Indian Law (American)

Insolvency
& Restructuring

Finance

October 31, 2011

Seventh Circuit Rejects Bond Indenture and Its Waiver of Tribal Sovereign Immunity, But Allows Leave to Amend for Equitable Claims

by Blaine I. Green, Craig A. Barbarosh and Daron T. Carreiro

A recent ruling by the United States Court of Appeals for the Seventh Circuit affirmed the invalidity of a trust indenture between a tribal corporation and bond trustee that was not approved by the National Indian Gaming Commission ("NIGC"). However, the Seventh Circuit granted the trustee leave to amend its complaint to assert equitable claims, remanding the case for the district court to determine if other bond documents could support a waiver of the tribal corporation's sovereign immunity, and whether the trustee has standing to sue for the return of funds to the bondholder.

Background

The case[1] centers on a trust indenture between Lake of the Torches Economic Development Corporation, a tribal corporation wholly owned by the Lac du Flambeau Band of Lake Superior Chippewa Indians, and the trustee for the holder of $50,000,000 in gaming revenue bonds issued by the tribal corporation to fund a gaming project and to consolidate existing debt.

The federal Indian Gaming Regulatory Act ("IGRA") requires that an Indian tribe have the "sole proprietary interest and responsibility for the conduct of any gaming activity,"[2] 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 by the NIGC, or else the contract is void,[3] and the NIGC broadly interprets those activities that fall within the scope of management.[4] A "management contract" is defined as "any contract, subcontract, or collateral agreement between an Indian tribe and a contractor or between a con-

[1] *Wells Fargo Bank, N.A. v. Lake of the Torches Econ. Dev. Corp.*, __ F.3d __, No. 10-2069, 2011 WL 3890518 (7th Cir. Sept. 6, 2011).

[2] 25 U.S.C. § 2710(b)(2)(A).

[3] 25 U.S.C. § 2711.

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

tractor and a subcontractor if such contract or agreement provides for the management of all or part of a gaming operation."[5] The definition of a "collateral agreement" is also broad, meaning "any contract, whether or not in writing, that is related, either directly or indirectly, to a management contract, or to any rights, duties or obligations created between a tribe (or any of its members, entities, or organizations) and a management contractor or subcontractor (or any person or entity related to a management contractor or subcontractor)."[6]

The indenture trustee alleged the tribal corporation breached the indenture, and sought a receiver to take possession of the tribal corporation's pledged assets and casino revenues that secured repayment of the bonds. The corporation argued that the contracts underlying the trustee's claims were void and unenforceable as unapproved management contracts, and also that any waiver of sovereign immunity in those documents was also void.

The trust indenture 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 for any reason 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 trustee to the appointment of a receiver (collectively, the "Alleged Management Provisions"). None of the bond documents, including the trust indenture and the Alleged Management Provisions contained therein, were ever submitted to the NIGC for approval.

District Court Ruling

Based on the Alleged Management Provisions described above, the U.S. District Court for the Western District of Wisconsin ruled that the trust indenture constituted a management contract under 25 U.S.C. Section 2711, and was therefore void *ab initio* because it lacked NIGC approval.[7] More specifically, the court held that the six Alleged Management Provisions voided the indenture when "[t]aken collectively and individually."[8] The court further ruled that the trust indenture's waiver of tribal sovereign immunity was equally invalid, and that neither the sovereign immunity waiver nor the management provisions could be severed (and "[e]ven if the waiver provision could be saved, the remainder of the Trust Indenture is void, so there would be no remaining obligations to enforce under the contract").[9]

The court also denied the trustee's subsequent motions to alter or amend the judgment, and for leave to file an amended complaint.[10] The trustee had asked to amend its complaint to add equitable claims and to incorporate additional bond documents, including the bonds themselves, in further support of its argument that sovereign immunity had been waived. The district court held that its ruling as to the void trust indenture subjected the entire transaction to the management contract approval process, and that "the parties would have been expected to submit all of the related (i.e., 'collateral') agreements to the NIGC for

[5] 25 C.F.R. § 502.12.

