PRATT'S JOURNAL OF BANKRUPTCY LAW

VOLUME 6 NUMBER 4 JUNE 2010

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207,

ISSN 1931-6992

Dealing with Troubled Tribal Casinos

MICHAEL M. EIDELMAN, TERENCE M. DUNLEAVY, AND STEPHANIE K. HOR-CHEN

In light of the general economic downturn and corresponding rise in tribal casino defaults, numerous issues concerning the procedures available for seeking recourse against troubled tribal entities are now coming into focus. The authors of this article discuss this timely, important topic.

Over the last decade, investors and lenders have provided tribal casinos with billions in equity and loans. Clearly, these investments and loans were not considered to be a gamble; typically, these casinos have clear geographic locations from which to pull in gamblers, and they have demonstrated a track record of success and substantiated their business model.

In light of the general economic downturn and corresponding rise in tribal casino defaults, numerous issues concerning the procedures available for seeking recourse against troubled tribal entities are now coming into focus. Absent compliance with regulatory procedures at the "front end" of the transaction, creditors of troubled tribal casinos and other tribal entities may lack authorization to foreclose on tribal assets or seize the casino business due to the status of such tribal entities as sovereign nations. For the same

Michael M. Eidelman is a shareholder at Vedder Price P.C., and a member of the firm's Corporate Practice Area, concentrating his practice in bankruptcy and insolvency matters. Terence M. Dunleavy is a shareholder at the firm focusing his practice on gaming law, tribal law, gaming regulatory matters, and government relations. Stephanie K. Hor-Chen is an associate at the firm. The authors may be contacted at meidelman@vedderprice.com, tdunleavy@vedderprice.com, and schen@vedderprice.com, respectively.

Published in the June 2010 issue of *Pratt's Journal of Bankruptcy Law.*

reason, it is unclear how, if at all, non-tribal (*i.e.*, federal and state) laws apply to tribal entities. This leaves creditors of troubled tribal casinos in uncharted territory, with limited recourse, and this may affect the ability of tribal entities to secure financing for future projects.

TRIBAL SOVEREIGNTY LIMITS RECOURSE AVAILABLE TO CREDITORS OF TROUBLED TRIBAL ENTITIES AND CASINOS

In a typical commercial transaction, creditors of a defaulting or troubled entity may seek recourse against such entity in a number of ways, including, for example, by foreclosing on the defaulting entity's assets or placing the defaulting entity into a receivership or bankruptcy. In these situations, the operative agreements between the lender and borrower control. Additionally, the lender may have other rights under the Uniform Commercial Code, or other state and federal law. On the other hand, the sovereign status of tribal nations and their lands limits the ability of non-tribal creditors to recover from troubled tribal casinos, especially once funds have been distributed to the tribal casino, notwithstanding the remedies available to the lender at the closing of the transaction.

Sovereign Immunity

As a sovereign entity, a tribal entity (including tribal casinos) may be sued only where Congress has authorized the suit or such tribal entity has waived its immunity.[1] Lack of legal precedence regarding waivers of tribal sovereign immunity has created much uncertainty as to the efficacy of such waivers of sovereign immunity. Indeed, as discussed below, a waiver of sovereign immunity may ultimately be meaningless in cases where the agreement containing such waiver is subsequently determined to be void.

Uncertainty Regarding Applicability of Federal Bankruptcy Laws

There also exists much uncertainty as to how, if at all, federal bankruptcy laws apply to tribal entities. No tribal entity has tested the federal bankruptcy laws; however, many legal experts believe that tribal entities,

as sovereign nations, would likely be precluded from seeking relief under the federal bankruptcy laws.

Uncertainty Regarding Applicability of Non-Tribal (*i.e.*, State and Federal) Laws

Tribal land and the tribal businesses conducted thereon, including tribal casinos, may not be sold, taxed or encumbered. Indeed, federal and tribal regulations require that tribal entities retain the sole proprietary interest in the tribal casino. As a result, tribal casinos may not agree to a debt-for-equity swap, and may not raise cash by selling off tribal land or assets to repay creditors. By the same token, tribal and non-tribal regulations prohibit creditors from taking over casino operations or foreclosing on tribal land or tribal assets located thereon.

