

Allocation of Gaming Licenses and Establishment of Bid Processes: The Case of Kansas, 2008 and 2009

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Abstract

This paper looks at the recent history of allocation of exclusive franchise or limited franchise casino licenses in jurisdictions throughout the world and comments on their strengths and weaknesses as well as successes and failures of various strategies that have been undertaken. The paper then examines the Kansas legalization and bidding process that emerged between 2007 and 2009 as a case study in evaluating the effectiveness of various principles that had emerged via the legislation and subsequent procedural decisions. The authors offer the opinion that many of the principles and processes developed in Kansas were based on those that had been implemented in successful bid processes in other jurisdictions. In spite of the inability or unwillingness by several winning bidders to act upon their awarded bids in Kansas in 2008 and the subsequent thinning of the bidding pool in 2009, primarily related to the severe economic downturn that affected the general economy and the casino industry in particular, the authors suggest the Kansas model provides an excellent template for other jurisdictions to develop and to execute similar processes in the future.

Introduction

The past four decades have been characterized by legalization of casinos and casino-style gaming in jurisdictions all over the world following a period where casinos were generally illegal and prohibited. Beginning with the British Gaming Act 1968, country after country and jurisdiction after jurisdiction introduced legalized casino gaming under a wide variety of ownership regimes, market structures, and tax policies during the past 40 years. Indeed, as of 2010, countries without legal casino gaming had become a distinct minority on the global scene.¹ Even in the countries still without casinos, the policy question of legalizing casinos often has been part of the recent political debate.

As of the end of the first decade of the 21st century, legal casino gaming had grown globally to an industry with gaming revenues well in excess of US\$100 billion.² Casino resorts, urban casinos, or gaming arcades and saloons had become a major presence in destination tourist locations (Las Vegas, Niagara Falls, Atlantic City, Macau, New Orleans, Cape Town, etc.) and in many capital and major cities (London, Melbourne,

¹ Among the G-20 economies, countries without formal casinos as of 2010 include Japan, Brazil, Mexico, Indonesia, Turkey and Saudi Arabia. All others have introduced casinos in one way or another, many within the past five decades. Japan already has a substantial Pachinko/Pachisuro industry that is very close to casino gaming in character. Mexico has a rapidly expanding gaming machine sector that has emerged from a loophole in legislation banning slot machines. Indonesia has substantial illegal casinos on islands near Singapore. Turkey had had legal casinos, but they were made illegal in the early 1990s.

² See, for example, "Global Gaming Revenue," Christiansen Capital Advisors, Insight, vol. 3, no. 10, November 2004, which reported casino gaming revenues of \$97.8 billion in 2004. Subsequent to this publication, gaming revenues in most jurisdictions continued to expand (at least until the recession years of 2008-2009), and most notably the Macau casino industry's gaming revenues expanded from about \$5 billion in 2004 to over \$15 billion in 2009.

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Sydney, Vancouver, Singapore, etc.) In some countries (United States, Canada, South Africa, Australia), casino gaming in proper casinos or in less formal settings (i.e. gambling saloons, community clubs, bars and taverns) had become nearly ubiquitous. A high proportion of those countries' residents presently have relatively easy geographic access to casino-style gaming, either in the form of slot machines (electronic gaming devices) or formal casino settings.

Limited Franchise Casino Licenses And Economic Rents

With very few exceptions, however, the approach that legislative bodies and policy makers have taken toward changing the legal status of casinos from proscribed to permitted has been either cautious or eccentric. Based on historic concerns regarding linkages between casinos and organized crime, political corruption, or the other "vices", the typical pattern has been to authorize casinos but then constrain the industry so that it is not allowed to expand to the point that the market could accommodate. There is a sense that if a jurisdiction were to do so, negative externalities related to casino gaming, in particular those related to problem and pathological gambling and possible spill-overs into criminal behavior, might be too much for society to tolerate. Jurisdictions where relatively wide-open and unrestricted (casino) gambling is permitted, such as Nevada, Mississippi, Atlantic City, or Macau, typically cater to a high proportion of "foreigners,"³ which has the effect of capturing significant economic benefits through the export of gambling services, but at the same time limiting social costs because of the correlated export of social problems related to the gambling offered.

Thus, lawmakers have typically created economic environments where permitted gambling is largely under-supplied relative to potential demand. This can be done in a number of ways, including:

- Issuance of a monopoly license for a geographic area, with stipulations as to minimum and/or maximum amounts of gaming and non-gaming amenities provided;
- Restrictions on the number of licenses and/or the number of gaming stations per licensee;
- Geographic restrictions on where casinos can be permitted;
- Restrictions as to the type of facility that is allowed to offer casino gaming (i.e. riverboats, race tracks);
- Limiting casino gaming to government-owned or government-owned-and-operated facilities.

Examples of each of the above categories can be found in jurisdictions that have authorized casinos and casino gaming since 1968.

When casino gaming is purposely under-supplied, or when potential licensees are offered an exclusive franchise to exploit a casino market, the result is often a situation where "economic rents," or excess profits, can be earned indefinitely into the future.⁴ The prospects for capturing such economic rents create a substantial amount of rent-seeking behavior among potential licensees competing for such a privileged situation. It also creates an environment where the government, as the entity that creates the rent seeking opportunities, can itself be a major benefactor of such economic rents.⁵

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One way that government can capture economic rents associated with exclusive or limited franchise casino licenses is to subject them to competitive bidding among interested parties.

3 A broad definition of "foreigner" is someone who resides outside of the political jurisdiction (state, province or country) in question.

4 Competitive markets would have the effect of bidding away excess profits over time, allowing participants the opportunity to earn only "normal" profits in the long term. Constraints on competition or supply prevent competitive market conditions from exercising this effect.

5 Other rent seekers are also often involved, in the sense of trying to influence enabling legislation in a manner that positively affects them. Other examples of rent seeking include mandated earmarks for specific causes (education, property tax relief, etc.), limits on procurement eligibility (i.e. licensees must buy locally), or labor (i.e. laws or regulations regarding labor practices, rights to organize, etc.)

competitive bidding among interested parties.⁶ In general, government specifies its objectives in its rationale for granting gaming licenses; it spells out criteria by which applications will be evaluated, and it defines the processes leading to the awarding of such licenses.

There are two general approaches that governments have undertaken in allocating limited casino licenses: *Auctions* and *Beauty Contests*. Both can result in government's capturing a significant amount of the economic rents that potentially exist. For an *Auction*, government specifies minimum standards that potential licensees must meet and the kind of project that they desire for a particular license. Those conditions are then publicized to potential bidders, who submit monetary offers (in cash or in kind) to win the bid.⁷ Government typically determines which bidders and corresponding projects are eligible (i.e. which ones meet the minimum qualifications to be eligible to compete for the license and also have project proposals that meet minimum specifications). The winning bidder is then the entity that offers the highest payment for the license.

