Indian LAW

Lake of the Torches

An Ongoing Saga in Indian Gaming Lending

By Bryan J. Nowlin

On Jan. 11, 2010, the world of Indian gaming finance was upended by the U.S. District Court for the Western District of Wisconsin's decision in *Wells Fargo Bank, N.A. v. Lake of The Torches Economic Development Corp.*[1] That decision, which voided a $50 million dollar bond indenture, if upheld in its entirety would leave no recourse at law for the bond holders to realize upon their collateral. Indian gaming finance in Oklahoma is vital to the state due to the number of tribes, number of gaming facilities and opportunities for gaming facilities within this state. Therefore, any decision and the rationale that that could throw out a large-scale financing transaction is of special interest to tribal leaders and the gaming industry in Oklahoma. While the initial shock of the decision has certainly worn off with time, the decision did not provide certainty as to which loan agreements may or may not constitute void, and hence unenforceable, contracts. Interestingly in the above cases, Wells Fargo Bank, the named plaintiff, serves as trustee under the bond indenture and had no role in structuring the financing for the casino development. The bank immediately appealed upon receiving the quick ruling that the bond indenture was unenforceable, and the Seventh Circuit then affirmed the district court's primary holding, namely that the bond indenture was void *ab initio*. But, the appellate court held that the bond holders might be able to seek some unspecified equitable relief.

Voiding a $50 million transaction does not occur every day. In fact, most of the time there would be no publicity pertaining to such a ruling due to the arbitration clauses found within most loan agreements with tribal gaming operations. These arbitration clauses also serve as an independent waiver of sovereign immunity by the tribe, assuming that the agreement is validly executed by a tribal authority with the ability to waive sovereign immunity.[2] Many of these arbitrations remain private, which means there is little case law on the regulatory hurdles of lending to the Indian gaming industry. *Lake of the Torches* is rare in that it has played out in the courts and been subject to multiple published legal opinions. The litigation is ongoing and enlightening.

When the Indian Gaming Regulatory Act (IGRA) became law in 1988, it sought to promote the economic development of Indian tribes by

regulating Indian gaming. Federal law and regulations are intended to ensure that tribes, and not outsiders, are the primary beneficiaries of Indian gaming.[3] To that end, IGRA required that Indian tribes, and not outsiders, are to control and manage casinos in Indian Country.[4] In *Lake of the Torches*, the federal courts had thus far voided the bond indenture (and the ability of the bond holders to realize upon their investment) because the document was an unapproved management contract. Because Indian tribes and gaming facilities are to be protected from nefarious influence and to ensure a level playing field as a trustee, the federal government requires that all contracts which provide for total or partial management of an Indian casino to be approved by the chairperson of the National Indian Gaming Commission.[5] An unapproved management contract is void.[6] While the policy itself is relatively straightforward, the devil of compliance is in the details. Intent is not relevant, as nearly every agreement for which NIGC approval is not sought will boldly declare on its face that it is not a management contract. A loan that neither party intended to provide for management of a casino is capable of being held void as an unapproved management contract.

Neither the text of IGRA nor federal regulations provide a comprehensive definition of what is and what is not a management contract. The regulations define a management contract as, "any contract, subcontract, or collateral agreement between an Indian tribe and a contractor... if such contract or agreement provides for the management of all or part of a gaming operation." Management is itself undefined. However, the regulations define a management official as any person, "who has authority . . . [t]o set up working policy for the gaming operation."[7] In 1994 the NIGC issued advice stating that management comprises many activities such as "planning or-ganizing, directing, coordinating, and controlling."[8] The NIGC further explained that, "the performance of any one of such activities with respect to all or part of a gaming operation constitutes management for the purpose of determining whether any contract or agreement for the performance of such activities is a management contract that requires approval."[9] Specific examples range from the appointment of third-party receiver, the approval of operating expenses, to a pledge of net gaming revenues.[10] Even the mutual selection of an auditor, which by definition is limited on the tribe's ability to choose the auditor of its choice, constitutes management of part of the casino.[11]

