# A WHOLE NEW BALLGAME

## Why tribal casino restructurings are changing quickly

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No one ever thought the gaming industry would run into trouble. The restrictions on commercial licenses to a dozen states and the limitations in many others to tribal lands led to almost 100 years of consistent revenue growth, in good times or bad. It seemed as though the demand for gaming would forever outstrip supply, and whenever anyone believes that the good times can never come to an end, unexpected challenges can ensue.

This unbridled optimism about gaming's future led to unprecedented levels of debt being raised in both commercial and tribal gaming. Yet as the recession hit the industry and for the first time ever revenues failed to meet expectations, lenders and casino owners were forced to work, either collaboratively or legally, to restructure and resolve financial issues. As these issues make their way to Indian Country, it has become clear that, as in many aspects of casino operations, the methods used by commercial casinos are different than those for tribal casinos.

In this article, three disparate experts—a financial consultant who specializes in casino restructurings, a gaming operator who has improved the operating performance of dozens of distressed properties, and an attorney who specializes in tribal gaming law—have come together to lay out a comprehensive guide to what makes tribal restructurings different, and a game plan for how to proceed.

## THE COURTS ARE NOT THE ANSWER

Absent compliance with tribal and federal regulatory procedures at the "front end" of the transaction, creditors of troubled tribal casinos and other tribal entities may lack the ability to work out the loan or investment at the "back end" of the transaction. For the same 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 may affect the ability of tribal entities to secure financing for future projects.

In a typical commercial transaction, secured creditors of a defaulting or troubled entity may seek recourse in a number of ways, including foreclosure on the defaulting entity's assets which are subject to such creditor's security interests; or placing the defaulting entity into a receivership or bankruptcy.

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The sovereign status of tribal nations and their lands limits the ability of non-tribal creditors to recover from troubled tribal casinos. As a sovereign nation, a tribal entity (including tribal casinos) may only be sued where Congress has authorized the suit or such tribal entity has waived its immunity.

There also exists much uncertainty as to how, if at all, federal bankruptcy laws apply to tribal entities. No tribal entity has tested the application of 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.

Tribal land and the tribal businesses conducted on them, 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 cannot agree to a debt-for-equity swap, and cannot raise cash by selling off tribal land or assets to repay creditors. For the same reason, creditors are prohibited from taking over casino operations or foreclosing on tribal land or tribal assets.

The recourse available to creditors of troubled tribal casinos is also limited by provisions of the Indian Gaming Regulatory Act. For example, creditors of troubled tribal casinos are prohibited from retaining all distributions 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.

Similarly, creditors of troubled tribal casinos must be cautious in taking any actions which may amount to "management" of such casinos, even if such actions are permitted by agreement of parties, unless such agreement has been approved by the chairman of the National Indian Gaming Commission.

Creditors seeking to "manage" operations of a tribal casino, upon default or otherwise, may ultimately find themselves with no remedies if their agreements with the tribe are subsequently determined to be unapproved management contracts.

The difficulties and limitations encountered by lenders and other creditors of troubled tribal casinos are highlighted by the United States District Court for the Western District of Wisconsin's recent opinion in *Wells Fargo Bank, N.A. v. Lake of the Torches Economic Development Corporation*.

In January 2008, the casino issued $50 million in bonds and entered into a trust indenture with its lenders. While the documents were submitted to the NIGC for approval prior to their execution, the casino'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 casino's interest in the "gross revenues" of the property, its equipment, and a variety of other items.

In November 2009, the lenders received a request for money that they considered suspicious, and after allegedly failing to receive a substantive response to its request, the lender said that the principal and interest of the bonds were immediately due. Thereafter, the lender filed a lawsuit 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" which lacked the required approval of the NICG chairman. The District Court based its determination on regulations which state 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."

The District Court determined the trust indenture was a management contract based on provisions that included restrictions on the property's ability to spend capital, the forced hiring of a "management consultant" if results did not meet expectations, the inability of the tribe to fire senior executives without lender approval, and several other issues.

Additionally, the District Court determined that it lacked jurisdiction over the casino because, in the absence of a clear waiver, the lawsuit was barred by the tribe'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, the District Court found that "even 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 lenders filed a motion to amend and alter the District Court's order or, in the alternative, for leave to file an amended complaint. The court rejected the lenders' arguments that the main purpose of the trust indenture was to obtain repayment of the bonds, not the management of the tribal casino. The District Court concluded that even if the objectionable management provisions could be removed, the remainder of the trust indenture would be null and void because the entire document constituted an unapproved management contract, leaving nothing to enforce. On April 25, Wells Fargo filed notice that it would appeal the court's decision.