A *Beauty Contest*, on the other hand, creates an environment where government, or its designated representatives, will choose among those proposals that are deemed eligible the one considered to be "prettiest" in the context of government's broadly stated objectives. In this case, the designated representatives — say, members of a selection committee — are given broad guidelines but then are allowed to exercise their discretion in evaluating alternative proposals with regard to how well they meet the guidelines. Thus, decision-makers can compare and contrast alternative proposals based on their proposed capital outlays, architectural features, mix of non-gaming amenities, marketing strategies, relative strengths and weaknesses of the bidding companies in their other gaming operations, etc.⁸

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There is a third approach that has been utilized in some jurisdictions, which will be referred to here as Insider Opportunity. In this case, a particular company may have an inside track with decision-makers to win a selection process and capture the related economic rents. When licenses are awarded based on Insider Opportunity, there is usually an absence of transparency and process as awards are made. Such awards could be made out of favoritism or patronage or even through (typically illegal) revenue sharing arrangements between the Insider company and the government's decision-makers. It is also possible that such licenses are awarded as a reward for prior services rendered by the Insider company to the government or the jurisdiction in the form of, for example, infrastructure or political developments that otherwise could not or would not have occurred or been completed.⁹

Obviously, the allocation of exclusive or limited franchise casino licenses is a process that can be compromised in terms of integrity and "fair play." Because there is so much economic value (in the form of economic rents) that government is dispensing, there are temptations that decision-makers might yield to that and exceed the boundaries of appropriate legal behavior. Governor Edwin Edwards' conviction in 2001, on charges (among others) related to the allocation of riverboat casino licenses in Louisiana, provides one such example.¹⁰ Furthermore, because of the potential for abuse of license

6 This is effectively the process that the State of Kansas followed in structuring its bid process in the Kansas Expanded Lottery Act, SB 66 (2007).

7 The government can specify what kinds of payments are acceptable. The simplest is an "up-front" payment, where the winning bidder makes a payment to government in return for the license. Variants of this can include payment schedules over time, combinations of monetary payments and capital or infrastructure investments as directed by the government, or combinations of monetary payments and capital or infrastructure investments as specified by the applicant.

8 The process that the State of Kansas chose to follow was much closer to a *Beauty Contest* than an *Auction*.

9 The bidding process for three casino licenses in Detroit gave favored status to two companies—Atwater Entertainment and Greektown Casino—that had financed and supported the statewide initiative that passed in 1996. These two companies, along with MGM, were awarded the three available licenses. The Michigan State Supreme Court later determined that such favoritism was unconstitutional.

10 See, for example, Tyler Bridges (2001), *Bad Bet on the Bayou: The Rise and Fall of Gambling in Louisiana and the Fate of Governor Edwin Edwards* (Farrar, Straus and Giroux)

allocation by government decision-makers, such processes also may be vulnerable to litigation by losing bidders who might hope to reverse unfavorable decisions via the courts.

A Brief Categorization of Casino Bid Processes

Historic bidding processes for casino licenses can be classified simplistically based on the above system. Among the noteworthy *Beauty Contests* over the past three decades were casino licenses awarded in Queensland, Australia, to Hilton in Surfer's Paradise and Brisbane (1985, 1988); in Auckland, New Zealand, to Harrah's/Brierley (1992); in Melbourne to Lloyd Williams' Crown Casino (1993); in Windsor, Ontario, to a consortium of the casino companies Hilton, Caesars and Circus Circus (1992); in Rama, Ontario, to Carnival Cruise Lines (1995); in Niagara Falls, Ontario, to Hyatt (1997); in Macau to SJM, Wynn Resorts and Las Vegas Sands/Galaxy (2002); and in Singapore to Las Vegas Sands and Genting (2006 and 2007). Noteworthy *Auctions* (or near-*Auctions*) took place in Sydney, Australia, where the bid was won by Showboat (1995) over Mirage Resorts and Circus Circus; and Cape Town, South Africa, where Sun International won a bid on the strength of a promised downtown convention center and canal system linking the central business district with the commercial and retail developments at the nearby Waterfront development.¹¹ Examples of Insider Opportunity license awards include the aforementioned riverboat casino licenses awarded under Governor Edwards in Louisiana, two of the three licenses in Detroit, and the original gaming license given for the Genting Highlands casino complex in the early 1970s.¹²

In reality, many casino bid processes are hybrids of Auctions and Beauty Contests (and perhaps of Insider Opportunities as well). In jurisdictions with strong "rule of law" institutions, it is difficult to justify non-transparent and extra-legal processes. Various jurisdictions have legislation that makes it difficult to award valuable contracts on a non-competitive basis, and those potential bidders who are excluded typically have the right to challenge the process under the principle of "due process."

There is one additional observation worth noting. Most jurisdictions will go through a bidding process for casino licenses only a limited number of times; often they only will do it once. Because of this, there is only limited specific knowledge on the intricacies and nuances of bidding processes that any particular jurisdiction can accumulate. Because of this, it is important that such jurisdictions draw from the experiences—positive and negative—of other jurisdictions.

Kansas and Gambling

Kansas, a state born amid great contention over the issue of slavery and at the cusp of the Civil War, ratified its constitution on Oct. 4, 1859. Consistent with prevailing public policy at the time, Kansas' constitution forbade lotteries: "Lotteries and the sale of lottery tickets are forever prohibited."¹³ For more than 100 years, despite creative business ventures and legislative efforts to circumvent the prohibition, the state maintained a legal veneer that opposed lotteries and gambling in all forms.

In 1974, the first divot formed in the absolutist position opposing state approved gambling when Kansas voters authorized a constitutional amendment permitting bingo for not-for-profit "religious, charitable, fraternal, educational and veterans organizations" by a 70% to 30% margin.¹⁴ The legislature authorized enabling legislation the following year. The law charged the state's Department of Revenue with the responsibility for regulating, licensing and collecting applicable taxes on bingo played in the state.

11 Of particular interest is the fact that the Cape Town area casino, the GrandWest, is located in a suburb about 10 miles away from the location of the major infrastructure projects that were built as part of the winning bidders' commitment.

12 The exclusive license for a casino at Genting Highlands, Malaysia, was given to Lim Goh Tong in exchange for infrastructure development in the region. (Lim, *My Story: Lim Goh Tong*, Pelanduk Publishers, Malaysia, 2004)

13 Kan. Const. art. 15 §3

14 Kansas Legislative Research Department, Feb. 24, 2004, page 4 (found in Kansas State Library, 300 SW 10th Ave., Room 343, Topeka, KS 66612 at Kan. Y7.2 G 192/2 c.2).

With the passage of the bingo amendment, the status quo persisted for 12 more years. Then, in 1986, Kansas experienced its “election of sin.” Constitutional amendments authorizing pari-mutuel wagering on horse and greyhound racing, a state-owned and operated lottery, and liquor-by-the-drink were all put before Kansas voters. All passed by substantial margins.¹⁵ In 1987, the legislature authorized implementing legislation creating the Kansas Lottery Commission and Kansas Racing Commission. In every sense, the passage of the lottery amendment opened the door to casino gambling in Kansas.

