

38 Studios: Broke Rhode Island now owns a video game company

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Former Boston Red Sox star pitcher Curt Schilling founded 38 Studios to bring jobs for skilled professionals to a state struggling to expand its workforce.

NEW YORK (CNMONEY) -- Rhode Island owns a video game company. That wasn't supposed to happen.

Taxpayers in the small, financially stricken New England state are on the hook for tens of millions of dollars loaned out to the video game company **38 Studios**. Founded by former Boston Red Sox star pitcher Curt Schilling, the company was supposed to bring jobs for skilled professionals to a state struggling to expand its workforce. But on Thursday, 38 Studios laid off its entire staff of roughly 400 employees with no pay. It also cancelled their health insurance.

For a lack of a better description, 38 Studios went out of business. Now Rhode Island is stuck with the tab of roughly \$112 million in loan principal, interest and fees. There's little chance taxpayers will make up even a quarter of their potential losses, according to industry experts.

The story of 38 Studios has everything: sports stars, political incompetence, government bailouts, taxpayer outrage and -- the kicker -- big-budget video games.

The storm began nearly two years ago, when the Rhode Island Economic Development Corporation, under political pressure from former Republican Governor Donald Carcieri, gave 38 Studios \$75 million in loan guarantees as an incentive to relocate from Massachusetts to Rhode Island.

The goal was noble: **Rhode Island suffers from the second-highest unemployment rate in the nation** -- 11.2% -- and **has struggled to attract companies**, which often prefer its northern

neighbor Massachusetts. The pitch to politicians and taxpayers was that a big video game venture would help catalyze a local technology hub.

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But the deal was flawed from the start, experts say.

38 Studios was barely three years old and hadn't shipped a single product. Further, 38 Studios' big project was the development of what's known as a "massive-multiplayer online role playing game," better known as a MMORPG. That's an extremely expensive genre with a very mixed track record of financial success.

"I think Rhode Island was star-struck by Curt Schilling," says Alexander Sliwinski, news editor for the video game site Joystiq. "You didn't see Rhode Island give Harmonix, Irrational, Turbine -- all companies with established track records -- \$75 million to move."

The loan was not popular with taxpayers. A poll done in September 2010 by CBS affiliate WPRI-TV found 54% of Rhode Islanders opposed the loan, versus 28% in favor. All candidates in the 2010 governor's election publicly opposed the deal, including current Governor Lincoln Chafee.

It didn't make a difference. "38 Studios had the support of the people who mattered," says Ted Nesi, reporter for WPRI.

38 Studios took the money and moved to Rhode Island in 2011, releasing its first game -- *Kingdom of Amalur: Reckoning* -- in February 2012. For a brand-new series, the game sold reasonably well: 400,000 units in the first month. Schilling later said the game went on to sell 1.2 million units since launch.

But the release of *Reckoning* was not enough to keep 38 Studios afloat. The company's main MMORPG project, known as *Project Copernicus*, was more than a year away from release. Gov. Chafee said in a press conference this week that 38 Studios was burning through roughly \$4 million a month in cash just to keep up with Copernicus' development.

38 Studios' troubles became public two weeks ago, when the company failed to make a \$1.125 million interest payment, causing it to default on its government-backed loan. Chafee called an emergency meeting of the Rhode Island Economic Development Corporation, his office and 38 Studios with the goal of "keeping 38 studios solvent."

38 Studios eventually did make the \$1.125 million payment -- but at the cost of making its payroll. Its staff hasn't been paid since May 1. Two weeks later, 38 Studios was out of business. The workers that Rhode Island spent millions to attract are now unemployed.

"The whole idea was flawed from the start," says Kevin Dent, a 14-year veteran of the industry who funds start-up video game companies.

"MMOs are the third rail of the industry. Even established publishers get into trouble with MMOs," he says. "The latest good product, *Star Wars: The Old Republic*, Electronic Arts spent \$200 million to develop plus \$80 million for post-launch content and support. Then they spent

\$50 million on marketing. You cannot make a MMO for \$75 million. Rhode Island didn't do their due diligence."

Nearly all of the Rhode Island Economic Development Corporation's board of directors have resigned or asked not to be reinstated when their terms end.

Rhode Island now effectively owns all of 38 Studios' intellectual property and the rights to *Kingdom of Amalur: Reckoning* and *Project Copernicus*. Dent expects Rhode Island to try to sell the assets to a major publisher -- most likely Electronic Arts (**EA**), since they were 38 Studios' publisher for *Reckoning*.

Financial analyst Michael Pachter, with Wedbush Morgan Securities, thinks 38 Studios might be worth \$20 million now. However, an out-of-business shell with a half-finished game and no employees isn't going to price well on the market, Dent says.

"[Rhode Island] should have gotten an injunction against 38 Studios from making any material decisions like laying off employees," Dent says. "You could have put together a tax credit package for 38 Studios employees. You need these creative people to make 38 Studios worth anything."

The political fallout from the 38 Studios debacle is likely to be felt throughout the industry, Dent and Sliwinski predict. The video game industry has relied on tax credit packages in return for setting up shop in certain states. Rhode Island, and the millions of dollars it is now owed, will be fresh in politicians' minds when these tax credits come up for renewal over the coming years.

"The industry is going to have to work hard now to show that Rhode Island's problems are not the norm in the industry, but a freak anomaly," Sliwinski says. ■

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