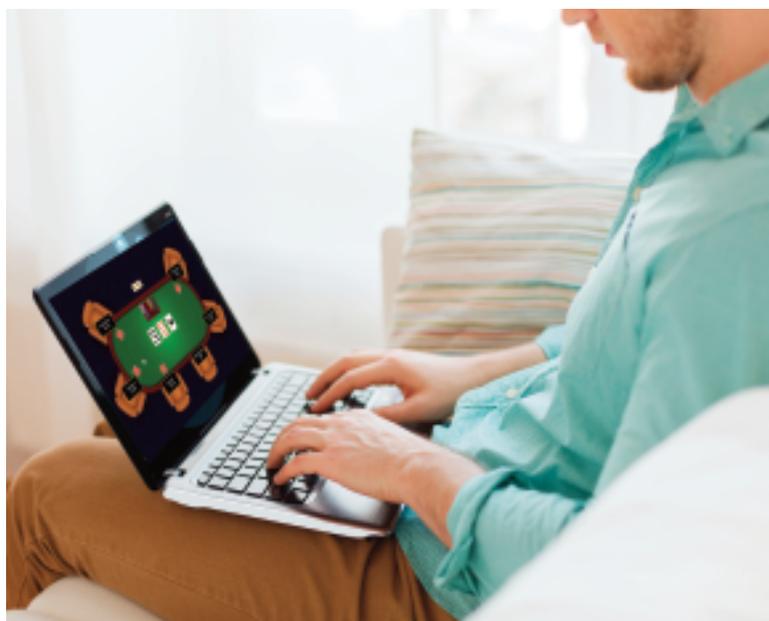


Change, Online Gaming and the Way Forward for Land-Based Casinos in the United States

By David Deitch

The difficulty of accepting change has a universal quality about it. Whether it is one's grandparents bemoaning the growing dominance of computerized applications, musicians mourning LP vinyl records, or publishers resisting the demise of printed media, it seems that change comes to nearly every aspect of our lives, and there are always those who oppose it. Change is not easy, and it is harder for some than others. But change is also often an opportunity for growth or improvement, and those who embrace change and take advantage of it may capitalize on it and enjoy even greater success. The trick is, of course, learning to recognize when change presents those opportunities.

Online gaming is one such change.



Legalized casino gambling has existed in the United States since 1931. For almost fifty years it was limited to brick-and-mortar casinos located in Nevada. The number of states permitting casino gambling (including Native American operations) has increased dramatically over recent decades, but brick-and-mortar casinos have largely remained the prevailing business model in the industry despite various ups and downs in the fortunes of these businesses.

For years, online gaming had existed in the United States only on websites operated by offshore companies whose activities violated U.S. law and the laws of many of the states. Even this avenue was largely closed when the U.S. Congress passed the Unlawful Internet Gaming En-

forcement Act (UIGEA) in 2006. That statute led most online gaming operators to stop serving U.S. customers. Many of those who persisted were the subject of criminal and civil law enforcement – most famously, the “Black Friday” cases that took down wildly popular online poker sites and resulted in criminal convictions of numerous individuals and the forfeiture of hundreds of millions of dollars.

Change came to American shores beginning in 2013 when regulatory schemes in Nevada, New Jersey and Delaware began to permit online gaming within the geographic borders of those states.¹ The regulatory scheme established in each of these states subjected companies wishing to offer online gaming to a

rigorous licensure process managed in Nevada and New Jersey by the experienced gaming control agencies in those states. In all three states, operators could offer online gaming only as a partner with a licensed brick-and-mortar licensee that was already offering gaming in that state.