To fully appreciate how Kansas ultimately arrived at a state-owned and operated version of casino gambling unique in the United States, some review of Kansas legal history regarding gambling is merited. Since 1861 with Kansas’ admission to the union and the adoption of its constitution, lotteries had been prohibited.¹⁶ However, it didn’t take long before enterprising individuals and the legislature were testing the boundaries of what a lottery was and what the law interpreted the word to mean. Starting in 1891, the Kansas Supreme Court started striking down as illegal various schemes and attempts to maneuver around the constitution’s lottery clause. These included declaring that the distribution of prizes by chance was an illegal lottery;¹⁷ the purchase of goods that included entry in a chance drawing was an illegal lottery;¹⁸ betting on horse racing was illegal;¹⁹ a theater’s “bank night” was illegal even though no purchase was required;²⁰ “punch boards” formed an illegal lottery;²¹ pari-mutuel wagering on greyhound racing was a lottery;²² slot machines were an illegal violation; and bingo played at an American Legion hall – before the bingo amendment was approved – was inconsistent with the constitutional prohibition on lotteries.²³ In an effort to prevent an encroachment of gambling beyond the commonly accepted notion of what a traditional lottery was – numbers in lots selected by chance – the Kansas Supreme Court expanded the definition of lottery to include any scheme or plan that included prize, chance and consideration. As the Supreme Court wrote in 1994, “It is clear that the term lottery was broadly defined in Kansas judicial decisions to encompass all forms of gambling which involve consideration, chance, and prize.”²⁴

In the early 1990s, Kansas Governor Joan Finney, a political advocate and ally to Kansas’ four resident Indian tribes, started the process of negotiating compacts with the tribes to open Class III tribal casinos, consistent with the Indian Gaming Regulatory Act (IGRA), which was passed in 1988.²⁵ Implicit in those negotiations was that Kansas’ common-law definition of a lottery – practically any game containing prize, chance, and consideration – extended to casino gambling. Under IGRA, if casino gambling was legal in a state, then that state was required to negotiate in good faith with the resident Indian tribes with qualified land to conduct gaming. Kansas’ attorney general filed suit challenging the definition of a lottery in an attempt to forestall the negotiation of compacts. Among other things, the Supreme Court clarified the expansive lottery definition in a different manner that had not been seen before: “Since 1891, we have construed the term ‘lottery’ to include *any* act of gambling which included the elements of consideration, chance, and prize. It is presumed that the legislature acts with full knowledge as to judicial decisions on prior law.”²⁶ With this, the Kansas Supreme Court equated all forms of gambling that had prize, chance and consideration with a lottery. The immediate impact of the 1994 Supreme Court decision forced the state to negotiate casino compacts with its resident Indian tribes. But the court’s ruling created the very real

15 Kansas Legislative Research Department, Feb. 24, 2004, page 1 (found in Kansas State Library, 300 SW 10th Ave., Room 343, Topeka, KS 66612 at Kan. Y7.2 G 192/2 c.2).

16 Kan. Const. art. 15 §3

17 State ex rel. Kellogg v. Merchantile Association, 45 Kan. 351, 25 Pac. 984 (1891).

18 Davenport v. City of Ottawa, 54 Kan. 711, 39 Pac. 708 (1895).

19 The State ex rel. [Dawson] v. Fair Association, 89 Kan. 238, 131 Pac. 626 (1913).

20 State ex rel. Beck v. Fox Kansas Theatre Co., 144 Kan. 687, 62 P.2d 929 (1936).

21 State v. Brown, 173 Kan. 166, 244 P.2d 1190 (1952).

22 State ex rel. Moore v. Bissing, 178 Kan. 111, 283 P.2d 418 (1955).

23 State v. Nelson, 210 Kan. 439, 502 P.2d 841 (1972).

24 State ex rel. Stephan v. Finney, 254 Kan. 632, 644, 867 P.2d 1034, 1043 (1994).

25 Public Law 100-497. October 17, 1988

26 State ex rel. Stephan v. Finney, 254 Kan. 632, 644, 867 P.2d 1034, 1044 (1994).

possibility – if the legislature acted – of creating commercial-grade casinos so long as they were “state-owned and operated.”

Kansas and Casinos

If the Supreme Court created the opportunity to expand casino-style gaming into Kansas, its neighboring states contributed to the matter’s urgency. In July 1989, Iowa became the first state in the country to authorize riverboat casinos.²⁷ Although not contiguous to Kansas, Iowa introduced casino-style gaming into the region for the first time. Undoubtedly pressured by Iowa’s legalization, Illinois became the second state to approve riverboats in February 1990.²⁸ Then, in the 1992 election, Missouri voters passed a constitutional amendment authorizing riverboats.²⁹ By the mid-1990s, five riverboat casinos had opened in the Kansas City, Missouri, area. Although the market eventually contracted to four facilities, Kansas license plates were replete in the casinos’ parking lots and garages. Furthermore, by 1995, Kansas had negotiated compacts with its four resident Indian tribes, leading to four tribal casinos opening in northeastern Kansas, north of Topeka.

In 2004, the Oklahoma legislature passed the State-Tribal Gaming Act that authorized a voter referendum on expanded gambling.³⁰ The vote, which passed, approved a model tribal compact, deemed a pre-approved offer to all federally recognized Indian tribes in Oklahoma.³¹ The resulting compacts allowed electronic “bonanza-style” bingo, electronic amusement games, electronic instant bingo and non-house banked card games.³² By Dec. 31, 2005, there were 3,230 compacted electronic gaming machines in Oklahoma. That number quickly exploded. By 2006, the number of games grew to 14,694; in 2007, to 25,036 and by the end of 2008 it had reached 35,328.³³

To Kansas, the impact of Oklahoma tribal casinos was immediate and noticeable on its southern border. In what had once been dingy bingo huts and glorified class II slot shacks, there exploded more professional and appealing gambling destinations. Class III games were mixed with bingo-based Class II machines, and the Class II games had evolved in a manner that was indistinguishable from Class III machines to the common gambler.³⁴ Given that many tribal lands were in the northern and eastern part of Oklahoma, an encroaching sense of gambling pervaded in the southern half of Kansas stretching from the Missouri state line to south of Wichita. Just as with riverboat casinos in Kansas City, a quick review of license plates in Oklahoma casino parking lots found Kansas residents well represented among the patrons. These developments added to the urgency to address casino gambling in the Sunflower State.

The Kansas Expanded Lottery Act of 2007

By the time Missouri authorized riverboat casinos in 1992, Kansas’ two year-round pari-mutuel facilities – The Woodlands in Kansas City and Wichita Greyhound Park – already were seeing declines in revenue and attendance. In 1990, the first full year of year-round racing, statewide pari-mutuel handle was \$273.4 million. By 2007, that number had dropped to \$68.1 million, a 75.1 percent decrease. The tracks’ solution: approach the legislature for authority to add slot machines to increase revenue and attendance and to subsidize the costs of racing. Lack of gubernatorial support during the term of Bill Graves from 1995-2003 made most attempts to expand such gaming directionless and ill-fated.

