of the completion of the rulemaking file. Please limit your comments to the modification to the texts of the regulations which appear as either *italicized with bolded underlined text* or in ~~*italicized double strikethrough text*~~.

At the **June 20, 2013** public hearing interested parties may present statements or arguments orally or in writing about the proposed actions described in this notice. Please limit any comments at the hearing to the modification to the texts which appear as either *italicized with bolded underlined text* or in ~~*italicized double strikethrough text*~~. It is requested, but not required,

that persons making oral comments at the hearing submit a written copy of their testimony at the hearing.

Questions concerning the proposed amendments may be addressed to Harold Coburn at (916) 263-6397, or at HaroldC@chr.ca.gov, or at the address above. If Harold Coburn is not available, questions concerning the proposed amendments may be directed to Andrea Ogden at (916) 263-6000.

CALIFORNIA HORSE RACING BOARD

June 4, 2013