[6] 25 C.F.R. § 502.5.

[7] *Wells Fargo Bank, N.A. v. Lake of the Torches Economic Development Corp.*, 677 F. Supp.2d 1056 (W.D. Wis. 2010).

[8] *Id.* at 1060.

[9] *Id.* at 1061.

[10] *Wells Fargo Bank, N.A. v. Lake of the Torches Econ. Dev. Corp.*, No. 09-cv-768, 2010 WL 1687877 (W.D. Wis. Apr. 23, 2010).

approval."[11] In other words, even if the other bond documents did not constitute management contracts, "the failure to procure NIGC approval in the first instance renders all of the collateral agreements void *ab initio*."[12] The court held that the bonds could not be separated from the trust indenture because (1) the bonds represented the corporation's obligation to repay its debt, while the trust indenture provided security for the transaction; (2) courts must construe together those instruments that are executed at the same time between the same contracting parties in the course of the same transaction; and (3) the bonds incorporated the terms of the trust indenture by reference, constructively forming a single instrument.[13]

The trustee appealed both district court rulings to the U.S. Court of Appeals for the Seventh Circuit.

Seventh Circuit Ruling

The United States Court of Appeals for the Seventh Circuit affirmed the lower court decision in part, holding "the indenture constitutes an unapproved management contract within the meaning of the statute and is therefore void" and that "Lake of the Torches' waiver of sovereign immunity contained in that document is also void."[14] Unlike the district court, however, the Seventh Circuit did not opine as to the *individual* effect of any of the six Alleged Management Provisions, and did not hold that any *single* one of the Alleged Management Provisions rendered the indenture a management contract. Instead, the court looked at the trust indenture as a whole, observing "there are provisions that militate in favor of characterizing the document as a management contract and other provisions that support the contrary characterization."[15]

Before addressing the Alleged Management Provisions identified by the district court, the Seventh Circuit called out a handful of provisions suggesting the indenture was not a management contract: (1) the indenture does not transfer, to the trustee or the bondholder, "wholesale responsibility over the daily operations or maintenance of the Casino, let alone compensate them for doing so"[16]; (2) it makes no provision "for the transfer of responsibility over the Casino's employment, accounting or financial procedures"[17]; (3) it contemplates that the tribal corporation would maintain control over casino licenses, permits, financial and accounting records, and other documents relating to casino operation; (4) it does not involve provisions for development or construction costs, nor allocate to the trustee or bondholder a percentage of casino revenues; and (5) the repayment schedule is not based on a proportion of gaming revenues.

On the other hand, the Seventh Circuit identified five provisions that are "more problematic," including the following: (1) requirement that casino gross revenues be deposited daily in a deposit account controlled by the trustee, subject to many conditions on allocation and disposition[18]; (2) prohibition on the tribal corporation making capital expenditures beyond a certain limit without bondholder approval; (3) bondholder's right to appoint a management consultant if the tribal corporation fails to meet a specified debt service coverage ratio; (4) limits on the ability of the tribal corporation to replace certain key management person-

[11] *Id.* at *6.

[12] *Id.*

[13] *Id.* at *7.

[14] *Wells Fargo Bank, N.A. v. Lake of the Torches Econ. Dev. Corp.*, __ F.3d __, No. 10-2069, 2011 WL 3890518 (7th Cir. Sept. 6, 2011), at *1.

[15] *Id.* at *12.

[16] *Id.*

[17] *Id.*

[18] While describing this requirement as problematic, the court observed: "We need not determine here the appropriateness of such an arrangement other than to note that, without some limitation on [trustee's] discretion to allocate or condition the release of the Casino's gross revenues even to pay operating expenses, this provision bestows a great deal of authority in an entity other than the Tribe to control the Casino's operations." *Id.* at *12.

nel without bondholder consent; and (5) in case of default, bondholder's right to require the tribal corporation to hire new management of bondholder's choosing.[19]

The Seventh Circuit concluded that, "taken together, the provisions discussed above transfer significant management responsibility to [trustee] and the bondholder and therefore render the Indenture a management agreement subject to the approval of the Chairman."[20] Like the district court, the Seventh Circuit also held that the offending provisions of the trust indenture could not be severed, including the waiver of sovereign immunity, which was therefore void *ab initio*.