27 Iowa Racing and Gaming Commission, <http://www.iowa.gov/irgc/Chronology.htm>, retrieved Jan. 31, 2010.

28 Illinois Gaming Board, <http://www.igb.state.il.us/>, retrieved Jan. 31, 2010.

29 Missouri Gaming Commission, http://www.mgc.dps.mo.gov/history_rb.htm, retrieved Jan. 31, 2010.

30 Oklahoma Office of State Finance, Gaming Compliance Unit, <http://www.ok.gov/OGC/index.html>, retrieved Jan. 31, 2010.

31 Oklahoma Office of State Finance, Gaming Compliance Unit, <http://www.ok.gov/OGC/index.html>, retrieved Jan. 31, 2010.

32 Oklahoma Office of State Finance, Gaming Compliance Unit, <http://www.ok.gov/OGC/index.html>, retrieved Jan. 31, 2010.

33 Oklahoma Office of State Finance, Gaming Compliance Unit.

34 See, for example, Alan Meister, “The Potential Economic Impact of the October 2007 Proposed Class II Gaming Regulations”, submitted to the National Indian Gaming Commission, Feb. 1, 2008

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In 2002, Kansans elected Kathleen Sebelius governor. With her election came a renewed focus on expanded gambling legislation and with it economic development in historically distressed parts of the state. Sebelius advocated for any reasonable plan that would expand gaming in Kansas, and she put the force of her office behind those efforts. Between 2003 and 2006, Sebelius' first term in office, 17 expanded gambling bills were introduced in the legislature. Those efforts culminated in 2007 with the passage of the Kansas Expanded Lottery Act, otherwise known as KELA. Legislative proponents of gambling took advantage of the required reauthorization of the Kansas Lottery to amend approval of Las Vegas-style casinos and slot machines at race tracks on the floor of the House of Representatives. The bill needed 63 votes to pass the House; it received 64. In the Senate, an unprecedented 12-hour filibuster paved the way for the slimmest of all possible margins, 21-19, allowing passage.

As in many other jurisdictions, the groups who had been in favor or in opposition to KELA created some interesting political bedfellows. Those in favor included the Governor and many of her supporters, tourism officials, local chambers of commerce, legislators looking to generate new state revenue, libertarians, persons involved with breeding and racing greyhounds and horses, and those who represented the construction trades. The opposition included a wide variety of church groups, family-values-oriented individuals and groups, those who were concerned with the exploitation of lower income and lower educated citizens by gaming operators, and Kansans who felt that turning to gambling as a means of solving fiscal problems was a fundamentally flawed idea. Others with varying levels of public opposition were gaming industry interests and government representatives in the state of Missouri and tribal interests linked to gaming operations in Kansas and Oklahoma. Though largely disorganized and politically invisible, another constituency in favor of gambling was made up of consumers who wanted to be able to participate in casino gaming more conveniently than the prevailing out-of-state options.³⁵

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KELA set up the framework for casino-style gaming. Consistent with the constitutional requirement for a lottery, the law required state ownership and operation of the casinos and slots at race tracks through the Kansas Lottery Commission.³⁶ However, the law anticipated that the state would contract with private entities to manage the day-to-day activities at the casinos, subject to final approval by the Lottery Commission and its executive director. Rather than endorse a bidding process for each licensee, the law called for a competitive selection conducted by an appointed panel of seven Kansans who were chosen to review the merits of each submission and select the winning bidders based upon statutory criteria. In every sense, Kansas affirmatively rejected the idea of a casino bidding war (an "auction") in favor of an evaluation based on the relative merits of proposals (a "beauty contest").

The law required comprehensive regulation of the gambling facilities by the Kansas Racing and Gaming Commission, the state agency previously charged with pari-mutuel oversight. The law also required regulatory oversight consistent with industry standards.

Among other key aspects of the law, four casino locations in disparate areas of the state were authorized subject to local approval: one for Wyandotte County (the Kansas City area in the extreme eastern part of the state); one for Ford County (Dodge City, in the southwestern part of Kansas); one for Crawford and Cherokee counties (in the

³⁵ For a detailed discussion of the forces involved in the legalization of gambling at the state level, see Denise von Herrmann (2002) *The Big Gamble*, Praeger Publishers, chapter 3.

³⁶ The following statutory citations can be found at K.S.A. 74-8734 to 74-8772

extreme southeast corner of the state, abutting Missouri and Oklahoma); and one for Sedgwick and Sumner counties (which includes Wichita, the state's most populous city, and stretching south to the Oklahoma border in central Kansas).

While Kansas would not formally have gaming taxes on these "Lottery Gaming Facilities" because the operations would be state-owned, the law prescribed a minimum share of gaming revenue that would accrue to the state. In no case would the state retain less than 22 percent of gross gaming revenue. Three percent was reserved for local units of government where the casinos were to be located, and the law entitled the state's problem gambling program to receive 2 percent of gaming revenue. The total take-out of state revenue made Kansas' "effective tax rate" at 27 percent comparable to other Midwestern gaming jurisdictions.

Finally, although not a focus of this paper, KELA authorized up to 2,800 slots at the state's three year-round pari-mutuel race tracks: The Woodlands in Kansas City, Kansas, a greyhound and horse racing venue; Wichita Greyhound Park, in Wichita, a dog racing only facility; and Cawthorne, a long-shuttered greyhound track in Crawford County. As of 2010, no race track had accepted slot machines, citing an inability to turn a profit under a revenue sharing structure that only allows track operators to retain 40 percent of gross gaming revenue. Efforts to amend the law through 2009 were unsuccessful.

On the day Gov. Sebelius signed KELA into law, she asked Kansas' attorney general to file a lawsuit challenging the constitutionality of the state-owned and operated model. Sebelius reasoned that prospective managers would not submit proposals or even incur development costs if there was a chance the law would be struck down.

The lawsuit had to be brought initially in district court,³⁷ where KELA's constitutionality was upheld. The attorney general appealed to the Supreme Court. Less than five months after the district court ruled, the Kansas Supreme Court found KELA constitutional and consistent with the requirement that gaming be state-owned and operated.³⁸

The court found that the state-owned-and-operated requirement did not mandate that the state hold title to anything or own any real property or equipment.³⁹ It only mandated that the actual conduct of gambling be subject to final state authority.⁴⁰ Said the court, "It is unnecessary that the state own the physical plant associated with the Lottery. It suffices that the state owns the game, or the scheme, or the enterprise. Such a definition is consistent with a standard of review favoring the constitutionality of KELA."⁴¹

KELA put three public bodies into motion for selecting Kansas casino managers. One purpose of this analysis is to highlight the unique approaches of the selection panel itself. However, the Lottery Commission and the Racing and Gaming Commission had roles that book-ended the Review Board's work.

KELA required that the Lottery Commission, as the state actor owning and operating casino gaming, set out requirements for receiving submissions. The Lottery had to establish a time certain for the applications to be received, but the Lottery could have chosen to allow as much time as it wanted. Once that deadline expired, by law the Lottery had 90 days to negotiate contracts with each applicant. If it needed more time, it could seek a one-time 60-day extension.