The notion of online gaming initially met with fierce opposition from brick-and-mortar gaming providers. The most oft-repeated argument was that online gaming would cannibalize brick-and-mortar revenues—that is, that players given an option would gamble online and would no longer go to the casinos and their associated hotel and entertainment properties. Even though most casino owners have seen the writing on the brick wall and have moved to participate in online



By the end of 2014, four casinos closed their doors in Atlantic City, including Showboat and Revel (pictured middle and right). The end of 2014 also saw the Taj Mahal casino (pictured left) teetering on the edge of failure, which has thus far been held off temporarily by outside loans.

gaming, there clearly remains some reticence and caution about how the “odd couple” of brick-and-mortar casinos and online gaming can coexist.

Online gaming will not hurt brick-and-mortar casinos, and in fact it may be the one thing that can save the industry. Online gaming is not a competitor; to the contrary, it is an opportunity for brick-and-mortar facilities to grow their businesses as long as it is viewed in that light and used effectively for that purpose. The rebirth of online gaming is still in its infancy in this country, but we predict that it represents the best chance for casino hotels to revitalize themselves in a changing world.

Flagging Revenues at Casino Hotel Properties

The willingness of Nevada and New Jersey to permit online gaming was motivated, at least in part, by concerns over a disturbing trend in the fortunes of casino hotel properties in those two states. To some extent, this decline was caused by competition as other states have authorized casinos within their borders, but saturation offers only a partial explanation.

The consequences of that trend have been most visible on the Atlantic City boardwalk. By the end of 2014, there were two shuttered casinos at the north end of the boardwalk (Revel and Showboat), one in the middle of the boardwalk (Trump Plaza), and a fourth at the south end of the boardwalk (the Atlantic Club Casino). The end of 2014 also saw the Taj Mahal casino teetering on the edge of failure, which has thus far been held off temporarily by outside loans.² With the state’s former gambling sanctuary losing one third of its casinos, New Jersey gambling revenues from casinos for 2014 reached only \$2.74 billion – less than half of 2006 revenues that topped \$5 billion.

Nevada’s casino hotels have suffered a similar fate: One study notes that the number of arrivals at Las Vegas McCarran Airport is now greater than in 2007 (before the so-called “Great Recession” hit the United States economy), but gross gaming revenues have not returned to 2007 levels.³ In addition, Caesars Entertainment was forced to place Caesars Entertainment Operation Co., which controls close to 80 percent of the company’s debt, into bankruptcy.

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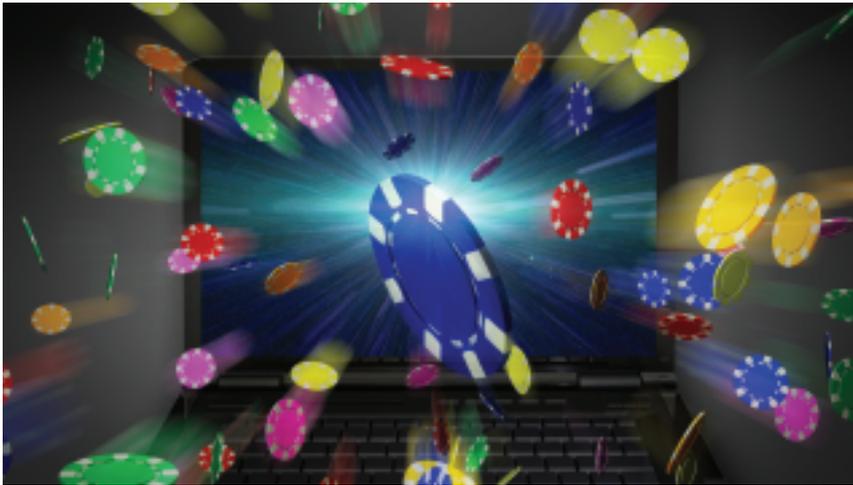
¹ Online gaming in Nevada and Delaware is thus far limited only to poker; the New Jersey regulatory scheme permits the online offering of other traditional casino floor games as well.

² “Icahn lending \$20M to Trump Taj Mahal to avoid shutdown”, New York Post (Dec. 18, 2014) (available at <http://nypost.com/2014/12/18/ica-hn-lending-20m-to-trump-taj-mahal-to-avoid-shutdown/>).

