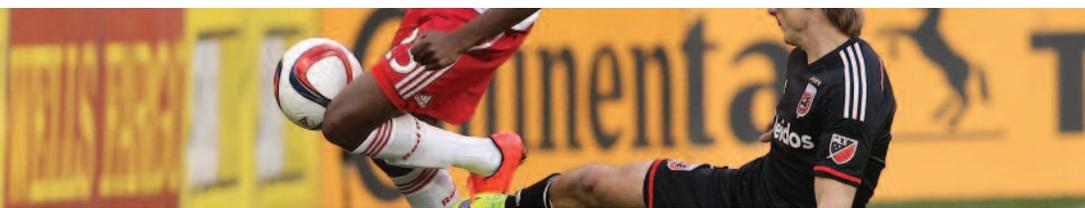


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The Future of Sports Betting in the United States

By Andrew Klebanow and John English

As the nation awaits the upcoming decision by the Supreme Court of the United States (SCOTUS) in *Christie v. NCAA*, various stakeholders are evaluating their next steps, and how to maximize the revenue potential from legalized sports betting.

Today, a federal law known as the Professional and Amateur Sports Protection Act (PASPA) limits most legal sports betting to Nevada and three other states. This article examines the critical success factors for sports wagering in the United States and the operators that will be best positioned to provide the products and services that sports wagering customers will seek.

At the outset, it must be stated that sports wagering is already widely available throughout the United States, within and outside of the four states that are currently allowed to offer some versions of sports betting. The vast majority of sports betting in the U.S. is handled by illegal sports book operators. They provide their customers with convenient forms of betting along with trusted relationships, short-term credit, favorable odds, rebates, VIP benefits, and convenient methodologies to place bets.

For any legal sports book operator to succeed against this entrenched competition, they must provide the right product at the right price and deliver that product through efficient channels of distribution so that sports betting is convenient and offers a high degree of entertainment value.

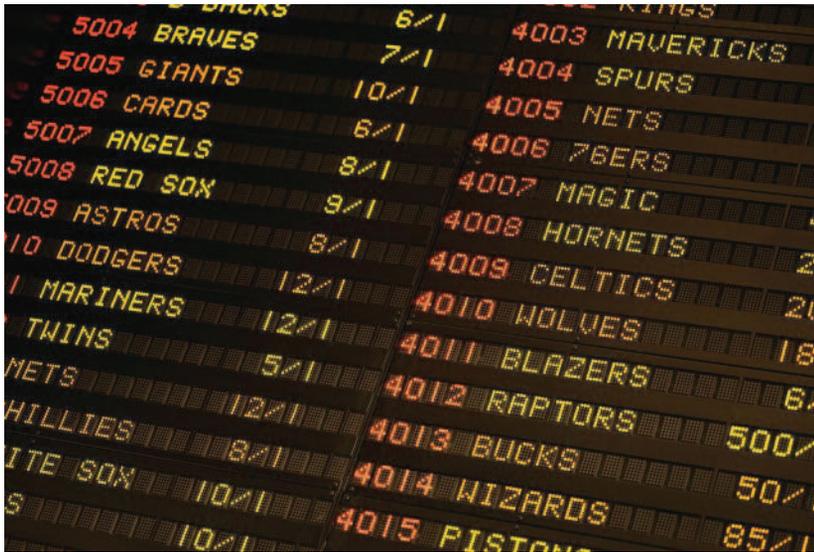
Price

As with any product or service, price is a critical success factor. In sports betting, price is comprised of a number of components. The most obvious are the odds that a sports book places on a game and the event's outcome. Bookmakers rely on a network of disseminators to provide basic information on point spreads and game/event outcomes.

These odds are often calculated with algorithms that take into account a number of variables such as weather, past performance, and team/athlete strengths. More seasoned bookmakers rely on qualitative and quantitative information, often by employing observers at team practice facilities. They look at possible injuries, off-the-field player behavior, and other factors that might affect performance. Finally, they watch the movement of money bet on a game. Human factors still play a significant role in the decision-making process.

What bookmakers today are not concerned with, with the exception of those licensed sports book operators in Nevada, is taxation. Taxation impacts price for legal sports book operators because it is a cost of doing business.

Nevada's licensed bookmakers are fortunate in that they have a reasonable tax rate of 6.75 percent of gross win, along with a federal tax on wagering handle of 0.25 percent. Those costs must be factored into the price of the



Anticipating PASPA's repeal, a handful of states have started the process by passing enabling legislation. **Pennsylvania is one notable example.** Unfortunately, the tax rate that state legislators set on sports betting revenue, currently at **34 percent**, will require operators to offer odds that are significantly less generous than what illegal bookmakers can offer.

product. Illegal bookmakers have considerable advantages, as they do not have to concern themselves with taxes, required reserve accounts, or regulations. Nevertheless, they may have other costs, such as customer acquisition expenses, and the payment of royalties to criminal elements for market exclusivity, licensing or protection.