Legislators wanted the process to be competitive, so multiple applications were expected and sought in each gaming zone. KELA required the contract between the Lottery Commission and the private casino manager to contain provisions addressing the types of games to be used; how revenues would be divided and paid to the manager; payment of a \$25 million one-time privilege fee (except for a lower privilege fee of \$5.5 million in Ford County) upon contract approval; financing commitments; designation of key employees; the waiver of sovereign immunity if the applicant was an Indian tribe; and provisions requiring the eventual manager to pay the Racing and Gaming

³⁷ K.S.A. 74-8733(a)

³⁸ State ex rel. Six v. Kansas Lottery, 286 Kan. 557, 186 P.3d 183 (2008).

³⁹ State ex rel. Six v. Kansas Lottery, 286 Kan. 557, 564, 186 P.3d 183, 190 (2008).

⁴⁰ State ex rel. Six v. Kansas Lottery, 286 Kan. 557, 564, 186 P.3d 183, 190 (2008).

⁴¹ State ex rel. Six v. Kansas Lottery, 286 Kan. 557, 564, 186 P.3d 183, 190 (2008).

Commission for the cost of regulation. The Lottery's executive director, its senior staff member overseeing casinos, and its attorneys negotiated the contracts on behalf of the state. The Lottery had also retained a consultant to evaluate the financial standing of applicants during contract negotiations, to advise on particulars related to the contracts, and to ensure that the applications met the KELA test of managerial competence. Once the contracts were negotiated, they were presented to the Lottery Commission for full approval. All approved contracts were then sent to the Lottery Gaming Facility Review Board to determine the preferred applicant in each zone. Despite the roles of the Lottery and Racing and Gaming commissions – long established and enduring governmental bodies – the responsibility of selecting the successful casino applicant fell to a newly formed, seven-member group called the Lottery Gaming Facility Review Board.

After the Review Board selected an applicant in each gaming zone, the Racing and Gaming Commission was responsible for conducting background investigations of the applicants. These investigations included reviews of the company itself plus its management, directors, and individuals involved with making decisions about the conduct and activities of the company. KELA gave the agency 10 days to complete this task, with the option of seeking a one-time 60-day extension from the Governor.

The Review Board and the Selection Process in Kansas

KELA only speaks briefly about the Review Board and its mission. The seven members were to be appointed by three different people: three members by the Governor, who also would select the Board chairman; two members by the Speaker of the House; and two members by the President of the Senate. With such a structure, no one appointing authority commanded a majority of the board, and, consequently, it was thought that the board would be insulated from political pressure or attempts to influence its choices.

Board members, in order to be eligible to serve, were required to demonstrate "evidence of significant business expertise, particularly in business development and location of new businesses to maximize revenue."⁴² A board member could not own property or have any interest in a venture conducting business in a gaming zone. Also, a board member could not have been, for the two years preceding his or her appointment, employed as a consultant by a casino applicant or have had a financial interest in any applicant.

The board's statutory requirements for making its decisions were both direct and sparse. In totality, the board was required to "determine which contract best maximizes revenue, encourages tourism and otherwise serves the interests of the people of Kansas."⁴³ That is it. That charge represents everything the Legislature told the board about how to craft its decisions and which companies to select in managing the state's casino industry. KELA gave the board 60 days to examine the contracts and proposals and make a selection. If necessary, it, too, could seek and receive a 60-day extension from the Governor.

For budgeting and administrative purposes, the Review Board was attached to the Racing and Gaming Commission and utilized the commission's staff. Each meeting included direct participation from the agency's executive director; attorneys, who are also assistant attorneys general; director of communications; director of administration; and a review board liaison, who was tasked with tracking deadlines for submission of documents and information and ensuring that agendas and submitted material got to the board. For each meeting, a court reporter was hired so an exact transcription of what was said could be preserved for the public records.

Each applicant was assessed \$150,000 to pay for the costs of the board's efforts, including travel, staff salaries, and the fees of retained consultants.

The Review Board, through the staff of the Racing and Gaming Commission, then set out to retain consultants on behalf of the state, in order to provide expertise on the gaming industry as well as a check on the reasonability of estimated revenue,

⁴² K.S.A. 74-8735(b)

⁴³ K.S.A. 74-8736(b)

performance, and economic impact provided by the applicants. A team of consultants was pulled together to give the Review Board resources to better understand, critically evaluate, and compare and contrast the various applications put forward.

The expertise and experience of the consultants were intended to cover a number of areas that would be useful and important in the selection process. Two consulting groups were brought on to estimate the revenue potential for generic Lottery Gaming Facilities in each of the four zones and then to modify those estimates in light of the proposed facility locations and gaming and non-gaming assets put forward by the various applicants. These groups developed their estimates independently of one another and without prior knowledge of the estimates provided by the applicants in order to provide a “reasonability check” on one another’s work and to allow for comparisons with similar estimates generated by the various applicants.

Other consultants were hired to assess various economic, financial and fiscal implications and impacts of the applications. One consulting group looked at the potential impacts of the proposed developments on local government finances and on such public services and infrastructure as police, fire, roadways and schools. Another was employed to estimate the direct, indirect, and induced economic impacts that would result in the zones if the proposed projects were actually undertaken. A separate group was hired to evaluate the non-gaming assets and amenities as well as the strategies of branding and product development proposed by the applicants. Yet another consultant was retained to evaluate the financial statements and financing capabilities of the applicants. Throughout the process, the consultant groups were actively involved in reviewing submitted documentation, evaluating the sites of the proposed Lottery Gaming Facilities, visiting competing gaming sites in adjacent states, interacting with government officials, offering their professional opinions on various matters, and participating in the public hearings of the Review Board.

Transparency and Ethical Conduct of the Review Board

The most significant actions taken by the Review Board in advance of consideration of any proposals was its adoption of policies to promote transparency and ethical conduct. The law itself contained some ethical restrictions on the board. A board member, as well as a large number of state officers and employees, could not purchase an interest in, be employed by, or represent a casino manager until five years after their service ended.⁴⁴ While the law did a straight-forward job of addressing post-service conduct, it was silent as to how the board should conduct itself during the course of its activities.

In September 2007, the Racing and Gaming Commission adopted a sweeping code of conduct that would govern its service and interaction with parties that had matters pending before it. At its first meeting in December 2007, the Review Board adopted nearly the same code of conduct that drew a distinct ethical line for future proceedings and committed them to an unprecedented level of transparency and openness. Among the responsibilities imposed by the code⁴⁵:

1. A duty for board members, their spouses and children to avoid conflicts of interest or situations that could cause the appearance of a conflict of interest, including personal, professional or financial. Under the code, the member is required to disclose any economic associations, direct or indirect, that could create the appearance of a conflict of interest.
2. A restriction on gambling at any affiliate of an applicant anywhere in the world. Also, an admonition not to excessively fraternize with employees, representatives or agents of an applicant. Gifts or complimentary items were strictly prohibited in all forms.
3. A prohibition on seeking or accepting any employment that conflicted with the board’s responsibilities or duties.

