



August 3, 2010

Via email: [Wallace.Schwartz@skadden.com](mailto:Wallace.Schwartz@skadden.com)

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Re: Denial of Protest of the Disqualification of Penn National's  
Proposal for the Development and Operation of a Video Lottery  
Facility at Aqueduct Racetrack

Dear Mr. Schwartz:

This is in response to your letter of August 2, 2010 (the "Protest"), on behalf of your client, "Penn National Gaming, Inc., and its subsidiaries, New York Gaming Ventures, LLC and Delvest, Corp." ("Penn National"), which protested the July 6, 2010, decision by the Division of the Lottery ("Lottery") to disqualify from further consideration the June 29, 2010, Proposal submitted by Penn National for the Development and Operation of a Video Lottery Facility at Aqueduct Racetrack (the "Proposal"). For the reasons explained below, the Protest is denied.

The Protest was premature, since a protest against a procurement determination should be made only after the award of the contract that is the subject of the procurement. To date, the State has not made a contract award pursuant to the May 11, 2010, Request for Proposals for the Development of a Video Lottery Facility at Aqueduct (the "RFP"). Nevertheless, in anticipation of a contract award, the Lottery has considered the merits of the Protest and the failure of the Proposal to comply with the requirements of the RFP.

The Protest asserted that "(a) the RFP was materially defective and (b) the [Lottery]'s interpretation and implementation of the RFP was defective and those defects should have been overcome through the exercise of the discretion afforded to the [Lottery] in the RFP" and the Lottery made "arbitrary and capricious decisions" that "were unfair to bidders such as" Penn National. However, the Protest offered no support for those assertions except the complaint that Penn National considered the RFP requirements "commercially unreasonable" and the claims that the many deviations between Penn National's Proposal and the RFP requirements could have been excused as "not 'material'" and that the Lottery could have, and therefore should have, engaged Penn National in an ongoing effort to remedy the shortcomings of the Penn National Proposal.

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The Protest asserted that the RFP demanded “strict and wooden compliance with the procedural requirements,” and that disqualifying Penn National’s non-compliant Proposal was contrary to the public interest for no other reason than it prevented a full consideration of a Proposal that plainly failed to meet the RFP requirements. There is no evidence that the MOU is unduly one-sided in favor of the State, and there is no law or other legal authority that prevents the State from insisting on a contract that protects the interests of the State and its taxpayers in an extremely valuable asset such as Aqueduct.

It is not unusual for a procurement competition to require bids to include signed originals of the proposed contracts, especially when the subject of the procurement is a large construction project financed by the State, as, in this case, where the MOU obliges the State to provide \$250 million of construction financing; and it is undeniable that over the 30 to 40 year term of the MOU the selected Aqueduct video lottery agent will have the opportunity for hundreds of millions, or even billions, of dollars in revenues. In return, the State has the authority and responsibility to require adequate contractual provisions to protect the public interest.

Penn National’s Proposal suggested more than 30 changes to the MOU and the other transaction documents that might have transformed the contract into a one-sided agreement in favor of Penn National, but that does not mean that the MOU required by the RFP was unduly one-sided in favor of the State. To the contrary, the Protest ignored the fact that potential bidders were given ample opportunity to suggest changes in the MOU and that many of those changes were incorporated into the final form of the MOU published on June 22, 2010.

The MOU, as revised, is an updated version of the same MOU that has been offered by the State in the last two rounds of Aqueduct competition in 2008 and 2009. It was carefully designed to further the public interest while offering an attractive business opportunity to the selected video lottery agent. Specifically, the MOU is intended to achieve the constitutional (Article 1, section 9) requirements of (i) operating the State Lottery to earn revenues for the support of education in the State, and (ii) enabling the State to derive a reasonable revenue for the support of government from pari-mutuel wagering on horse races.

The MOU is entirely consistent with the statutory principles governing State procurements, which call for “fairness in contracting with the business community,” but define the overarching goals of State procurements as “to facilitate each state agency’s mission while protecting the interests of the state and its taxpayers.” State Finance Law §163(2). The MOU embodies an appropriate balancing of public and private interests. The provisions that are favorable to the State and its taxpayers are reasonable and necessary measures to protect the public interest in the valuable Aqueduct asset. Contrary to the Protest’s assertions, it is not “arbitrary and capricious” for a State agency to establish procurement requirements favorable to the public interest and to insist that bidders meet those requirements.

The Protest ignored the fact that the Lottery made absolutely clear that non-compliant Proposals would be disqualified. At the mandatory bidders conference attended by 10 Penn National representatives at Aqueduct on June 8, 2010, a potential bidder asked, “What if a bidder cannot agree to the terms and conditions of the MOU, but would still like to submit a proposal with a marked up version of the MOU?” The Lottery Director responded, “That bid will not

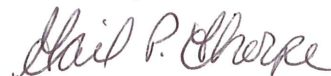
win!” and went on to explain, as stated in the written summary of the bidders conference published on the Lottery’s website on June 11, 2010, “The bidder will be taking a great risk of immediate disqualification for submitting a non-conforming Proposal. Theoretically, it’s possible the bidder could remain under consideration if no other bids are submitted, but we think among the group of bidders we will get a few who will agree to the terms.” That question and answer, and all the other Q & A’s at the bidders’ conference and in the two other rounds of Q & A’s were expressly made a part of the RFP. In many other places in the RFP and the procurement record, the Lottery made clear that agreeing to the transaction documents was a material non-negotiable requirement.

Penn National apparently believed that no bidder would submit a conforming bid, and was willing to risk disqualification in an attempt to gain more concessions in the MOU. Simply because Penn National chose such a risky bidding strategy is no reason to disqualify any other bidder. As for the Protest’s comments about previous unsuccessful attempts to select an Aqueduct video lottery agent, those attempts established no precedents for the May 11, 2010, RFP, which was expressly designed to follow the much more rigorous standards of a State procurement process. As was made clear at the bidders conference, the current process was specifically designed to avoid the mistakes of past, failed processes. It is telling that companies who currently operate as video lottery agents, Delaware North and Empire City/Yonkers, clearly understood that the Lottery would not continue to negotiate the MOU after bids were submitted. And since they were unwilling or unable to agree to the State’s requirements, they chose not to bid rather than to attempt to continue to negotiate the clearly defined requirements.

The Protest asserted that the procurement evaluation should not have continued after SL Green’s and Penn National’s disqualifications because there would be only one remaining proposal under consideration, which the Protest calls “antithetical to what needs to be a competitive process.” However, the Protest mischaracterized the nature of a competitive evaluation. As explained in Part 5 of the RFP, each proposal is evaluated and scored by reference to the requirements clearly established by the RFP. Proposals are not scored in comparison to each other. Each proposal is scored only by determining how well it responds to the State’s requirements and not by comparison to any other proposal. Therefore, the absence of other proposals does not make it impossible to evaluate a single proposal, since the only relevant points of reference are the requirements of the RFP and not the details of other proposals.

The Lottery acknowledges Penn National’s request for a debriefing. After the Aqueduct award is approved by the Governor, the Temporary President of the Senate, and the Speaker of the Assembly, the Lottery will contact Penn National to schedule the debriefing.

Sincerely,



Gail P. Thorpe  
Contracting Officer