As legislators look at sports betting as a new source of revenue, they must be cognizant that to compete with illegal bookmakers, tax rates must be fair and reasonable. Also, user-friendly technologies such as mobile phones, kiosks and online offerings will make a major difference in each state's considerations.

It is very important to note that convenience will need to be a key consideration to engage and retain customers. If not, each state's chosen operators will be unable to offer sports betting products at a price and convenience that will divert bettors from illegal bookmakers.

Product

The products are the kinds of wagers that an operator can offer and features that are unique to that operator. Among states that offer sports betting today, only Nevada offers straight bets, futures bets, a wide variety of parlay bets, wagers on all major professional sports, collegiate sports, boxing, and other major sporting events. Oregon and Delaware's products are limited to parlay cards on professional football. Illegal bookmakers will take bets on any sporting event that customers have sufficient interest in.

Any state that fails to permit a full suite of sports betting options limits the kinds of products that operators can sell to their customers. Failure to provide a full range of betting options will not disrupt the current relationship bettors have with illegal bookmakers. Rather, it will allow those bookmakers to maintain their current share of the nation's sports betting market.

Channels of Distribution

Channels of distribution refers to the places consumers can purchase their products. The more places that a bettor has to place a bet, and the more convenient the act of placing bets is, the greater the revenue potential for sports betting.

In Nevada, bettors can place bets at point-of-sale terminals in licensed

casinos and at kiosks. Some casino operators and licensed sports book providers have developed mobile betting applications where players can place wagers on their mobile devices. This process requires bettors to first open up an account at their favored casino or sports book and place money on deposit. Once their account has been approved and funded, they can then place bets on their phone from any location within the state of Nevada.

These apps rely on geo-fencing and know-your-customer procedures to prevent wagers from being placed outside of state boundaries. Should a player extinguish his funds, he must return to the casino (or a kiosk at a tavern) to recharge the account.

Again, illegal bookmakers currently have an advantage over licensed Nevada operators. They offer credit, where customers can settle up their accounts on a weekly basis. Illegal bookmakers even offer mobile apps where customers can place bets. Since illegal bookmakers are located within neighborhoods where players reside, they also offer convenience, allowing customers to place bets, collect winnings and settle up debts.

The Landscape in 2018

New Jersey Governor Chris Christie predicted that, should SCOTUS determine that PASPA is indeed invalid, Atlantic City's casinos will have sports books operational within two weeks after the decision.

While this timeline appears aggressive, one can expect New Jersey's seven casinos and three racetracks to begin taking sports bets in fairly short order. William Hill, a European provider that operates in Nevada, has already entered into a strategic partnership with Monmouth Park Raceway, and their terminals are expected to be operational shortly after the state of New Jersey gives the green light to commence sports wagering.

Anticipating PASPA's repeal, a handful of states have started the process by passing enabling legislation. Pennsylvania is one notable example. Unfortunately, the tax rate that state legislators set on sports betting revenue, currently at 34 percent, will require operators to offer odds that are significantly less generous than what illegal bookmakers can offer. Furthermore, given the prohibitive costs of licensing, the number of operators in the state will be limited, making sports betting inconvenient for those who do not reside near a casino.

Residents of nations in Europe have long enjoyed sports betting, and sports book providers have developed myriad products and services to satisfy consumer demand. For example, sports bettors can use their mobile devices to place wagers while observing sporting events.

To be successful, states will have to balance their needs for tax revenue with a tax environment that allows operators to provide wagering products that are appealing to sports bettors.

The Future of Sports Betting

As state governments and operators await SCOTUS' decision, it is important to look at the potential providers of sports betting, along with their strengths and weaknesses:

Land-Based and Riverboat Casinos

Commercial casino operators of land-based, barge and riverboat casinos are all anxiously awaiting the SCOTUS decision, and are poised to add sports book wagering once their respective state legislatures provide authorization. Some of the larger casino operators such as Caesars, MGM and Penn National, along with several others, are positioned to begin taking bets immediately, provided regulations are in place, and they have the infrastructure to expand their operations rapidly.

State Lotteries

State lotteries are uniquely positioned to offer sports betting, and lottery providers can quickly enhance their IT infrastructure to process sports betting transactions. With thousands of retail outlets, state lotteries will be able to provide convenient venues where sports bettors can place wagers.