⁴⁴ K.S.A. 74-8762(c)

⁴⁵ Kansas Lottery Gaming Facility Review Board Code of Conduct, §§2, 3, 4, 5, 6, 7, 8, 10, & 13.

4. No direct ownership of any casino manager applicant through stock. Holding shares in mutual funds or traded investment companies that have stock in a prospective manager was not prohibited.
5. A requirement to complete and file with the Kansas secretary of state a statement of substantial interest, revealing all financial and personal relationships publicly.
6. A commitment not to engage in ex parte communications, or any material discussion outside a properly noticed, public meeting of the board. Such discussions extended to any matter pending before the Lottery, the Racing and Gaming Commission or the board itself. This provision in particular was intended to set a high standard of conduct and make clear to the prospective managers and their employees agents, lawyers and lobbyists that every discussion and consideration was going to be aired before the public and not behind closed doors where the appearance of inappropriate deals and considerations could be perpetuated.

Each member signed and acknowledged his or her commitment to upholding the terms of the code of conduct before a casino proposal had ever been put before them.

In addition to the prohibitions contained in the law and the high ethical standards imposed by the code of conduct, the board set out to make the casino selection process the most transparent and open of any American jurisdiction so similarly tasked. The board committed that all discussions and conversations regarding matters relevant to its charged task would be conducted in an open meeting. With the exception of executive sessions for attorney-client communication and to receive background investigative reports, including some limited financial data, all discussions, presentations, questions and ponderings of the board were done in public. Also, the board committed to make public all documents involved in the process, including applicant materials, consultant reports, public comments and information requested by the board from the applicants, consultants and staff. An agenda packet containing all prepared items and reports was posted seven days before each meeting on the Racing and Gaming Commission's website (www.krgc.ks.gov). The public had access to this information at the same time the board did. Documents were captured in the portable document format (PDF) so the public, applicants and consultants could download information relevant to them. New documents distributed at meetings would be gathered by staff and also placed on the commission's website within a day of the meeting.

This apparent commitment to ethical conduct and transparency set a tone that carried throughout the board's proceedings. It captured an intentional attempt to set a high standard for the reviewing and awarding of casino applications and, hopefully, to serve as a model for future selection efforts in other jurisdictions, domestically and internationally. The importance of holding to high standards of ethical conduct and transparency is closely related to the potential value that would accrue to applicants winning such a license. The original applications, which ranged upwards of \$767 million in proposed capital outlays, pointed out that the winning bidders potentially had much to gain with a successful application, so providing a process that was above reproach carried an extremely high priority for all officials involved.

Structure of the Review Board Process

The board organized its approach for reviewing the proposals around four public meetings. The first meeting called for the initial introduction of the board to the applicants and their proposals in each gaming zone. At this meeting, a Lottery Commission representative presented to the board the contract agreed to by the Lottery and the applicant, clarifying any issues or terms unusual or distinct. Then each applicant received 70 minutes to present its proposal for constructing and managing a state-owned casino. The board then asked questions and sought clarifications regarding the proposal for as long as it wanted. The process of Lottery contract review, applicant presentation and board questions normally lasted between two-and-a-half and three hours. After each applicant, the endorsing local government authority – either a city or county – was given 15 minutes

to express why the proposal should be selected. (In cases where an endorsing authority had multiple proposals, it was not unusual for it to make only one presentation, extolling the benefits and impact on its community of a casino in general while expressing no favoritism among competing proposals.) When all applicants and endorsing authorities had been heard from, the board took public comment.

At the second meeting, the team of consultants hired by the Board had its opportunity to present and justify its reports and findings. Initially, extensive time was spent going over the methodology that led to the basis of the reports. The consultants offered all their opinions concerning one zone at the same time with extensive questioning from the board. At the conclusion of the reports for a zone, each applicant in that zone would be given up to 45 minutes to present a response, or rebuttal, to the information presented. This forum also allowed the board to ask additional questions and seek clarification on matters from the applicants.

The third meeting was a teleconference involving the board, staff, consultants and a representative of each applicant. This call afforded the opportunity for board members to ask questions seeking clarification on any issue – whether presented by staff, a consultant, or an applicant – that was still unresolved to them. The intent was to provide a forum to ask any questions that required additional study or examination, so that the solicited information could be presented at the fourth meeting. The public received access to the calls, although they were not allowed to speak.

The fourth and final meeting of the Board started by receiving any additional information requested at the third meeting, and additional questions could be posed to applicants. Each applicant was given 15 minutes to present a final statement about the merits of its proposal. The board then adjourned into executive session to receive character and financial investigative reports about the applicants and their key personnel. After the executive session, the board recessed, taking the rest of the day and night to consider its vote. The next day, the board came back to vote, with each member publicly stating his or her choice and providing an explanation for his or her decision. A proposal needed four votes to win.

How The Process Worked

It appeared that Kansas was fortunate in its first attempt with casino expansion. With applications due for all zones in December 2007, the state's deadline preceded the first clear signs of distress in the national economy. As a result, 12 applications for the four zones were submitted. By the end of May, the Lottery had negotiated 11 casino management contracts. Only a joint venture between MGM and Foxwoods failed to sign its negotiated contract. At the time, MGM cited a failure to agree on terms with the Lottery; however, it was probably the first signal of the difficulties that would emerge from the economic recession of 2007-2009 that had significant negative impacts on the financial sector and the gaming industry in particular.

By the end of June, 2008 the seven-member board, its staff and consultants were on a great tour of Kansas, stopping in every gaming zone for the first meetings to hear proposals from the 11 applicants who had signed Lottery contracts. Each zone presented different economic and political circumstances that affected the competitive nature of the process. In the Southeast Gaming Zone, the sole applicant was Penn National Gaming, which sought to build a \$225 million facility on a site less than a half-mile from the Oklahoma state line. Unique to this zone, Penn submitted a plan to the Kansas Lottery that would phase-in its required \$225 million investment over 12 years, motivated by the intense competition in northeast Oklahoma from tribal facilities. In particular, the opening of the \$300 million tribal Downstream Casino on property within a quarter mile of the Penn site but across the Oklahoma state line absorbed a significant portion of the market potential and made it difficult for Penn to justify the minimum capital investment required under the KELA. The Board voted to approve the Penn contract 5-2 on August 22, 2008. However, on September 11, Penn withdrew its proposal from consideration,

before it had been finalized by KRGC background approval, citing declining revenue projections and fierce competition from the new Downstream Casino that had been built in 2007-2008, after Penn had filed its original application.

In the South Central Gaming Zone, three applicants signed contracts with the Kansas Lottery – Penn National Gaming for a \$340 million facility with its location in Wellington, approximately 19 miles from the Oklahoma border; Marvel Gaming, for a \$368 million casino complex, also in Wellington; and a joint venture involving Harrah's and a Topeka-based company for a \$535 million casino complex in Mulvane, 14 miles closer to the city of Wichita than the Wellington locations. One of the most contentious issues for this zone was whether the casino should be located in Wellington, the county seat in the center of Sumner County, or in Mulvane, at the north end of the county, a city that straddles the Sumner and Sedgwick county line. Residents of Wellington, as well as the Sumner County Commissioners, felt strongly that Wellington be the preferred site. However, Mulvane is 14 miles closer to Wichita than is Wellington, and Wichita is the primary population center that would be attracted to the South Central Zone casino. The state's consultant reports suggested that a Mulvane casino would outperform a casino in Wellington.