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Naturally, gaming investors and their counsel can be creative in hiding management contracts. For that reason, a management contract may be found within a series of agreements.[12] Any agreement or series of agreements, such as lending facility agreements, may be determined to be a management contract when the agreements give third parties the authority to set policy for an Indian casino.[13] Congressional and regulatory guidance remains sparse, as noted by the Seventh Circuit itself.[14] The regulations, however, are deemed sufficient by the courts.[15] In addition, the NIGC offers a free and confidential review process whereby the general counsel's office will issue an opinion as to whether or not a submitted document constitutes a management contract requiring the chairperson's approval.[16]

Perhaps more troublesome for potential casino lenders is the reality that a potential for management of a casino is sufficient to convert an otherwise inoffensive loan into an unapproved management contract. The 10th Circuit explicitly in *First Am. Kickapoo* rejected the argument "that a contract is only a management contract if it confers rights rather than opportunities to manage."[17] The reality remains that lenders require security for a loan to ensure that it is repaid. Uncertainties as to repayment typically lead to higher interest rates. Common sense dictates that the greater security, the lower the interest rate available. The 7th Circuit in *Lake of the Torches* held that a number of provisions which become operative in the event of default rendered that bond indenture to be a management contract.[18] Contingent management still constitutes management of an Indian casino.

The NIGC Office of General Counsel maintains that the pledge of gross gaming revenues without limitation allows for potential management of a casino. As explained by then-Acting General Counsel Penny Coleman, "We

take this position because in the event of default, a party with a security interest in a gaming facility's gross revenues has the authority to decide how and when operating expenses at the gaming facility are paid, which is itself a management function. Furthermore, a party that controls gross revenue potentially can control everything about the gaming facility by allocating or putting conditions on the payment of operating expenses. Therefore, agreements with such a security interest constitute management contracts that are void unless and until they are approved by the chairman of the National Indian Gaming Commission."[19] The NIGC has approved limiting language to be used in loan agreements to eliminate this concern and ensure that the pledge of revenues does not lead to management of the gaming facility.[20]

An unapproved management contract is void *ab initio*. While severability clauses are common in all contracts, such clauses cannot be given effect in a void management contract. A void management contract is not a contract at all, and none of its provisions, including a severability clause, were ever lawfully agreed by the parties.[21] There simply are no clauses to enforce, including the severability clause.[22] The waiver of sovereign immunity likewise fails. And without the waiver of immunity, a tribe's gaming entity or the tribe itself, cannot even be hauled into court. The tribe is also at risk. When the NIGC finds that a tribe allowed a casino to operate under an unapproved management contract, it may close the facility and enforce penalties.[23]

What remains unclear from the 7th Circuit's opinion is whether a lender may recover funds on a void lending contract under any equitable cause of action. Sovereign immunity bars both actions at law and equity.[24] However, the panel held that Wells Fargo should be allowed to amend its complaint before the case could be dismissed with prejudice for lack of subject matter jurisdiction. The court held:

> "In sum, on remand, the district court should grant Wells Fargo's motion for leave to file an amended complaint insofar as it states claims for legal and equitable relief in connection with the bond transaction. The court should then address whether Wells Fargo's standing to seek such relief on behalf of the bondholder survives the voiding of the Indenture. It should proceed to address whether the transactional documents, taken alone or together, evince an intent on the part of the Corporation to waive sovereign immunity with respect to claims by Wells Fargo on its own behalf and, if it has standing to do so, on behalf of the bondholder."[25]

What happened next in the federal litigation provides little help to anyone. Wells Fargo did file its amended complaint, but that amended complaint attempted to add parties to destroy the diversity jurisdiction of the federal court. In the words of Judge Randa, "It isn't very often that a case comes before the court in which both parties want the case to be dismissed, albeit for different reasons."[26] The district court then entered an order to show cause why Wells Fargo should not be sanctioned. While it did persuade the court of a good faith basis to join new parties to the suit, Wells Fargo ultimately changed tack and filed a notice of voluntary dismissal pursuant to Fed. R. Civ. P. 41. The voluntary dismissal, filed on June 28, 2012, may have achieved the lender's goal of preventing a ruling on the merits of the bond indenture, or at least delaying a final ruling for when the tribe brings suit. (If not preclusive, any future court reviewing the bond indenture will likely find the 7th Circuit's opinion highly persuasive.).

