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Commercial Law

Troubled Domestic Sovereign Debt: *What Every Commercial Professional Should Know*

Since the inception of Tribal[1] gaming, billions of dollars have been provided to Tribal casinos by investors and lenders. Clearly, these investments and loans were not considered to be a gamble. Tribal debtors borrow for many reasons; their debt is considered "sovereign" due to their unique legal standing.

In these turbulent economic times, investments in gaming facilities with the omnipresent substantial cash flow may at first seem very attractive. In many instances, investments in casinos, racetracks and related gaming projects are very secure investments. However, Tribal casinos present a few different issues to consider.

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 much clearer focus. 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, which 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 by foreclosing on the defaulting entity's assets that are subject to the creditor's security interest 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. Lenders need to be extremely sensitive to issues surrounding sovereign immunity, uncertainty regarding applicability of federal bankruptcy laws, uncertainty regarding applicability of non-Tribal (i.e., state and federal) laws, and the application of the Indian Gaming Regulation Act (IGRA), 25 U.S.C. §§ 2701 et seq. and accompanying regulations.

The recourse available to creditors of troubled Tribal casinos is also limited by provisions of the IGRA. 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.[2]

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.

Lake of the Torches Case

The difficulties and limitations encountered by lenders and other creditors of troubled Tribal casinos are highlighted by the U.S. 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*.[3] The Lac du Flambeau Band of Lake Superior Chippewa Indians, a federally recognized tribe, established the Lake of

the Torches Economic Development Corporation for purposes of owning and operating the Lake of the Torches Resort Casino.

In January 2008, the corporation issued $50 million in bonds[4] and entered into a trust indenture with Wells Fargo Bank, N.A. as the trustee. Saybrook Capital LLC of Santa Monica, Cal. 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 (NIGC) 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 Corporation, 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."

In November 2009, the treasurer 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 requesting documentation underlying the funds transfer. After allegedly failing to receive a substantive response to its request, Wells Fargo notified the corporation that the principal and interest of the bonds were immediately due. Thereafter, Wells Fargo filed a 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" under the IGRA which lacked the required approval of the NIGC Chairman. As a result, bondholder Saybrook now finds itself holding worthless obligations valued at $46.6 million. It is reported that the Tribe intends to honor their financial obligations and serious negotiations are under way to restructure the transaction. One can only assume that an agreement will be reached on much more favorable terms for the Tribe.

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 or whether it is "sui generis,"[5] *Lake of the Torches* presents several issues non-Tribal entities should consider prior to entering into financing agreements with tribes and Tribal entities or acquiring sovereign debt:

1. **Obtaining Prior Approval of NIGC Chairman**

The threshold lesson is the importance of obtaining preapproval 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. While, in practice, parties may rely on letters of counsel opining that the operating documents are not management agreements, it is clear that the district court gave little, if any, weight to the opinion letter issued to the corporation.

2. **Limit 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 ability to control or manage any aspect of casino operations.

3. **Limited Applicability of Waiver Provision Where Agreement Is Void**

Another lesson that arises from the case concerns Tribal waivers of sovereign immunity. Here, the trust indenture contained a provision whereby the corporation "expressly waived" its sovereign immunity. 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. Given the potential impact of this decision in the financial markets servicing the Tribal gaming industry, we are confident that the NIGC will issue some guidance to clarify this most important issue.

4. **Similarly, creditors of troubled Tribal casinos must be cautious in taking any actions that may amount to "management" of such casinos, even if such actions are permitted by agreement of parties, unless the agreement has been approved by the Chairman of the NIGC.**

This unfortunate situation could likely have been avoided if counsel had submitted the loan and financial documents to the NIGC seeking a declination letter prior to closing. While this process is encouraged by the NIGC, it is important to understand that a NIGC declination letter is not an official NIGC agency decision and, as a result, is subject to judicial challenge. Consequently, a judge could set aside the NIGC declaration letter and issue a ruling that the loan and financing documents are in fact management agreements. Clearly, one of the lessons of the *Lake of the Torches* case is that seeking counsel from experienced attorneys with an expertise in Indian gaming law is imperative and may likely prove to be the least costly alternative.

If you have questions, please contact **Terence M. Dunleavy** at (312) 609-7560, **Michael M. Eidelman** at (312) 609-7636, **Stephanie K. Hor-Chen** at (312) 609-7786, or any other Vedder Price P.C. attorney with whom you have worked.

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[1] The term "Tribal" includes all 336 federally recognized tribes.

[2] 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 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 …." 25 U.S.C. § 2710(b)(2).

[3] Case No. 09-CV-768, 2010 WL 62638 (E.D. Wis. 2010).

[4] The bonds carried a 12 percent interest rate and required a monthly payment from the Tribe of approximately $800,000.

[5] Many gaming attorneys have opined that the instant trust indenture was unique and not consistent with the standards set by the NIGC.

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Gaming Law Practice

The Vedder Price Gaming Law Practice consists of an experienced group of multidisciplinary attorneys that understand the unique issues that arise within the gaming industry and are prepared to address any hurdle that may come in the finance, development or operation of a gaming facility. Led by James S. Montana, Jr. and Terence M. Dunleavy, the firm's gaming law attorneys provide a complete range of legal services to the gaming and entertainment industries and also advise financial service, asset manager and investment banking firms on gaming regulatory matters related to the financing of and investment in regulated gaming entities.

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