On Aug. 22, 2008, the Board accepted the contract and proposal of Harrah's and its Kansas partner with four votes in favor, two cast for the Marvel Gaming proposal and one vote for the Penn National submission. However, on Nov. 17, Harrah's withdrew its contract and application before the final background approval could be given by the Racing and Gaming Commission. Harrah's cited declining financial markets, the growing softness in the American economy, the slowdown in entertainment and discretionary spending and the inability to secure credit at a reasonable rate as justification for its withdrawal. Additionally, Harrah's joint venture partner experienced a significant drop in its worth as equity markets reduced the value of its investments and the underlying capital it had expected to tap to finance the project.

The Lottery reopened the South Central Gaming Zone for applications with an April 1, 2009, submission date. At that time, three new applications were submitted but none by the previous group of bidders. By September 2009, the number of bidding entities for the South Central Gaming Zone had been reduced to one. In December, the one remaining applicant asked for an additional extension of time, and renegotiated its contract with the Lottery, anticipating a final decision by the review board in April 2010.

Two applicants put forward proposals in the Southwest Gaming Zone to build and manage the state's casino in Ford County. Both proposals sought to locate the facility on the outskirts of Dodge City, the famed Old West town. Butler National Service Corp., a Kansas-based publicly traded company that manages a tribal casino in Miami, Okla., proposed an \$86 million casino; a group of Kansas investors calling themselves Dodge City Resort and Gaming applied to build a \$73 million facility.

On Sept. 26, 2008, the board adopted the Butler National contract and proposal by a 5 to 2 vote. This proved to be the only proposal of the first attempt to select casinos in Kansas that actually resulted in the construction and opening of a casino. The group broke ground December 22, 2008, on the first phase of its facility. The casino opened to the public on December 15, 2009.

In the Northeast Gaming Zone, five applicants initially signed contracts with the Lottery Commission: Golden Gaming of Las Vegas, to build a \$662 million casino facility; Kansas Entertainment, a joint venture between Baltimore's Cordish Co. and International Speedway Corp., for a \$681 million casino complex adjacent to the Kansas Speedway; Legends Sun, another joint venture between Kansas City based RED Development and the Mohegan Tribe of Connecticut, which proposed to build a \$767 million casino complex; Pinnacle Entertainment of Las Vegas, which was proposing a \$624 million facility; and Las Vegas Sands. All the sites were located within a mile of the Kansas Speedway and largest shopping complex in the region.

By summer of 2008, it was becoming apparent that the national economy was in a

severe recession, and that many of the major casino companies found themselves in over-leveraged financial positions. Las Vegas Sands withdrew its application on July 23, 2008, before its proposal could be presented to the Review Board or consultant analysis could be concluded. Pinnacle dropped its bid September 15, 2008, three days before the Review Board was to commence its final meeting to select a winner for this gaming zone. On Sept. 19, 2008, the Board accepted the contract and proposal submitted by Kansas Entertainment by a four to three vote, with all dissenting votes in favor of the proposal submitted by Golden Gaming. However, on the evening of Dec. 4, 2008, the day before the Racing and Gaming Commission was prepared to vote on final approval of the proposal and contract, Kansas Entertainment withdrew. This entity, like Harrah's before it, cited the eroding economy, particularly contracting credit markets, as reason to change the scope of its project, which could not be done without amending the contract.

By summer of 2008, it was becoming apparent that the national economy was in a severe recession, and that many of the major casino companies found themselves in over-leveraged financial positions.

It is interesting to note that, even though the review board followed a highly transparent and structured process, all three of the licenses that were awarded under competitive conditions in 2008 went to bidders that had strong Kansas links, arguably stronger than those competing bidders who were not selected. This could have been a coincidence, but it could also reflect a reality that in any selection process that utilizes a “beauty contest” approach, there is going to be a home-team advantage. Whether explicitly acknowledged or otherwise, a company with Kansas roots, *ceteris paribus*, may be preferred by review board members who are themselves from Kansas. In one sense, there may be no way to totally remove the “Insider Opportunity” dimension from bidding processes altogether.

The Lottery reopened the gaming zone for applications with an April 1, 2009, submission date. At that time, three applications were submitted: proposals by previous applicants Kansas Entertainment and Golden Gaming and a new submission by Penn National Gaming. Golden Gaming subsequently withdrew its application in June 2009, and Penn National dropped its proposal when it replaced the Cordish Co. in the Kansas Entertainment bid, which was subsequently offered the license in December 2, 2009.

What Went Wrong: The Process, The Recession and The Casino Industry Crisis of 2007-2009

In many other states, casino selections have become political quagmires with public officials charged and even jailed for transgressions.⁴⁶ In Kansas, there was intense disagreement about some of the companies selected to manage the state's state-owned and operated casino enterprise, with the selection process in south central Kansas being particularly contentious. But, as the first selection process ended in 2008, there was no sign of corruption or inappropriate activity by the board selected to make these crucial decisions. The charges of cronyism and corruption that dogged states like Louisiana and Missouri in their selection processes were nonexistent in Kansas – to the relief of public officials and those responsible for moving this process forward.

However, the story of the review board selection process in Kansas in 2008 and 2009 is not complete without a greater understanding of the financial and economic crisis that gripped the country and the world for those two years. Beginning in the summer of 2007, problems in the financial sector linked to increasing foreclosure rates on residential housing, especially those linked to declining housing prices and sub-prime mortgages, led to liquidity and solvency crises within individual financial institutions and development companies, growing pessimism among consumers, and retrenchment by banks and other financial institutions, who would ultimately become focused on their own survival. The forced sales in 2008 of Bear Stearns, Merrill Lynch, Wachovia

⁴⁶ Bridges, Tyler, op. cit.

Securities, and other major financial institutions, along with the bankruptcies of Lehman Brothers and Washington Mutual, among others, pushed the American (and ultimately the global) financial system to the brink by the fall of 2008. Falling home prices, accelerating rates of foreclosure, reductions in consumer spending and capital investment, growing unemployment, and collapsing stock market prices added to the sense of economic collapse. The worst recession in America since the Great Depression had become a reality.

The casino sector, and especially the major companies that had grown to dominate the industry by the second half of the first decade of the 21st century, were particularly adversely affected by the downturn. Some companies, such as MGM, Las Vegas Sands, Boyd Gaming and Wynn Resorts, had earlier committed to major multi-billion dollar development projects in Las Vegas or Macau. Indeed, some of the projects were billed as the largest private sector construction projects ever undertaken; MGM's CityCenter in Las Vegas, which opened in December 2009, cost an estimated \$8.5 billion; Las Vegas Sands' Cotai Strip developments in Macau were estimated to cost \$12 billion at build-out in about 2012. For the most part, these multi-billion dollar projects were heavily leveraged, and in many cases, a portion of the financing was linked to projected sales of condominium and time-share units within the Integrated Resort casino complexes.