While it is unclear whether other courts will adopt the District Court's

analysis and position or whether it is was unique to that situation, *Lake of the Torches* presents several issues non-tribal entities should consider prior to entering into financing agreements with tribes and tribal entities.

The threshold lesson is the importance of obtaining pre-approval of the NIGC chairman with respect to any agreements containing provisions which may be potentially construed as providing non-tribal entities with the ability to manage all or a part of tribal gaming operations. 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 ability to control or manage any aspect of casino operations.

## COLLABORATION IS THE ONLY PATH

In the absence of the traditional Chapter 11 path of restructuring—or at least the threat of it leveraged by either side to bring about change—what restructuring options remain for tribes and their lenders?

Some traditional options remain, such as waivers or amendments to existing loan documents (typically in exchange for hefty fees) and debt exchange offers, which enable a company to refinance existing debt on a non-cash basis by offering bondholders the opportunity to exchange existing bonds for newly issued debt. Others don't, even were both parties willing—because federal and tribal regulations require that tribal entities retain the sole proprietary interest in the tribal casino, solutions such as the sale of existing equity interests to new, well-capitalized operators, or the exchange of debt for equity, are not feasible options for tribal issuers and their creditors.

So what does this mean for distressed tribal gaming enterprises and their creditors who wish to undertake successful financial restructurings and preserve their respective interests and claims?

The answer is simple—a willingness of both parties to align many conflicting and often competing interests and cooperate with one another is paramount to successfully effecting the turnaround. It should be noted that this is in contrast to many commercial casino workout situations, where secured creditors with superior lien rights have the ability to control the restructuring process and may therefore be less inclined to cooperate with existing equity holders that are in violation of important credit agreement covenants.

## IMPROVED RESULTS HELP EVERYONE

As the lynchpin of that collaboration, both parties should do everything in their power to quickly and forcefully improve the cash-generating position of the facility. The more cash the facility can generate, the greater the recovery can be for those that have lent money and ultimately the more available to the tribe and its tribal members for socially important purposes.

This accelerated process improvement is most effective when led by someone on the outside, unencumbered by the biases that have come through historical decision-making. In other words, "he who dug the hole can't fill it back up." In an ideal world, these individuals or firms would be independent of both the tribe and the lenders, with a simple charter to maximize the profitability of the facility in order to maximize the value of the enterprise.

This adviser—unlike the legal or financial—stays out of the restructuring negotiations, indifferent to the concessions and gains made by financiers and the tribe. It is imperative, as discussed in the first section of this article, that the retention of this adviser, consultant or manager be appropriately vetted and approved through the NIGC.

The adviser needs to scientifically and forensically break the business into its two component parts—cost to operate and revenue generation—and systematically restructure both. On the cost side, many gaming operations were designed around business volume projections that have evaporated during this recession—some were not realistic even in the absence of a downturn. The operations adviser needs to be able to renegotiate purchasing contracts, change product and service offerings, and right-size staffing levels to be more appropriate for the existing economic conditions. With that "fresh eyes" approach, the adviser is almost guaranteed to find extensive opportunity.

But in many cases, no matter how much costs are diminished, revenues must be increased for the facility to return to or improve its profitability. In these instances, the adviser must provide world-class database marketing, promotions analysis, players card re-launch, slot floor analysis and brand marketing to increase the throughput of the facility.

On average, each million dollars of incremental cash flow allows a facility to support $6 million to $8 million in debt, so these improvements can add up quickly.

## RESTRUCTURE FOR SUCCESS

The limitation on legal options and restriction on restructuring tools, coupled with the potential for improvement via turnaround operations, makes it clear there is really only one viable path which leads toward the successful restructuring of a tribal gaming enterprise—keeping the property operating while collaboratively restructuring or reorganizing the existing debt obligations and working vigorously to restore profitability and enhance operating cash flows.

During this process, creditors may insist on bringing in new outside management consultants to help drive increases in profitability, but tribal interests are likely to be aligned when this happens, since the casino is often a primary cash-flow generator for the tribe, providing significant funding for governmental services and in some cases, distributions to tribal members.

The most successful restructuring processes are those which are begun when initial warning signs of financial distress first surface. To this point, both lenders and tribal gaming operators should consider engaging experienced, competent financial, operational and legal professionals early on in the process so that the underlying issues causing financial distress can be identified and addressed immediately, and a clear path to viability can be established.

While engaging outside professionals creates additional expense for all stakeholders, measures can be taken to hold professionals to reasonable budgets, and in some circumstances, "pay for performance" or "success fee" contracts can be implemented to ensure that professional compensation is commensurate with the property's financial performance.

Finally, a warning—while it is always tempting to bake optimism into any turnaround plan, any restructured debt obligations should be based on realistic projections of the cash flows the asset can generate. Otherwise, the gaming operation may find itself in another workout situation a few years down the road.

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