7th Circuit Court of Appeals Voids Tribal Gaming Loan
and Asks the NIGC to Promulgate Regulations as to Permissible Financing Agreements for Indian Gaming Projects

by Sam Cohen

On September 6, 2011, the United States Court of Appeals for the 7th Circuit in *Wells Fargo v. Lake of the Torches EDC*, held that a tribal bond indenture secured by tribal casino revenues (the "loan") is void as an unapproved management contract pursuant to the Indian Gaming Regulatory Act (IGRA). This decision is, on the one hand, of concern to both tribal leaders interested in securing loans during difficult times and the shrinking number of lenders willing to finance tribal casinos. At the same time, the decision contains an element of good news. Specifically, in a footnote, the 7th Circuit recognizes that there is an urgent need for some forms of safe harbor regulations and calls on the National Indian Gaming Commission (NIGC) to promulgate some regulations to clarify when tribal casino loans and other financing agreements are not management contracts.

The entire area of management contracts in IGRA is problematic because while all management contracts must be approved by the Chairman of the NIGC (25 U.S.C 2710(d)(9) and 2711(a)(1)) there are no clear definitions as to what is a management contract. The regulations at 25 C.F.R. 533.7 are clear that unapproved management contracts are "void." However, the definition of a management contract in the regulations tautologically defines a management contract as a contract for management. Specifically, 25 C.F.R. 502.5 defines a management contract as "any contract, subcontract, or collateral agreement between an Indian tribe and a contractor or between a contractor and a subcontractor if such contract provides for the management of all or part of a gaming operation."

We get slightly more guidance with the definition in the regulations of a primary management official who is any person who has authority to hire and fire employees or to set up work policy for the gaming operation. The Chief Financial Officer is also a primary management official. However, primary management officials also include the "person having management responsibility for a management contract." 25 C.F.R. 502.19(a). As in the definition of management contract, the definition of primary management official is defined tautologically as one who has management responsibility.

It does need to be mentioned that the loan agreement/bond indenture before the 7th Circuit did have some unusually egregious management elements. Wells Fargo was only the bond trustee and did not participate in drafting such terms. The 7th Circuit described six factors that "taken together transfer significant management responsibility" to the lender:

1. Creating a security interest in all revenues of the casino which are all deposited in a blocked account and placing numerous conditions on all payments even for operating expenses;

2. Requiring approval of all capital expenses in excess of 25% of those made in the prior year;

3. Appointing a management consultant in the event of a failure to meet certain debt service coverage ratios who will then make a report on the operation;

4. Requiring best efforts be made to implement the report and recommendations of the management consultant;

5. Limiting the ability of the tribe to remove, without bondholder approval, the general manager, controller, Chairman of the Gaming Commission and others even where there is misconduct or regulatory issues; and

6. Giving the bond trustee the ability to hire new management.

The loan agreement also allowed for the judicial appointment of a receiver to operate the gaming operation upon default. The District Court found this independently to be an unapproved management contract. On appeal, the 7th Circuit held the loan agreement to be an unapproved management contract without having to decide the judicial receiver issue.

The decision of the 7th Circuit implies a number of likely reactions by those lenders still willing to make loans to finance tribal casinos:

(1) Getting NIGC declination letters for all Indian gaming loans: The NIGC has an informal process to review documents and provide an opinion of the Office of General Counsel that the documents are not management contracts. This is also referred to as a declination letter. However, this process is not always quick and may slow down significantly in the future if each loan or other financing is sent to the NIGC for a declination letter. In addition, the 7th Circuit also pointed out that these letters are of limited legal effect.

(2) Having separate loan agreements with separate sovereign immunity waivers for each loan participant. Many larger loans are with multiple financial institutions with one as the lead and the others as participants. The 7th Circuit also separately ruled that independent of the loan agreement/indenture, other loan documents may still be valid even if the loan agreement/indenture is void as

an unapproved management contract. However, IGRA and its regulations do not provide any guidance as to when such a secondary agreement, also referred to as a collateral agreement, is not a management agreement and when it survives even when the loan agreement/indenture is void. The 7th Circuit itself only remanded this collateral agreement issue back to the District Court for additional findings which may take a few more years and possibly a few more appeals.

Another lender response to the decision of the 7th Circuit might simply be to make fewer loans for tribal gaming facilities. Since loans for tribal gaming facilities cannot be collateralized with any tribal trust land upon which such casino is located, these loans are more relationship loans with other lesser forms of collateral such as blocked and collateralized bank accounts and floating liens on furniture, fixtures and equipment (so-called FF&E liens). Many marginal loans were rejected at the beginning of this recession and credit contraction. If lenders start to question their current collateral package, they might reduce the already limited number of loans for tribal gaming facilities.

It is the possibility of less available financing that needs to be avoided, especially during this credit contraction. Fortunately, the decision of the 7th Circuit itself may provide a road map for a solution.

Perhaps the best response to the decision of the 7th Circuit may be provided in the decision itself in footnote 13 that the NIGC should "give the entities that it regulates more certain guidance as to the permissible scope of financing agreements." While defining the complete contours of what is a management contract may be a lengthy project, safe harbor rules could be promulgated on an expedited basis to protect the current handful of different financing structures for tribal gaming facilities. Such NIGC safe harbor regulations would go a long way to help to restore confidence to lenders who are willing to finance Indian gaming projects. In addition, it can be argued that this is the perfect time as the new Chairwoman of the NIGC is reviewing all current regulations including those for management contracts. A strong case can certainly be made that in the course of its review, the NIGC needs to designate these safe harbor regulations as a top priority to help ensure that tribal governments and their gaming operations continue to have access to the capital markets. ♣

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