Other gaming companies relevant to this analysis had been acquired through private equity buy-outs at prices that were at a premium over their 2007 share prices. Noteworthy for Kansas, Station Casinos and Harrah's were taken private by acquisitions that closed in November 2007 and January 2008, respectively. In these cases, the private equity buy-outs were largely financed by new debt: more than \$17 billion in the case of Harrah's and about \$5.5 billion for Station Casinos. (Including assumed debt, the new owners had debt burdens of about \$24 billion for Harrah's and \$8.8 billion for Station.) Penn National, which was in contract to be taken private in a similar transaction by Fortress Capital and Centerbridge for \$8.9 billion in June 2008, was paid the equivalent of \$1.5 billion to get out of the leveraged buy-out contract after the financial markets had fallen significantly in the first half of 2008.

Prior to 2008, the common belief among financial analysts and gaming industry executives was that the casino industry in general and Las Vegas in particular were recession resilient. Conventional wisdom suggested that if the national economy slowed, or went into recession, the growth of gaming revenues might slow down, but it was almost inconceivable that positive economic growth would not continue. The analysts, gaming industry executives and the financial companies that backed them were all wrong.

Almost all the major American gaming companies have some presence in Las Vegas. Beginning in November 2007, Las Vegas gaming revenues began to experience negative growth over prior year results on a month-to-month comparison, a trend that did not let up for the next two years. Negative growth was moderate at first, but after the financial crisis came into full bloom in September 2008 double digit declines became more common. Gaming revenues in 2009 were about 8% below those of 2008 and more than 20% below gaming revenues in 2007.

Las Vegas, which historically had hotel occupancy rates in the 90-plus percent range, suddenly was confronted with declining visitation numbers, excess hotel room capacity and the dilemma that many major new hotel-casinos were scheduled to open in the next couple of years. Subsequent price cutting for hotel rooms led to dramatic declines in average daily room rates; from 2007 to 2009, occupancy in Las Vegas fell from 90.4% to 81.5%, and average daily room rates fell from \$132 per night to \$93 per night. Convention attendance declined from 6.2 million in 2007 to 4.5 million in 2009.⁴⁷

As a result of heavily leveraged capital investment projects or heavily leveraged private equity buy-outs, almost all the significant casino gaming companies had substantial debt servicing obligations that were supposed to be funded primarily out of cash flow. If the world had not changed so dramatically after 2007, then this strategy may in general have been successful. However, cash flows of the major casino companies were

⁴⁷ Las Vegas Convention and Visitors Authority, LVCVA Executive Summary, January 2010

squeezed not only by lower gaming revenues but also by declining hotel room revenues and convention sales as well as by declining revenues from other sources. Most of the proposals for casino projects under KELA were completed by October 2007, which is the point in time when the financial markets in the United States in general peaked, and share prices for publicly traded gaming companies also reached their maximums. From October 2007 to March 2009, the Standard and Poor's Index had lost 56.1% of its value. But over the same time frame, MGM shares lost 98.0% of its market value, Las Vegas Sands 98.7%, and Wynn 90.6%.⁴⁸ Harrah's and Station, which were no longer publicly traded, saw their bond prices decline just as dramatically. There was, at that time, a strong probability that most of these casino companies would have to declare bankruptcy.⁴⁹

Thus, an observable phenomenon in the Kansas bidding process throughout 2008 was the withdrawal, one by one, of publicly traded companies from consideration. The withdrawals by MGM/Foxwood's, Las Vegas Sands, and Pinnacle probably were driven as much by their weakening balance sheets and cash positions than by the concern over losing out in the competitive process. The Harrah's partnership, which had won a bitterly contested license in South Central Zone, had to walk away from a very attractive monopoly casino license because they could not fund the half-billion dollar project under the prevailing economic conditions. Circumstances had to be extremely dramatic for a company with the development reputation of Harrah's to turn down such a potentially profitable opportunity. Finally, the withdrawal of Golden Gaming from the competition for the Northeastern Zone license in 2009 might have been as much related to the bankruptcy of Station Casinos (and Golden's owners' involvement with the leveraged buy-out in 2007) and the legal challenges filed against that private equity buy-out as by other considerations.

Thus, an observable phenomenon in the Kansas bidding process throughout 2008 was the withdrawal, one by one, of publicly traded companies from consideration.

Conclusion

In retrospect, the state of Kansas was very unfortunate in its timing. KELA was written in a manner that would provide substantial potential economic rents for the state and excess profit opportunity for winning bidders; the competitive bidding process was devised for the state of Kansas to capture a substantial portion of the economic rents for the benefit of the state of Kansas through both revenue enhancement and tourism development. The process was very carefully thought out and well executed. The vulnerability of the bid process to compromise was dealt with in a manner that left most of the outside observers of the process satisfied that it was fair and transparent, even if they disagreed with the outcome.

Of the four licenses offered in 2008, three were unsuccessful.

Nonetheless, of the four licenses offered in 2008, three were unsuccessful. With second efforts by the state of Kansas, by the end of 2009, only one additional license had been granted, in the Northeast Zone. The Dodge City casino did open consistent with its contract in December 2009, and the Southeast Zone project will probably remain unclaimed because of the limited size of the market, the required \$250 million investment, the 27 percent effective tax rate, and the pre-emptive construction and opening of the \$300 million Downstream Casino on the Oklahoma-Kansas state line. The only bidder in the South Central Zone at the end of 2009 was still attempting to win its bid, but at a severely reduced scale, proposing an initial investment of \$125 million with additional required investment

⁴⁸ By the end of 2009, share values for these companies recovered from their March 2009 lows, but remained far below their historic highs in 2007.

⁴⁹ From March through the end of 2009, financial conditions for many gaming companies had improved considerably, though bankruptcies were declared by Station Casinos, Trump Entertainment, Tropicana Resorts, and Terrible Herbst, as well as by various other casino companies in the United States. Furthermore, other gaming organizations, such as Foxwood's, were experiencing severe financial challenges by the end of 2009 which were probably apparent within the organization by early to mid 2008.

spread over the 15 years of the contract. In the Northeast Zone, the 2009 Kansas Entertainment consortium of International Speedway and Penn National committed to a project of roughly half the capital investment in their Phase 1 proposal (\$362 million compared to \$681 million in 2008) and did not commit to building hotel rooms.

Thus, in spite of a reasonable law and a substantial process built around principles of transparency and integrity, the state of Kansas was largely a victim of poor timing.

Thus, in spite of a reasonable law and a substantial process built around principles of transparency and integrity, the state of Kansas was largely a victim of poor timing. Nonetheless, as has been demonstrated in this analysis, the general mandates of the law are likely to have been fulfilled in three of the four zones in the next few years. How well the Lottery owned casinos will perform in the long term remains to be seen, but the procedures followed in implementing the law provide a useful template for other jurisdictions still seeking to introduce casinos as part of a broader economic strategy.

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