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SEVENTH CIRCUIT TO LAC DU FLAMBEAU: "THEY CAN'T TOUCH YOU!"

by Dennis J. Whittlesey

Lac du Flambeau can continue its casino operations without facing any liability for its \$46.6 million bond default two years ago. The bondholder still has some hope of recovery if it can persuade the courts that there was an informal or implied sovereign immunity waiver in the transaction. However, the documents pursuant to which it purchased the \$50 million in bonds have been determined to be void, including the formal waiver of tribal sovereignty executed in conjunction with the transaction.

On Tuesday, the United States Court of Appeals for the 7th Circuit affirmed the lower court's ruling made 20 months ago that the Indenture under which the \$50 million bond offering was issued constituted a "management contract" under the federal Indian gaming law that never had been approved by the Chairman of the National Indian Gaming Commission ("NIGC") and was consequently void under the federal gaming law. Worse for the bondholder, the law also dictates that all documents "collateral to" the principal agreement also are void – including all loan documents and the aforementioned waiver.

As a result, it appears that the bondholder is reduced to a single course of action which would be both complicated and challenging. The appeals court ruled that the Trustee can attempt to establish some form of sovereign immunity waiver in new litigation by presenting claims for legal and equitable relief "in conjunction with the bond transaction on its own behalf and on behalf of the bondholder."

So, what happened and why?

Let's revisit January 6, 2010, when a federal judge in Wisconsin refused to put the Lac du Flambeau tribal casino into receivership after the tribe defaulted under the Indenture for the \$50 million bond which was sold in 2008, ruling that the Indenture gave the Trustee illegal management control over the gaming operations in direct violation of the Indian Gaming Regulatory Act ("IGRA"). In a one-paragraph Order, U.S. District Judge Rudolph T. Randa initially ruled that the Indenture was effectively a management contract which was not approved

by the NIGC as required by IGRA Section 12, 25 U.S.C. § 2711, and – accordingly – was null and void as a matter of federal law. Five days later, Judge Randa followed up with a 12-page Decision and Order explaining his decision in detail.

The judgment came in litigation filed by Wells Fargo Bank, acting as Trustee for the bondholder, and seeking to invoke the remedy provisions of the Indenture which allowed for a receivership of the tribe's casino in the event of default. *See Wells Fargo Bank, N.A. v. Lake of the Torches Economic Development Corporation* (W.D. Wisc.). Instead of securing a receivership, the bondholder suddenly found itself on the wrong side of a decision that it has no rights and no enforceability.

While Wells Fargo acted as the Trustee for the transaction, it neither originated the deal nor invested in the bonds. The Wells Fargo involvement was limited to its role as Trustee under the Indenture, and was at all times relevant to the dispute acting at the direction of the bondholder.

The sole bondholder is Saybrook Capital LLC of Santa Monica, California, a private firm which reportedly directs in excess of some \$1 billion in private equity and fixed income investments for a cadre of domestic and offshore investors.

The Indenture was entered into by Wells Fargo, acting as Trustee, and the Lake of the Torches Economic Development Corporation (“EDC”), a tribal corporation wholly owned by the Lac du Flambeau Band of Lake Superior Chippewa Indians. The EDC was established specifically to own and operate the tribal casino and was federally chartered under Section 16 of the Indian Reorganization Act of 1934, 25 U.S.C. § 461, *et seq.*

The parties to the transaction reportedly sought and obtained legal opinions from Milwaukee and New York law firms blessing the transaction and its structure. However, they did not avail themselves of the process through which the NIGC Office of General Counsel upon request will review project documents for management contract provisions. If none are found, the NIGC issues what is known as a “declination letter” and it, in turn, serves as additional “comfort” for potential investors. This process is relatively efficient and has been used many times in the 23 years since IGRA became law. Significantly, the NIGC has long encouraged parties to take advantage of the declination letter process as a means for avoiding the very situation presented in Lac du Flambeau, and many gaming attorneys routinely insist on invoking it. It is critical to understand that a declination letter is advisory only and subject to challenge in any appropriate forum. Nonetheless, NIGC and the Department of the Interior have consistently argued that such letters are “informative” because NIGC has special expertise in such matters. Thus, while a declination letter is not dispositive, it can be extremely influential when transaction documents are alleged to be unapproved management contracts.

Following default by the EDC, Wells Fargo filed litigation contemplated by the Indenture seeking the immediate appointment of a temporary receiver to exercise oversight over the revenues, issues, payments, and profits of the casino. Among the allegations was that the EDC diverted some \$5 million from the Indenture's trust for an impermissible purpose and soon thereafter defaulted on the bonds.

EDC moved to dismiss on the grounds that the Indenture was a management contract never approved by the NIGC, an argument buttressed by two briefs filed only a few days apart and an Affidavit by Kevin Washburn, Dean of the University of New Mexico School of Law and former NIGC General Counsel. Dean Washburn opined that the Indenture likely would be deemed a management contract under the standards applied during NIGC review. This conclusion strongly implied that the failure to seek a declination letter was a significant error in a case where the documents contemplated that the Trustee could gain control over the gaming operations following a default on the bonds.

The Wells Fargo attorneys responded to the motion to dismiss with an eight-page brief stating that it was “disingenuous” for the EDC to raise the management contract issue so late in the game and describing the motion as nothing more than “a transparent attempt to repudiate a valid, duly authorized contract that merely secures the \$50 million in bonds issued by the EDC.” The crushing blow came seven days later in the form of the EDC Supplemental Response which can only be described as a 37-page treatise on management contracts. The one-paragraph Order of Dismissal was rendered 24 hours later.

The Seventh Circuit affirmed the lower court, discussing the relevant provisions of the Indenture and explaining why it was a management contract. And the court also affirmed the lower court's conclusion that the Indenture's waiver of tribal sovereign immunity is void since it was part of a contract which is void.

As noted above, the appellate court has given the Trustee an opportunity to prosecute claims for legal and equitable relief in conjunction with the bond transaction on its own behalf. However, it first must establish that there is some waiver of tribal immunity apart from the direct and specific waiver relied on in the federal litigation. Judicial acceptance of an implied waiver is somewhat rare, but not unprecedented. Moreover, litigation seeking an equitable resolution might well be given favorable consideration, since it is undisputed that Lac du Flambeau banked the \$46.6 million and has no intention of repaying any of that windfall. However, for the time being, it is the tribe's money.