³ “Casino Trends: 10 for ‘15”, Global Gaming Business Magazine, Vol. 13, No. 12 (Dec. 2014).

⁴ “Casino Trends: 10 for ‘15”, Global Gaming Business Magazine, Vol. 13, No. 12 (Dec. 2014).

⁵ “Pennsylvania casino revenue down for second straight year amid competition”, LehighValleyLive (Jan. 15, 2015) (available at http://www.lehighvalleylive.com/breaking-news/index.ssf/2015/01/pennsylvania_casino_revenue_do.html).



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Casinos in other states have suffered similarly declining revenues. For example, the two large tribal casinos in the eastern end of Connecticut have watched their revenues decline over the past five years.⁴ Likewise, Pennsylvania casino revenues fell in 2014 for the second year in a row,⁵ while revenues of Detroit, Michigan's three casinos experienced a third straight year of declining revenue.⁶

The Cannibalization Myth

In the past, the most prominent objection to online gaming – and the one most relevant to the premise of this article – is that it would “cannibalize” the revenues of land-based casinos. Thus far, the history of online gaming has shown this to be a myth.

First, the type of experience that online gaming offers is significantly different from the land-based casino experience. A recent report prepared for the Legislative Budget and Finance Committee of the Pennsylvania General Assembly noted several such differences. Internet gaming typically allows for much smaller bets than are available in casinos and also gives the ability to play multiple games at once and to automatically track bets, withdrawals and deposits for number-crunchers. Casinos also offer a social function and social amenities that online gaming does not; in fact, surveys of

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iGamers reveal that the convenience of not leaving the home, 24 hour availability and the avoidance of crowds are some of the perceived advantages of online gaming. The Pennsylvania report notes that this combined with the fact that online gaming typically happens in the home in the afternoon or evening suggests that for many this is a substitute for other forms of home entertainment rather than a substitute for casino gaming.⁷

Second, the type of player who engages in online gaming is demographically different from the typical casino player. The Pennsylvania report noted that online users tend to be younger, more likely to be male, have a higher income, more education and are more likely to be employed than casino players.⁸ This is consistent with the experience of land-based casinos that have formed partner-

ships with online gaming providers under the newly available regulatory schemes. For example, early in the New Jersey online experience, Keith Smith (the president of Boyd Gaming, which co-owns the Borgata Hotel in Atlantic City with MGM) described the way in which their online and casino player databases were distinct:

When matching our online and land-based databases, we found that 60 percent of online casino customers had not been to Borgata in over a year, and over 75 percent had made fewer than two trips to Borgata in the past year. . . . And on a combined basis, online and land-based poker revenue at Borgata was up more than 40 percent from our land-based play in December 2012. Clearly, online gaming is complementary to our land-based business, not competitive.⁹

And while it would be easy to write off these comments as justifications for a business that has already bought into iGaming, these comments echo those of others.

How Online Gaming Can Boost Brick-and-Mortar Revenues

The question then is how can land-based casinos that partner with online gaming providers coax online users into the hotel casinos?

First, the casinos and providers need to manage their relationship in a manner that capitalizes on existing brand loyalty to the online provider and increases brand exposure for the land-based casino. There are certainly instances in which online providers who have partnered with casinos have a historical customer following that they can bring to bear on these efforts. If providers can bring their loyal customer base to the casino's online gaming site, that can only increase the eyes on that site and potentially the revenues that the casino and the provider garner from the site.