IGRA Regulations

The recourse available to creditors of troubled tribal casinos is also limited by provisions of the Indian Gaming Regulation Act ("IGRA").[2] For example, creditors of troubled tribal casinos are prohibited from retaining all distributions[3] from tribal casino operations upon a default because the IGRA requires that at least a portion of the cash flow from gaming operations be used to support tribal government operations. Specifically, Section 2710((b)(2) of the IGRA provides, among other things, that in order to be approved by the Chairman of the National Indian Gaming Commission (the "NIGC"), tribal ordinances or resolutions authorizing gaming on tribal lands must provide that: (A) the tribe has the sole proprietary interest and responsibility for the conduct of any gaming activity, and (B) net revenues from tribal gaming will be used solely "(i) to fund tribal government operations or programs; (ii) to provide for the general welfare of the Indian tribe and its members; (iii) to promote tribal economic development; (iv) to donate to charitable organizations, or (v) to help fund operations of local government agencies…."[4]

Creditors of troubled tribal casinos are also prohibited from seizing the operations of tribal casinos unless such creditor has obtained a license,

pursuant to the provisions of IGRA, to operate the tribal casino.[5]

Similarly, creditors of troubled tribal casinos must be cautious in taking any actions that might amount to "management" of such casinos, even if such actions are permitted by agreement of the parties, unless such agreement has been approved by the NIGC Chairman.[6] As discussed below, creditors seeking to "manage" operations of a tribal casino, upon default or otherwise, may ultimately find themselves with no remedies if their agreement(s) with the Tribe are subsequently determined to be unapproved management contracts.

LAKE OF THE TORCHES CASE

The difficulties and limitations encountered by lenders and other creditors of troubled tribal casinos may be amplified in light of the United States District Court for the Western District of Wisconsin's (the "district court") recent opinion in *Wells Fargo Bank, N.A. v. Lake of the Torches Economic Development Corporation*[7] ("*Lake of the Torches*" or the "lawsuit"). The Lac du Flambeau Band of Lake Superior Chippewa Indians (the "Tribe"), a federally recognized tribe organized under Section 16 of the Indian Reorganization Act of 1934, 25 U.S.C. § 461 *et seq*., chartered the Lake of the Torches Economic Development Corporation (the "Corporation" or "EDC") for purposes of owning and operating the Lake of the Torches Resort Casino (the "Casino").

On or about January 1, 2008, the Corporation issued $50 million in bonds and entered into a Trust Indenture with Wells Fargo Bank, N.A. ("Wells Fargo") as the Trustee. Saybrook Capital LLC ("Saybrook") was the sole holder of bonds under the Trust Indenture. While neither the Trust Indenture nor any related documents were submitted to the National Indian Gaming Commission for approval prior to their execution, the Corporation's counsel issued a letter opining that such documents were neither a "management contract" nor an agreement that is a "collateral agreement" to a management contract.

The security provided for the bonds included, among other things, all of the Corporation's right, title and interest in the gross revenues of the Corporation, investment earnings on the gross revenues of the Corpora-

tion, the Casino's equipment, and "[a]ll right, title, and interest in and to the Corporation's accounts, deposit accounts, general intangibles, chattel paper, instruments and investment property and the proceedings of each of the foregoing and all books, records and files relating to all or any portion of the Pledged Revenues." As the Trustee, Wells Fargo was obligated to enforce the rights of Saybrook, as the bondholder, in the event of a default or a breach of the Trustee Indenture.

On November 30, 2009, the treasurer and vice president of the Tribe, acting on behalf of the Corporation, requested that $4,750,000 be transferred from the Corporation's Operating Reserve Account to the Corporation's Master Account. Saybrook subsequently sent a letter to the Corporation and the Tribe questioning the purpose of the transfer, and Wells Fargo requested documentation underlying the funds transfer. After allegedly failing to receive a substantive response to its requests, Wells Fargo notified the Corporation that the principal and interest of the bonds were immediately due. Thereafter, Wells Fargo filed the lawsuit, alleging breaches of the Trust Indenture, and sought the appointment of a receiver.

The district court denied the motion to appoint a receiver and dismissed the lawsuit on the grounds that the Trust Indenture was a "management contract" that lacked the approval of the NIGC Chairman. Pursuant to Section 2711 of IGRA, tribes may enter into contracts for the management of gaming operations only with the approval of the NIGC Chairman. A "management contract" is defined in the IGRA regulations as "any contract, subcontract, or collateral agreement between an Indian tribe and a contractor or between a contractor and a subcontractor if such contract or agreement provides for the management of all or part of a gaming operation."[8] The district court further noted that, based on the regulations, a "necessary condition for a management contract is that it grant to a party other than the tribe some authority with regard to a gaming operation."[9] The district court subsequently determined that the Trust Indenture was a management contract due to the following provisions:

- The Trust Indenture limited the right of the Corporation to incur capital expenditures in excess of 25 percent of the prior fiscal year's capital expenditures without the written consent of at least 51 percent of the bondholders;

- The Trust Indenture provided for the appointment of a "Management Consultant" at the direction of the majority of the bondholders if the "Debt Service Ration" fell below a certain level;
- The Trust Indenture provided that the Corporation could not replace or remove the Casino's general manager, controller, or chairman or executive director of the Gaming Commission without the written consent of at least 51 percent of the bondholders;
- In an Event of Default, the majority of the bondholders had the right to require the Corporation to hire new management, who were all subject to the bondholder's consent; and
- In an Event of Default, Wells Fargo has the right to appoint a receiver of the assets pledged by the Corporation to secure the bonds, including all revenues, equipment, and accounts of the Casino, and of the revenues, issues, payments and profits of the foregoing.

