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Is Corporate Bankruptcy an Option for Tribal Casinos?

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Tribal economies are not immune to the recent global financial crisis and economic downturn. The Indian gaming industry was hit especially hard. After consistent year-over-year growth in tribal gaming revenues during the 1990s and continuing through 2008, industry revenues declined in 2009 and have continued to stagnate. Amid reports of several tribal casino defaults—and many more tribes with significant debt maturing in the near future that will need to be restructured—tribes and creditors must consider two questions: Are tribes and their corporations eligible for bankruptcy? If so, is bankruptcy an attractive option for a tribal casino?

A number of recent articles conclude (or assume without discussion) that bankruptcy is unavailable for tribes and their gaming businesses. See e.g., Steven T. Waterman, "Tribal Troubles—Without Bankruptcy Relief," XXVIII ABI Journal 10, 44-45, 87 (January 2010); Shmuel Vasser and Janet Bollinger, "Casino Creditors, Heads-Up: American Indian tribes may be ineligible for bankruptcy," New York Law Journal, Dec. 13, 2010. See also Anthony S. Broadman, "Indian Self-Governance and Bankruptcy: The Case for Tribal Law," Casino Enterprise Management, Feb. 1, 2011 (citing Waterman's conclusion that tribes are ineligible for bankruptcy relief).

However, this conclusion is far from certain. Indeed, a reasonable case can be made that tribal corporations are in fact eligible for bankruptcy. And, in the context of a tribal casino, bankruptcy may be an attractive option for tribes to restructure their looming debts—but much less attractive for creditors.

Tribes as Governmental Units

Although some American Indian tribes were historically positioned within federal bankruptcy statutory provisions,[1] the modern Bankruptcy Code (U.S.C. Title 11, or the "Code") does not expressly refer to

[1] *See* Bankruptcy Act of July 1, 1898, 30 Stat. 544-566 (including "Indian Territory" within its definitions).

American Indian tribes. Because tribal entities are not statutorily defined, existing Code definitions must be analyzed to determine whether and how tribes fit them.

Individuals, partnerships, and corporations are generally eligible as Chapter 7 and Chapter 11 debtors, but most "governmental units" are not.[2] "Governmental units" are defined to include the federal government, states and municipalities, foreign states, and "other foreign or domestic government[s]. . . ."[3]

Though the issue has been raised in many cases, courts are split about whether tribes are "governmental units" under the Code. To date, the "governmental units" question has not arisen for tribes as debtors, but rather in the context of sovereign immunity of tribes as creditors. Section 106 of the Code expressly abrogates the sovereign immunity of governmental units to the extent set forth in 59 enumerated Code sections.[4] Section 106 was amended in 1994 to provide that a governmental unit that has filed a proof of claim in a case is deemed to have waived its sovereign immunity with respect to certain claims.[5]

One line of cases, decided mostly under the current Section 106, holds that tribes fit the definition of "governmental units" and, as a result, they waive their sovereign immunity by filing a proof of claim.[6] Another line of authority, decided under both the current version as well as the pre-1994 version, holds that Section 106 does not clearly and unequivocally abrogate tribal sovereign immunity, and that tribes do not fit the definition of "governmental units."[7]

Tribal Corporations as Bankruptcy Debtors

Section 109 of the Code broadly authorizes that any "person" (subject to certain exceptions not applicable to tribes or casinos) may be a debtor. Section 101(41) defines "person" as including "individual, partnership and corporation, but does not include governmental unit . . . ."

Based on the definition in Section 109, the bankruptcy eligibility of a tribal casino may depend on whether the tribe has set up a corporation with respect to its gaming business. If a tribe has chartered a corporation (whether tribal, federal or state) for its casino business and borrowed funds through that entity, then

[2] 11 U.S.C. § 109(b) (eligibility under Chapter 7), 11 U.S.C. § 109(d) (eligibility under Chapter 11); 11 U.S.C. § 101(41) ("'person' includes individual, partnership, and corporation, but does not include governmental unit…").

[3] 11 U.S.C. § 101(27).

[4] 11 U.S.C. § 106(a).

[5] 11 U.S.C. § 106(b); Pub.L. 103-394, Title I, § 113, Oct. 22, 1994, 108 Stat. 4117.

