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Showdown at OK Corral

By **Dave Palermo** *Wed, Aug 24, 2016*

Oklahoma tribal casino talks getting tense



When Oklahoma Governor Mary Fallin is termed out of office in 2018, she might well leave the state with a budget shortfall that this summer reached \$450 million—a monetary crisis largely blamed on the failing oil and gas industries.

Schools have been particularly hard-hit, with the state legislature slashing the education budget by \$106 million, a cutback that threatens implementation of a four-day school week.

“I’m hoping the legislature knows the decisions they’re making will affect future generations,” Sand Springs Superintendent Lloyd Snow told the Leader newspaper in outlining anticipated cuts in education programs.

The Sooner State’s financial pains could be lessened if Fallin manages to renegotiate tribal-state agreements, or compacts, with 33 American Indian tribes operating some 124 gambling operations ranging from travel plazas to upscale casino resorts.

Tribes under current compacts pay the state 4 percent to 6 percent of the Class III slot machine win and 10 percent of table game revenues, or roughly \$128 million a year, according to state regulators. Education is the primary recipient of Indian casino money.

Eye on Revenue

Cash-strapped states often turn to Indian casinos to ease budget woes. And Fallin would like to see Oklahoma get a bigger share of its robust \$4.2 billion tribal government gambling industry.

But the state has virtually no leverage when it comes to getting tribes to renegotiate compacts set to expire in 2020, but with a renewal clause that could extend agreements another 15 years.

Tribes are pleased with revenue sharing, and slot machines and table games provisions in the existing agreements. Moreover, unlike many of the 28 states with Indian casinos, Oklahoma compacts do not cap the number of slots, allowing tribes to adjust inventory to market demands.

“I believe tribes are satisfied with the gaming they have on the floor,” says Sheila Morago, executive director of the Oklahoma Indian Gaming Association (OIGA), a lobby and trade group. “I’ve not heard” of any desire by the tribes to renegotiate compacts, she says.

Moreover, relations between Fallin and Oklahoma tribes regarding gambling and other Indian matters—tobacco and sales tax compacts, for instance—are strained, making it highly unlikely Indian leaders will talk casino compacts with Fallin before she leaves office in 2018.

Tribes also are angry that state regulators late last year wrote the U.S. Department of the Interior, questioning whether slot machines at a half-dozen tribal casinos violated the compacts, an apparently brazen, though ill-conceived, effort to force tribes to redo the agreements.

Interior refused to get involved in the dispute.

“Fallin approached things ass-backward,” says a tribal official who requested anonymity.

“Instead of going to the tribes and saying, ‘We’d like to renegotiate compacts early,’ the governor’s people tried to issue notices of violation regarding the machines,” regulatory authority the state does not have under the compact.

“Instead of offering the tribes a carrot, the state tried to whack the mule with a stick,” the official says. “That didn’t go over too well.”

“It was very evident they were trying to pick a fight,” Comanche Wallace Coffey said before resigning in February as tribal chairman.

Fallin’s office refused to respond to interview requests.

The governor’s hard line on negotiating tobacco compacts and her decision to pursue litigation on reservation sales taxes angered tribes.

And it didn’t help that her rock singer daughter, Christina, donned a traditional native headdress in a promotional photo for the band Pink Pony.

“Things have really deteriorated into an acrimonious relationship,” says Indian law attorney Michael McBride of the Tulsa office of Crowe & Dunlevy.

Rather than discussing new and potentially more generous compacts with the state, tribal leaders and operators of government gambling enterprises are increasing their inventory of Class II, bingo-style devices that, under federal law, are exempt from state taxes and regulations. (See page 116.)

Technological advances to Class II machines have greatly increased their player appeal and profitability, allowing the devices to become powerful tools for tribes seeking to avoid onerous compact demands.

Already the nation’s strongest Class II gambling market with some 30,000 bingo-style machines, Oklahoma will likely grow its Class II inventory even more before the time comes to negotiate new compacts.

And it’s not likely Fallin will be occupying the governor’s mansion when the talks begin.

“Not only is she anti-tribe, she’s anti-gaming,” says Jamie Hummingbird, gaming commissioner for the Cherokee Nation Enterprise.

No Talks In The Works

As is the case nationwide with Indian casinos, double-digit gambling growth in Oklahoma has slowed since the 2008 recession. But it has maintained a nearly 5 percent annual revenue increase.

The positive growth has contributed to the diminished impetus by tribes to deal with compact negotiations, particularly with Fallin’s lawyers.

“I think there’s an inclination to kick the can down the road,” McBride says.

It’s not clear under what circumstances the 15-year automatic renewal kicks in. Indian law experts contend the wording in the compact is ambiguous.

Since the bungled overture to Interior about the legality of machines, state officials have not formally approached the tribe about negotiations.

“The state has gone dark,” Hummingbird says.