The district court determined that the foregoing provisions, collectively and individually, gave non-tribal parties the authority to exert significant control over the management operations of the Casino. The district court indicated that "it ha[d] no choice but to conclude that the Trust Indenture is a 'management contract' even though many of the foregoing provisions are contingent because 'the regulations' definition of a management contract as an agreement that provides for the management of 'all or part' of a gaming operation suggests a definition of management that is partial rather than absolute, contingent rather than comprehensive."[10] The district court then determined that the Trust Indenture was void because it lacked the approval of the NIGC Chairman.[11]

Additionally, the district court determined that it lacked jurisdiction over the Corporation because, in the absence of a clear waiver, the lawsuit was barred by the Tribe's and the Corporation's sovereign immunity. While the Trust Indenture contained a provision whereby the Corporation expressly waived its sovereign immunity with respect to suits to enforce the Corporation's obligations under the Trust Indenture and related documents, the district court found, without expressly determining whether the waiver provision in the Trust Indenture was invalid by virtue of the fact

that the entire Trust Indenture was void *ab initio*, that "[e]ven if the waiver provision could be saved, the remainder of the Trust Indenture is void, so there would be no remaining obligations to enforce under the contract."

The district court also declined to accept Wells Fargo's argument that the Corporation should be estopped from arguing that the Trust Indenture is invalid because the Corporation failed to exhaust its administrative remedies. Specifically, the district court stated as follows:

> Given the size of the transaction and the complicated nature of the regulatory scheme, it is a bit surprising that Wells Fargo did not insist upon NIGC review and approval. "Because the regulatory landscape appears uncertain to the untrained observer and because transactional attorneys seek to minimize risk and uncertainty, it is common for parties to obtain NIGC review of transactional documents for the finance of Indian gaming operations, even when the parties assert that the financing arrangement does not constitute a management contract."[12]

LESSONS LEARNED IN LIGHT OF *LAKE OF THE TORCHES*

While it is unclear whether other courts will adopt the district court's analysis and position, *Lake of the Torches* presents several issues lenders, bondholders, indenture trustees, and other non-tribal entities should consider prior to entering into financing agreements with tribes and tribal entities.

Obtaining Prior Approval of NIGC Chairman

The most important lesson that arises from *Lake of the Torches* is the importance of obtaining approval of the NIGC Chairman with respect to any agreements that contain provisions that may be potentially construed as providing non-tribal entities with the right to manage all or a part of tribal gaming operations. While, in practice, parties may rely on letters of counsel opining on whether certain agreements are management agreements, it is clear that the district court gave little, if any, weight to the fact that counsel for the Corporation had issued a letter opining that the Trust Indenture and the related documents were not management agreements.

Limited Provisions Providing for the Control or Management of Casino Operations by non-Tribal Entities

In those circumstances in which NIGC approval of financing agreements prior to execution is not possible, it is important to review such agreements to ensure that relevant provisions, including default provisions, do not provide non-tribal entities with the right to control or manage any aspect of casino operations.

Limited Applicability of Waiver Provision Where Agreement Is Void

Another lesson that arises from *Lake of the Torches* concerns tribal waivers of sovereign immunity. In *Lake of the Torches*, the Trust Indenture contained a provision whereby the Corporation "expressly waived" its sovereign immunity. As discussed above, the district court found that even if such waiver provision survived, because the Trust Indenture itself was void, there were no obligations for Wells Fargo to enforce under the Trust Indenture. In other words, regardless of whether an agreement contains a waiver provision, if the agreement itself is void, any existing waiver provision may be meaningless because there are no enforceable obligations.

MOTION TO AMEND AND ALTER—AMENDED COMPLAINT

On February 8, 2010, Wells Fargo filed a Motion to Alter or Amend the court's January 6, 2010 Order and for leave to file an amended complaint. On April 23, 2010, the court issued an Order and Decision denying Wells Fargo's motions and thereby reaffirming its earlier determination that the Trust Indenture constitutes an illegal management contract.[13]

In its Motions, Wells Fargo argued that the court committed error when it found that the Trust Indenture was a management contract and, therefore, null and void because NIGC approval was not obtained. Wells Fargo argued that the primary purpose of the Trust Indenture was repayment of the Bonds—not the management of the Tribe's casino—and therefore severance of the provisions of the Trust Indenture that the court found to be trou-

bling "management provisions" would be appropriate. However, the court rejected Wells Fargo's contention, reasoning that, even if the management provisions could be severed, the remainder of the Trust Indenture would nevertheless be null and void because the entire document constituted an unapproved management contract, leaving nothing left to enforce.