[6] *See Santa Ynez Band of Mission Indians v. Torres*, 2d Civil No. B188413, 2008 WL 174338 (Cal. App. Jan. 22, 2008 (tribal government satisfies 11 U.S.C. § 101(27) definition of governmental unit and abrogated its sovereign immunity under § 106(b) by filing a proof of claim); *Krystal Energy Co. v. Navajo Nation*, 357 F.3d 1055 (9th Cir. 2004) (Congress expressly abrogated the sovereign immunity of Indian tribes when it enacted § 106 of the Bankruptcy Code because tribes fit the definition of "domestic governments" for "governmental units"); *In re Russell*, 293 B.R. 34, 44 (Bankr. D. Ariz. 2003) ("§106(a) unequivocally, and without implication, abrogates sovereign immunity as to governmental units, including Indian tribes…."); *Davis Chevrolet, Inc. v. Navajo Nation*, 282 B.R. 674 (D. Ariz. 2002); *In re Vianese*, 195 B.R. 572, 575 (Bankr. N.D.N.Y. 1995) ("[s]overeign immunity is abrogated to the extent set forth in various Code sections."); *In re Sandmar Corp.*, 12 B.R. 910 (Bankr. D.N.M. 1981).

[7] *See In re Nat'l Cattle Congress*, 247 B.R. 259, 267 (Bank. N.D. Iowa 2000) ("Congress has not unequivocally abrogated the Tribe's sovereign immunity to suit under the Bankruptcy Code"); *In re Mayes*, 294 B.R. 145 (10th Cir. 2003); *In re White*, 1996 WL 33407856, at *3 (E.D. Wash. 1996) ("Congress has not unequivocally expressed clear legislative intent to abrogate tribal sovereign immunity pursuant to the Bankruptcy Code"), *aff'd on other grounds*, 139 F.3d 1268 (9th Cir. 1998) ("White did not appeal the district court's alternative holding that § 106 of the Bankruptcy Code did not abrogate tribal immunity. Therefore, that issue is not before us and we express no view on whether an Indian Tribe is a 'governmental unit' for purposes of § 106(a) or (b)."); *In re Greene*, 980 F.2d 590, 597-98 (9th Cir. 1992) ("the waiver of sovereign immunity accomplished by § 106 does not extend to actions for money damages against Indian tribes"). It should be noted that *Krystal Energy* distinguished *In re Green* based in part on the 1994 amendments to Section 106. 357 F.3d at 1057 n.1. *Krystal Energy* did not address the district court's holding in *In re White*, but instead cited the Ninth Circuit opinion which did not consider Section 106's impact on tribal sovereign immunity. *Id.*

arguably the corporation would be an eligible debtor under Sections 101(41) and 109 of the Code. There is at least one Chapter 11 case involving a tribal casino debtor, although neither the tribe's nor the casino's eligibility under the Code was contested or analyzed in the reported opinion.[8]

Further, eligibility under the Code is not necessarily limited to traditional corporate entities. For example, Chugach Alaska Corporation, an Alaska Native corporation organized under the Alaska Native Claims Settlement Act (ANCSA),[9] filed for Chapter 11 bankruptcy protection in 1991,[10] and Si Tanka University, a tribally chartered university, filed for Chapter 11 bankruptcy protection in 2005.[11]

Bankruptcy Protections Available to Tribal Corporate Debtors

The Code provides many protections that would be useful to tribal corporation debtors (assuming eligibility as discussed above). As examples:

- Upon the commencement of a case under Chapter 11, an "automatic stay" arises immediately under Section 362 of the Code and acts to enjoin all creditors from taking any actions against the debtor or debtor's assets. Any pending litigation must cease, and any creditor action that continues past the bankruptcy filing date is void or voidable, with the creditor potentially subject to sanctions.

- Another powerful bankruptcy tool is the debtor's ability to use, in certain circumstances, cash collateral to fund its continued operations without the consent of the lender. In addition, debtors may borrow additional funds on top of their existing debt, with special protections to lenders who provide such bankruptcy financing.

- A debtor may relieve itself of obligations under non-profitable or otherwise undesirable contracts and leases by "rejecting" them pursuant to Section 363 of the Code. That section allows the debtor to treat the obligations remaining under such contract or lease as general unsecured claims in a significantly reduced amount—and then pay only a percentage of the resulting claim under a plan of reorganization.

- A reorganizing debtor may seek to force a creditor to accept a restructuring of its debt pursuant to a plan of reorganization under the "cramdown" provisions of the Code. For example, a debtor may seek to force a secured creditor with a loan past maturity to accept an extended repayment period of years at a new contract rate.