“The state doesn’t seem to have any real plan beyond the belief that they need to get more money out of the tribes,” says John Tahsuda of Navigators Global, a Washington political consulting firm. “I don’t know what they can offer to entice the tribes to renegotiate.”

Taking a hard line on the tobacco compacts may not have been a wise strategy, as smoke shops do not play a significant role in most tribal economies, particularly with Oklahoma’s larger gambling tribes.

“That was a miscalculation on the state’s part,” Tahsuda says. “They approached the tobacco compacts very hard-nosed. And arguably, the state had a stronger hand to play on that front.”

"But for the tribes, tobacco is not as big a piece of the economic picture as it was 20, 25 years ago, when they negotiated the first tobacco compacts. If the state thought the tobacco talks were a precursor for how the gaming compacts will go, forget it."

The Indian Gaming Regulatory Act and Interior policy discourage states from extending compact negotiations beyond the scope and regulation of gambling. But attorney George Wright, who won a tax arbitration judgment on behalf of the Citizen Potawatomi Nation, believes the state may draw tobacco and sales tax compacts into the talks.

"If we have an administration similar to the current administration, I think you're going to see compliance with lots of state laws through the compact despite what IGRA does or doesn't allow," Wright says, including tobacco and tax compacts.

"I think the state is going to try to get a lot more off that table than the gaming compact itself."

Preference for Tribal Unity

Tribes were unified earlier this year in blocking efforts to legalize daily fantasy sports, a move they saw as violating gambling exclusivity guaranteed in tribal-state compacts.

"We killed that bill in seven hours," Morago told an economic summit at the Cherokee Nation's Hard Rock Hotel & Casino in Tulsa.

Tribes may be willing to discuss new compacts after Fallin leaves office and the 2020 expiration date nears.

Much may depend on the economy. The Oklahoma market is approaching saturation and tribes are pondering how to grow their gambling industries. Many are investing in non-gambling amenities such as hotels, retail and entertainment development.

"I don't think we have necessarily reached a plateau," Hummingbird says, noting a nearly 5 percent growth in the nationwide tribal gambling industry, which sits at \$29.9 billion. "But I think growth is somewhat limited by the terminology in our compact.

"If we do go forward and look to renegotiate those compacts, what is the goal of the tribes? That's really kind of the \$64,000 question. Where do we go from here with our compacts?"

Tribes may seek some kind of expanded gambling, he says, which could include Class III machines comparable to Nevada devices, along with house-banked table games.

The state, in response, will likely seek an increased share of casino revenues.

"Because our state budget is in dire straits, our discussions regarding the percentages are going to be the hot-button issue," Hummingbird says.

Tribal unity will help in leverage with the state.

"United we conquer," OIGA Chairman Brian Foster says. "Divided we get conquered."

The larger Oklahoma tribes with political clout and financial resources such as the Chickasaw, Cherokee and Choctaw nations have historically led the way on gambling and pan-Indian issues.

But there have been rumors of mid-size and smaller tribes meeting with state officials to discuss the gambling agreements.

"The state has been able to sow some discord among the tribes," says a tribal official who requested anonymity. "A couple of the tribes expressed a willingness to strike out on their own, if the state had something to offer."

The tribes have been generous, paying the state \$1 billion in exclusivity fees since 2006, according to a report by the Steven C. Agee Economic Resource and Policy Institute and research firm KlasRobinson.

Tribal gambling employs 27,277 people, pays \$910 million in wages and generates \$264 million in taxes, according to the report.

The ripple of economic growth, particularly in rural parts of the state, has proven valuable to Oklahoma's prosperity, competing with the traditional oil and gas industries.

That the state needs more irks more than a few indigenous leaders. Tribal gambling under IGRA is intended not to assist the states, but to generate revenue for tribal government programs.

"The state looks at us as if we have deep pockets," Coffey says. "But we give our resources back to our membership."

Indian Country's mecca of Class II, bingo-style slot machines is poised to grow even larger as Oklahoma tribes face the renegotiation of tribal-state gambling compacts due to expire in 2020.

Unlike Class III casino-style slot machines subject to state taxes and regulations, tribes can operate Class II devices free of restraint beyond oversight by a tribal-friendly National Indian Gaming Commission (NIGC).

The bingo-style machines—which sources contend make up about 15 percent of the 350,000 gambling devices in the 28 states with Indian casinos—are crucial leverage in negotiating new agreements with state officials.

As a result, many of the 30 Oklahoma tribes with gambling facilities are increasing their inventory of Class II machines.

"Compact negotiations are coming up," says Robert Perry, vice president of sales for Las Vegas-based slot supplier AGS, which produces Class II video machines for the Oklahoma market.

"Whether it's Oklahoma, California or anywhere else, there's always a trend up on Class II because it's used as a negotiations tactic, because tribes don't pay taxes on Class II devices."