Under Oklahoma law it is apparent that a party should not be able to recover on an unjust enrichment theory under a contract that is void for public policy.[27] Any person claiming an equitable right to recover for evading NIGC scrutiny surely would qualify for unclean hands.[28] "Courts have long recognized that Indian tribes possess common law immunity from lawsuits."[29] Furthermore, "[t]ribes enjoy immunity from suits on contracts, whether those contracts involve governmental or commercial activities and whether they were made on or off a reservation,"[30] because "sovereign immunity is an immunity from trial and the attendant burdens of litigation, and not just a defense to liability on the merits."[31] Put more directly, the disappearance of a sovereign immunity waiver along with all clauses in a contract render recovery, even under equitable causes of action, highly unlikely.

The result of the *Lake of the Torches* saga will still not be known for some time. Despite the dismissal, litigation continues in new lawsuits filed by the bond holders in state court as noted by Judge Randa's March 30, 2012, order, and in the Western District of Wisconsin itself

where a new lawsuit was filed against the Lake of the Torches Economic Development Corporation regarding the debt evidenced by the bonds but without Wells Fargo as a named plaintiff.[32] The lessons to be learned remain unclear, but it is certainly a cautionary tale.

Counsel representing both tribes and lenders must be mindful of the NIGC's position regarding gross revenues and other management features which become operative upon default. Counsel should also be prepared to recommend and to use the NIGC's review process which at no expense will review a proposed contract and issue a yea or nay opinion on its management features. Finally, on the litigation front, counsel should advise both lenders and tribes that nothing is absolutely certain regarding the insertion of a management contract issue into a dispute. However, counsel for a tribe should not cower from raising the issue. It may seem counterintuitive to many, but a tribe who has signed an unapproved management contract even though it receives loan proceeds, has still been wronged. Tribes are entitled to the protections attendant with NIGC review. The NIGC's role as a regulator of gaming in Indian Country is part of the United States government's trust responsibility. That some lenders believe it is unconscionable that a tribe may be able to free itself from a loan, miss the point of the regulations which aim to ensure that tribal members, and not outsiders, are the primary beneficiaries of Indian gaming revenues. Indian gaming should remain an Indian resource. Tribes are entitled to this protection. Those lenders and investors who wish to comply face a complicated but not an impossible task of compliance.

1. *Wells Fargo Bank, N.A. v. Lake of The Torches Economic Development Corp.*, 677 F.Supp.2d 1056, 1061 (W.D. Wis. 2010), affirmed in part and rev'd in part, 658 F.3d 684, 702 (7th Cir. 2011).

2. *Kiowa Tribe of Okla. v. Mfg. Techs., Inc.*, 523 U.S. 751 (1998) (holding arbitration clause also itself serves as a waiver of sovereign immunity); *See also, Dilliner v. Seneca-Cayuga Tribe*, 2011 OK 61, 258 P.3d 516 (holding a purported sovereign immunity waiver's validity must be determined in accord with tribal law).

3. 25 U.S.C. §2702(2).

4. *Wells Fargo Bank, N.A. v. Lake of the Torches Economic Development Corp.*, 658 F.3d 684, 695 - 700 (7th Cir. 2011) (IGRA's management contract provisions exist "to ensure that the tribes retain control of gaming facilities set up under the protection of IGRA and of the revenue from these facilities.."); *Casino Res. Corp. v. Harrah's Entertainment, Inc.*, 243 F.3d 435, 438 fn.3 (8th Cir. 2001) ("IGRA recognizes a tribe's authority to enter into contracts for the management and operation of an Indian gaming facility by an entity other than the tribe or its employees, so long as certain requirements are satisfied and subject to approval by the Chairman of the National Indian Gaming Commission.").