Creditors' Remedies Limited in Tribal Casino Bankruptcy

In the typical bankruptcy, powers granted to debtors under the Code are generally tempered with rights provided to creditors to ensure a fair process. However, in the tribal gaming context, tribal corporate debtors would have significant additional advantages because of the impact of the Indian Gaming Regulatory Act ("IGRA") and associated regulations and case law.

[8] *See In re Cabazon Indian Casino*, 57 B.R. 398 (9th Cir. B.A.P. 1986).

[9] 43 U.S.C. § 1601 *et seq.*

[10] *See Chugach Alaska Corp. v. United States*, 34 F.3d 1462 (9th Cir. 1994).

[11] *See In re Si Tanka Univ.*, No. 05-30027, Adv. No. 05-3006, 2006 WL 852127 (Bankr. D.S.D. Jan. 7, 2006).

IGRA requires that the tribe have the "sole proprietary interest and responsibility for the conduct of any gaming activity,"[12] which means that ownership and control of the casino must remain with the tribe. In addition, "management contracts" for a tribal gaming operation must be approved in advance else the contract is void,[13] and the National Indian Gaming Commission ("NIGC") broadly interprets those activities that fall within the scope of management.[14] And, as shown by the recent decision in *Wells Fargo Bank, N.A. v. Lake of the Torches Economic Development Corp.*,[15] courts will not enforce contracts that violate IGRA.

In *Lake of the Torches*, the tribal corporation issued $50 million in bonds to fund a gaming project and to consolidate existing debt. The indenture trustee alleged that the corporation breached the indenture and sought a receiver to secure repayment of the bonds. The court held the indenture constituted a management contract because it contained provisions that: (1) pledged as collateral the casino's gross revenues and rights to its equipment and accounts; (2) required bondholder consent prior to certain capital expenditures; (3) allowed bondholders to require the corporation to engage an independent management consultant and force the corporation to use its best efforts to implement the consultant's recommendations if the debt service ratio fell below a certain level; (4) prohibited the corporation from replacing or removing executive management without prior written consent of bondholders; (5) upon an event of default, allowed bondholders to require the corporation to hire new management; and (6) upon an event of default, triggered the right of the indenture trustee to appoint a receiver. Because the indenture was never approved by the NIGC, the *Lake of the Torches* court determined that the indenture was void as an unapproved management contract.

In light of the foregoing, many creditors' remedies simply would not apply in the context of a tribal casino bankruptcy. For example, in a typical bankruptcy, creditors may obtain appointment of a Chapter 11 trustee to take control of and operate the debtor in cases of fraud or mismanagement prior to or during the Chapter 11 case. However, appointment of a Chapter 11 trustee would not be possible under IGRA. Nor would it be possible for creditors to (i) force the tribal corporation to bring in a new management for its casino, (ii) require approval of changes to management, or (iii) require a tribe to retain and follow recommendations of a gaming consultant.[16]

Federal Indian gaming law also has implications for restructuring tribal casino debt. Because IGRA requires each tribe retain "sole proprietary interest" in their gaming operation, bondholders cannot exchange debt for equity, nor otherwise take an ownership interest in the gaming operation. Among other things, this would likely frustrate the absolute priority rule under the Bankruptcy Code, prevent marketing of new value reorganization plans, and prohibit sales of casino operations.

Conclusion

Whether tribes are eligible for bankruptcy protection remains an open question. A reasonable argument can be made that tribal corporations, if not tribes themselves, are eligible as debtors under the Bankruptcy Code. Federal Indian gaming law alters the balance of debtor rights and creditor remedies in bankruptcy,

[12] 25 U.S.C. § 2710(b)(2)(A).

[13] 25 U.S.C. § 2711.

[14] NIGC Bulletin, No. 1994-5.

[15] 677 F. Supp. 1056 (W.D. Wis. 2010). The case is on appeal to the Seventh Circuit, and was fully briefed and argued as of October 2010. The Seventh Circuit's decision is expected later this year.

[16] Bondholders or other creditors could ask that the tribe enter into a management contract—either with the creditors themselves or with some independent management company—but the contract would require the tribe's consent, as well as NIGC review and approval.

tilting heavily in favor of tribal gaming debtors. Therefore, bankruptcy—or at least the threat of bankruptcy in the context of a restructuring negotiation—may be an attractive option for tribes and a problem for creditors.

If you have any questions about the content of this client alert, please contact the Pillsbury attorney with whom you regularly work or the authors below.

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