"Compact negotiations are between the tribes and the state government. We have no place in that discussion," says Jay Sevigny, president of Video Gaming Technologies (VGT), the Tennessee-based subsidiary of Aristocrat Technologies that divvies up Oklahoma's Class II market with AGS.

"Our commitment in that whole process is to make sure tribes have a successful Class II product, which gives them the economic strength to protect their sovereign rights and negotiate from a position of strength."

"We have seen a rise in Class II machines," says John Estus, spokesman for the Oklahoma Gaming Compliance Unit. "We have not seen Class III keep up with that increase."

Class III machines subject to tribal-state compacts operate with random number generators while Class II devices use a pre-programmed bingo format.

Class II devices were traditionally slower and less entertaining than Class III, but recent technological improvements and regulatory standards have made them more appealing and, in some cases, indiscernible to the players from Class III machines.

Of the 28 states with Indian gambling, Oklahoma is by far the country's largest Class II market with 28,640 devices, or roughly 65 percent of the 43,859 bingo machines nationwide, industry sources told Global Gaming Business.

Class II devices make up nearly 44 percent of Oklahoma's statewide inventory of 65,298 machines, the sources said.

Economist Alan Meister, author of the 2016 Indian Gaming Industry Report, put the 2014 inventory of machines in Oklahoma at 70,219, with 29,609 Class II devices making up roughly 42 percent of the total.

The Oklahoma Gaming Compliance Unit 2015 annual report—citing Meister's figures—shows the state's percentage of Class II machines increasing from 34 percent in 2008 to 42 percent in 2014, a growth trend that is likely to continue.

Unlike other Indian gambling jurisdictions, Oklahoma residents had been patronizing tribal casinos for several years by the time legislators in 2004 approved landmark tribal-state compacts. Players were weaned on Class II devices, most of them VGT products.

Oklahoma compacts called for a Class III electronic instant bingo machine that conformed to the Oklahoma State-Tribal Gaming Act but fell short of replicating the Class III casino-style devices found elsewhere in the country, including Nevada.

Tribal and state regulators in 2006 agreed to tweak technical specifications for the Class III compacted games to speed up play and make the devices more appealing to gamblers.

The percentage of Class III machines in Oklahoma casinos initially increased dramatically with signing of the compacts, jumping from 36 percent of the state's inventory in 2004 to a peak of 66 percent in 2008.

The trend then reversed, and the percentage of Class III games began to fall—rapidly—in part because of player loyalty to Class II devices.

"Oklahoma came of age, really, with stepper (three-reel mechanical slots) and VGT," says VGT's Sevigny. "When compacts were signed... there was a general view that Class III would displace a great deal of the Class II product."

Operators purchased machines or signed revenue-sharing deals with Class III manufacturers, Sevigny says, only to realize many of their players preferred Class II games.

"The Class II product proved, over time, to be very successful with the players. It's a great value," Sevigny says, with a high payback. "Customers have been very loyal to that."

"The players pretty much grew up on our product," says Perry. The AGS Class II video product ranks second to VGT in the Oklahoma market but casts a wider net in other states. "Oklahoma players are very knowledgeable and savvy in that Class II space."

The value of Class II in tribal-state compact talks nationwide is evident as agreements come up for renewal. But the issue is particularly significant in Oklahoma, the nation's second-largest Indian casino state behind California, which generates \$7 billion-plus a year.

Technological improvements to Class II machines and regulatory support from NIGC have increased the popularity of bingo-style devices.

Other states with large Class II inventories, according to industry sources, are Alabama (6,576), California (2,342), Washington (1,591), Wisconsin (1,242) and Arizona (1,059).

But no state compares to Oklahoma, which, depending on various sources, has 28,000 to 30,000 Class II machines.

The tax-exempt status of Class II games, coupled with the technological improvements, provide even casino operators in Class III markets with a viable, economical alternative to casino-style slots.

“When tribes can find a Class II product, they’re giving it every opportunity,” industry consultant Randy Carnett says.

AGS, the nation’s second-largest producer of Class II devices, is anticipating a big demand both in Oklahoma and throughout the country.

“There’s some pretty compelling Class II product being offered,” Perry says.

VGT, acquired in 2014 by Aristocrat Leisure Limited—increasing that company’s U.S. machine inventory from 8,200 to 28,000 devices—is rolling out Ovation, a video product advertised as “taking Class II gaming to the next level.”

“People are going to see that Class II games are really spectacular,” Sevigny says.

Meanwhile, leading slot manufacturer International Game Technology is ready to launch its first Class II product.

“There’s a huge amount of interest in Class II, from all the tribal customers,” says Knute Knudson, IGT’s vice president of business development and tribal relations. “We are responding by investing considerable resources in new Class II platforms and new Class II games, and new hardware. We’ve got a team devoted to that.”

By [Dave Palermo](#)



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