Second, casinos and providers need to use their gaming websites as a tool for increasing the visibility of the casino

MEMBERS IN THE NEWS

New Book Releases

ALL BETS ARE OFF

Arnie Wexler's compulsive gambling spiraled out of control... now after forty-plus years in recovery he is a nationally known expert on gambling addiction and helps others to "quit the bet." *All Bets Are Off* chronicles Wexler's life as a gambler that began on the streets of Brooklyn, New York, flipping cards, shooting marbles, and playing pinball machines. At age fourteen he found the racetrack, a bookie to take his bets, and started playing the stock market. His preoccupation with gambling accelerated until a fateful day in 1968 when it all came crashing down. Wexler's gripping narrative leads us through the dungeon of a compulsive gambler's world—chasing the big win and coming up with empty pockets—and how his addiction drove him and his wife, Sheila, to the edge of life. With help, they managed to escape, and together they have devoted themselves to helping others with the problem they know so well.



2015 EDITION OF INDIAN GAMING INDUSTRY REPORT

In March 2015, Alan P. Meister, Ph.D., Principal Economist with Nathan Associates and a California-based member of IMGL, released the latest edition of his annual Indian gaming study, the *Indian Gaming Industry Report*. In its thirteenth year of publication, the study provides comprehensive and up-to-date nationwide and state-by-state data and analysis on Indian gaming in the United States. A summary of the study's findings is included in Dr. Meister's article starting on page 29 of this issue of *American Gaming Lawyer*.



brand. It is simply common sense that an online user who becomes loyal to the casino brand is more likely to visit that casino (rather than another). As online gaming has developed thus far, some companies have formed partnerships in which the online gaming is largely (or even completely) unassociated with brand of the land-based casino under whose auspices the iGaming is conducted (for example, Betfair's provision of online gaming under Trump Plaza's New Jersey license). A gaming website that does not promote the brand of its land-based partner does so at the risk that its benefits will be limited entirely to its online revenues, and it foregoes the opportunity to use its website to leverage a larger customer base and greater overall revenues.

Finally, casinos need to cash in on the expansion of their customer bases and increased brand loyalty by bringing online users into the casino hotel. The techniques for doing this are limited only by the creativity of each business. For example, online users could earn points in loyalty programs that are redeemable at the brick-and-mortar establishments of the land-based casinos. Gaming websites could also be used to conduct qualifying rounds of tournaments for which final rounds could be conducted in the land-based casinos themselves.

In the end analysis, the key to leveraging online gaming for greater success for land-based casinos lies in viewing the relationship as a single business enterprise and not as separate efforts. The additional revenues that casinos now enjoy by virtue of online gaming are undoubtedly a significant benefit for those businesses. But the casinos that make the most effective use of their relationships with online gaming providers will unquestionably enjoy the greatest success.

Online gaming not only does not hurt the revenues of brick-and-mortar casinos, but when used correctly, Internet gaming can be used to leverage greater revenues out of the physical properties of the companies that partner with online providers. This is a result of the valuable data acquired through online gaming, and the potential that online gaming presents for creating greater brand loyalty. ♣

⁶ "Strong 4th quarter slows revenue dip at Detroit casinos", The Detroit News (Jan. 13, 2015) (available at <http://www.detroitnews.com/story/business/2015/01/13/detroit-casinos-revenues-decline/21709127/>).

⁷ "The Current Condition and Future Viability of Casino Gaming in Pennsylvania," May 2014, prepared for the Legislative Budget and Finance Committee of the Pennsylvania General Assembly (available at <http://lbf.legis.state.pa.us/Resources/Documents/Reports/491.pdf>) (the "Pa. Legislative Report") at 144 (citing Gainsbury, et al., "A digital revolution: Comparison of demographic profiles, attitudes and gambling behavior of internet and non-internet gamblers," *Computers in Human Behavior*, 2012).

⁸ Pa. Legislative Report at 144 (citing Gainsbury, Sally, "Internet Gaming: Current Research Findings and Their Implications," 2012).

⁹ "First Jersey iGaming Revenue Report Issued," GGB News, Jan. 17, 2014 (available at <http://ggbnews.com/issue/vol-12-no-35-september-15-2014/article/first-jersey-igaming-revenue-report-issued>).