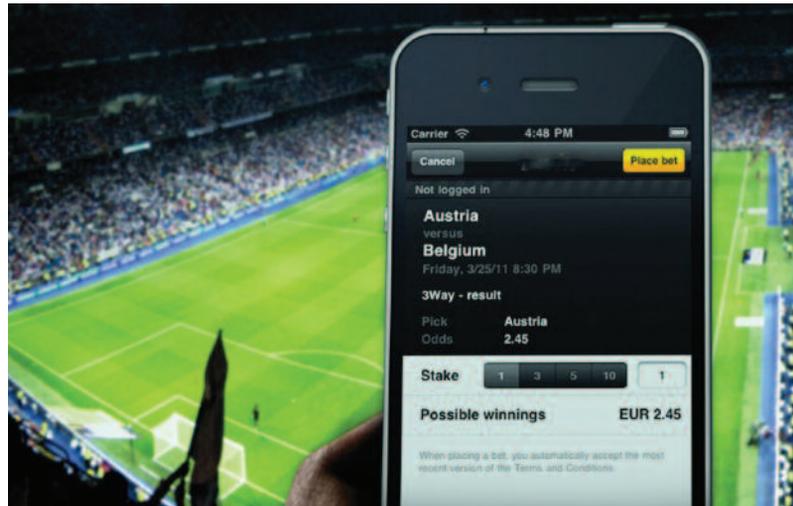
Lottery systems can be modified to handle these kinds of bets, with bettors filling out wagering slips much like they do when placing a lotto bet. The challenge will be for lotteries to provide the wagering options and odds that are competitive with illegal sports betting operators. Lotteries, accustomed to providing stingy odds in their lottery products, will be hard pressed to change their culture and create a system that employs a certain degree of risk.

Their business models rely on betting programs that maximize revenue to the state with no risk. Both legal sports betting operators in Nevada and illegal bookmakers accept a certain amount of risk when pricing their products. For them, it is a small-margin, high-risk business. Nevertheless, a lottery that offers casual sports bettors the option of playing parlay cards at convenient locations throughout the state is a compelling reason for states to look at this distribution model.

Racetracks

Racetrack operators continue to be a formidable political force in several states, particularly in Texas and Kentucky. They will lobby for the exclusive right to offer sports wagering, and are uniquely suited for the task. Tracks and parimutuel facilities already have facilities with ample seating, video displays, IT infrastructure and employees that know how to conduct wagering transactions. Racetracks are also eager to attract a younger demographic, and sports betting will help them achieve that goal.

The problem is that racetracks offer limited channels of distribution,



since there are only a few outlets in each state where parimutuel wagering takes place.

Currently New Jersey, Nevada and Delaware have adopted alternative pay methods such as Pay Near Me, which allows customers to deposit cash at a convenience store and top off their accounts. To date, successful applications from TVG and Churchill Downs have dominated in the horse-racing sector with thousands of daily users, betting with real money. If PASPA is repealed, expect to see an explosion in sports betting technology.

European Sports Book Providers

Residents of nations in Europe have long enjoyed sports betting, and sports book providers have developed myriad products and services to satisfy consumer demand. For example, sports bettors can use their mobile devices to place wagers while observing sporting events. They can choose from a steady stream of betting propositions as the game progresses.

European providers have developed technologies, regulatory framework and infrastructure that can easily be exported to the United States. European companies such as William Hill already provide a comprehensive sports wagering solution in Nevada, and are prepared to bring their systems and technology to New Jersey. Other European providers offer comparable products and solutions, and are poised to introduce them in U.S. states. In many European jurisdictions, multiple providers compete within the same market, which forces them to create ever more compelling gaming products.

Taverns and VLT Facilities

A growing number of states, such as Illinois, Montana, Oregon and Nevada, offer slot machines and video lottery terminals in taverns. Taverns offer an attractive option for some states. Taverns are age-restricted and offer fairly robust channels of distribution. Customers need not travel far to place wagers or reload their accounts. Many taverns in Nevada feature kiosks, where patrons can place bets or recharge their accounts.

Tribal Casinos

Tribal casinos face a number of obstacles, not the least of which are revisions to their compacts. Each tribe is obligated to negotiate a compact with the governor of the state in which its casino(s) are located, and any new game must also be negotiated. Some governors may take these negotiations as an opportunity to renegotiate their revenue-sharing and exclusivity agreements. Once negotiations are complete, each tribe's gaming regulatory authority will then have to establish rules, policies and procedures for the conduct of sports wagering.

Like other land-based and barge casinos, Indian casinos will face similar challenges in their ability to reach customers who wish to wager remotely or live too far away to conveniently place a bet.

The Next Step

Ultimately, each state must balance the needs of all stakeholders, including the sports betting public, commercial casino operators, tribes, racetrack operators and lottery providers, against their needs for tax revenue. Failure to address these competing interests will result in a legal sports betting environment that fails to meet consumer demand, fails to optimize tax revenue, and fails to create sports betting products that move market share from illegal sports betting operators.

The Pennsylvania model, which proposes onerously high tax rates and limited channels of distribution, will most probably fail to meet the state's goals of enhanced tax revenue. The Nevada model, which provides a reasonable tax rate, multiple channels of distribution, attractive betting odds, and environments throughout the state where sports bettors can place wagers and enjoy their favored games, has proven to be successful, and is one that other states should examine more closely.

State legislators are advised to not simply rush out and select the sports betting solution that would appear to generate the most tax revenue. As may soon be revealed in Pennsylvania, 34 percent of nothing comes out to nothing.

Andrew Klebanow and John English are partners in Global Market Advisors, a leading consulting firm in the gaming industry.



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