5. 25 U.S.C §2710(d)(9) and 2711(a)(1).

6. 25 C.F.R. §533.7.

7. 25 C.F.R. §502.19.

8. NIGC Bulletin 1994-5, available at www.nigc.gov/Reading_Room/Bulletins/Bulletin_No._1994-5.aspx.

9. *Id.*

10. *Wells Fargo Bank, N.A., v. Lake of the Torches Economic Development Corp.*, 658 F.3d 684 (7th Cir. 2011).

11. *In re the March 26,2008 disapproval of a management contract between New Gaming Systems Inc. and the Sac & Fox Nation of Oklahoma*, Final Order, National Indian Gaming Commission (May 22, 2008).

12. *See, e.g., United States ex rel Bernard v. Casino Magic Corp.*, 293 F.3d 419, 424-25 (8th Cir. 2002) (series of agreements that gave the contractor "a percentage ownership interest in the tribe's indebtedness" and "mandated the tribe's compliance" with the contractor's recommendations is a management contract).

13. *Id.*

14. *Lake of the Torches*, 658 F.3d at fn 17.

15. *New Gaming Systems v. NIGC*, Order at p. 10, 08-CV-698-HE (W.D. Okla. Sept. 13, 2012) (affirming NIGC decision regarding management contract and rejecting challenge to enforceability of regulations for vagueness).

16. Judge Randa noted, "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." *Lake of the Torches*, 677 F.Supp.2d at 1062. To be fair, Wells Fargo was not involved in the drafting and negotiation of the bond indenture and therefore was unlikely to have been in a position to insist upon an NIGC declination letter. Review letters may be viewed at www.nigc.gov/Reading_Room/Management_Review_Letters.aspx.

17. 412 F.3d at 1175; *Lake of the Torches*, 677 F.Supp. 2d at 1060-1.

18. *Wells Fargo Bank, N.A., v. Lake of the Torches Economic Development Corp.*, 658 F.3d 684 (7th Cir. 2011).

19. Acting General Counsel Penny Coleman to Kent Richey, Jan. 23, 2009 available at: www.okbar.org/s/nigc (last accessed Jan. 25, 2013)

20. "Notwithstanding any provision in any Loan Document, none of the Lending Parties shall engage in any of the following: planning, organizing, directing, coordinating, or controlling all or any portion of the Borrower's gaming operations (collectively, "Management Activities"). including, but not limited to..." *Id.*

21. *First Am. Kickapoo*, 412 F.3d at 1176 (an unapproved management contract "does not become a contract").

22. *See Lake of the Torches*, 677 F.Supp. 2d at 1061 n. 3.

23. 25 U.S.C. §2713.

24. *Santa Clara Pueblo v. Martinez*, 436 U.S. 49, 58-9 (1978) (holding sovereign immunity bars suit against tribe for declaratory and prospective injunctive relief).

25. *Lake of the Torches*, 658 F.3d at 701-2 (7th Cir. 2011).

26. *Wells Fargo v. Lake of the Torches*, Decision and Order, 09-CV-768 (W.D. Wis. March 30, 2012).

27. To hold otherwise would run the precarious position of allowing a drug dealer's investors to seek redress through the courts despite the illegal aims of their business.

28. *Tulsa Torpedo Co. v. Kennedy*, 1928 OK 383, 268 P. 205.

29. *Santa Clara Pueblo*, 436 U.S. at 58.

30. *Kiowa Tribe of Okla. v. Mfg. Techs., Inc.*, 523 U.S. 751, 760 (1998); *Berrey v. Asarco Inc.*, 439 F.3d 636, 643 (10th Cir. 2006) (holding that federally recognized Indian tribes possess immunity from suit in federal court).

31. *Enahoro v. Abubakar*, 408 F.3d 877, 880 (7th Cir. 2005) (quotation omitted).

32. *See* Complaint, *Saybrook Tax Exempt Investors, et al. v. Lake of the Torches*, 12-CV-255 (W.D. Wis. filed April 9, 2012).

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