Interestingly, the provisions that Wells Fargo sought to enforce—those governing "Event of Default," which included the appointment of a receiver—were among the clauses that the court found to be "purely" management provisions.

In addition to its Motion to Alter or Amend the judgment, Wells Fargo also sought to file an Amended Complaint, to expand the allegations of wrongdoing on the part of the Tribe to include claims brought pursuant to all the commercial documents associated with the bond transaction—including the Bonds themselves. The court indicated that the Bonds contained a provision that ostensibly waived the EDC's sovereign immunity. Wells Fargo argued that the Bonds and related transaction documents were not void, even if the Indenture was, because they were merely "collateral agreements" to the Trust Indenture. The court rejected Wells Fargo's arguments, finding that its determination that the Trust Indenture is a management contract required that the entire transaction (which includes those documents Wells Fargo identified as "collateral agreements") was subject to the NIGC management contract approval process. As a result, the court concluded the parties should have submitted all the documents to the NIGC for review, and their "failure to procure NIGC approval in the first instance renders all the collateral agreements void *ab initio*."

The court also concluded that, because the Bonds and the Trust Indenture are highly interconnected, it was "hard to imagine" one existing without the other. In fact, the court noted that the Bonds incorporated the terms of the Trust Indenture by reference. Accordingly, the court concluded that the Bonds and the Trust Indenture together reflected the parties' intention for a trustee to exert managerial control over the gaming operation in the event that the EDC defaulted.

Lastly, the court found that, by virtue of the conclusion that the Trust Indenture is an unapproved management contract, this finding also effectively terminates the court's jurisdiction over the defendants. In general, in

the absence of a clear waiver, suits against tribes (and tribal business organizations) are barred by the principal of sovereign immunity. The court's finding that the Trust Indenture is an unapproved management contract negates the court's jurisdiction over the defendants. The Trust Indenture contains a waiver provision, whereby the Corporation "expressly waives its sovereign immunity" in relation to "a suit to enforce the obligations of the Corporation under the Indenture, the Bond Resolution, the Security Agreement, or Bond Purchase Agreement."[14] However, the entire contract is void *ab initio*, so the waiver in the Trust Indenture is also invalid.

In a press release following the Order, Lac du Flambeau Tribal President Jerome "Brooks" Big John stated, "this significant victory confirms the strength of the Tribe's legal position and provides the [Tribe] with further confidence in the Tribe's ability to manage tribal operations in support of the tribal membership."

On April 30, 2010, Wells Fargo filed a notice that it would appeal the *Lake of the Torches* decision.

NOTES

[1] *Kiowa Tribe of Oklahoma v. Mfg. Technologies, Inc.*, 523 U.S. 751, 754, 118 S. Ct. 1700, 1702 (1998).

[2] 25 U.S.C. § 2701 *et seq*.

[3] Pursuant to Section 2711(c) of the IGRA, "a management contract providing for a fee based upon a percentage of net revenues of tribal gaming activity if the Chairman determines that such percentage fee is reasonable in light of surrounding circumstances." 25 U.S.C. § 2711(c)(1).

[4] 25 U.S.C. § 2710(b)(2).

[5] *See* 25 U.S.C. § 2710(b).

[6] *See, e.g.,* 25 U.S.C. § 2711 (requiring that management contracts be approved by the NIGC Chairman).

[7] *Wells Fargo Bank, N.A. v. Lake of the Torches Economic Development Corporation*, Case No. 09-CV-768, 2010 WL 62638 (E.D. Wis. 2010).

[8] 25 C.F.R. § 502.15.

[9] *Lake of the Torches, supra* note 7 at *3 (citing *Machal, Inc. v. Jena Bank of Choctaw Indians*, 387 F. Supp. 2d 659, 665 (W.D. La. 2005).

[10] *Id.* at *5 (citing *First Am. Kickapoo Operations, L.L.C. v. Multimedia*

Games, Inc., 412 F.3d 1166, 1175 (10th Cir. 2005)).

[11] *Id.* at *3 (citing *First Am. Kickapoo*, 412 F.3d at 1176) (noting that management contracts lacking the approval of the NIGC Chairman are void).

[12] *Id*. at *6.

[13] *Wells Fargo*, No. 09-CV-768 (W.D. WI April 23, 2010) (Order and Decision).

[14] Trust Indenture § 13.02.