The Seventh Circuit reversed the district court's refusal to allow the trustee to amend its complaint to assert equitable claims. Whereas the district court concluded that such an amendment would be futile, the Seventh Circuit disagreed, directing the district court to grant the trustee leave to file an amended complaint.[21] The Seventh Circuit also directed the district court to consider a "more fundamental" issue left unanswered in earlier opinions: Does the indenture trustee have standing to sue for the return of funds to the bondholder if the trust indenture is determined to be void?

Analysis and Issues for Future Consideration

In many respects, the Seventh Circuit's decision in *Lake of the Torches* is much more narrow than the district court opinion. Whereas the district court suggested that any *one* of the Alleged Management Provisions could render the indenture (or any other financing agreement) a management contract, the Seventh Circuit held only that, "*taken together*," the discussed provisions rendered the Indenture a management agreement. However, the court was silent on the issue of whether any single one of the Alleged Management Provisions could, on its own, render an agreement a management contract.

In addition, the Seventh Circuit raised—but declined to answer—questions about two specific provisions in the Indenture: the requirement that gross revenues from a casino be deposited daily in an account controlled by the trustee; and the provision for appointment of a receiver to manage the trust security in the event of default.

The Seventh Circuit expressly limited its holding to "the provisions of this particular financial arrangement,"[22] and refused to set any bright line rules for what is, or what is not, a management contract. In this regard, the court explained: "we do not attempt here to delineate precise guidelines for parties to loan agreements involving an Indian gaming operation, a task better left to the [National Indian Gaming] Commission."[23]

[19] The court expressed no opinion on two of the Alleged Management Provisions identified by the district court: the grant of a security interest in the casino's gross revenues and trustee's right to seek appointment of a receiver in the event of default. With respect to the receivership provision, the court explained: "Because we have determined that the provisions discussed in the text suffice to establish that the Indenture is a management contract, we need not determine whether the provision relating to the appointment of a receiver is similarly problematic." *Id.* at *13, n.14.

[20] *Id.* at *13.

[21] Although it purported to review the district's court's denial of the motion for leave to file an amended complaint for abuse of discretion (*id.* at *7), the Seventh Circuit gave little deference to the district court's legal reasoning for denying the motion to amend. This is especially true with respect to the district court's holding that the collateral documents, and their waivers of sovereign immunity, were void because they could not be separated from the trust indenture. The Seventh Circuit did not completely reject this last point, but held that "[i]t is not immediately apparent that the waivers contained in the documents attached to the proffered amended complaint, when read separately or together, ought to be construed as dependent on the validity of the waiver in the Indenture and that they do not make clear the Corporation's intent to render itself amenable to suit for legal and equitable claims in connection with the bond transaction." *Id.* at *15.

[22] *Id.* at *12.

[23] *Id.* at *13.

On the regulatory front, the court bemoaned "the fact that we do not have the definitive guidance from the [National Indian Gaming] Commission that Congress had anticipated."[24] The court acknowledged the relevance of NIGC's informal agency pronouncements—including NIGC Bulletins and "informal declination letters" from NIGC's Acting General Counsel—but held that such informal agency pronouncements are not entitled to deference.[25] The court urged that the NIGC, "through its regulatory authority," should more clearly define what is (and what is not) a management contract "in order to give the entities that it regulates more certain guidance as to the permissible scope of financing agreements."[26]

Conclusion

In the wake of the Seventh Circuit decision in *Lake of the Torches*, attention now shifts back to the Wisconsin district court to consider whether the indenture trustee has standing to pursue equitable claims when the indenture is void, and whether the tribal corporation waived sovereign immunity in ancillary financing documents. But, for the tribal finance community and Indian Country as a whole, the larger question is whether NIGC will propose formal regulations that more comprehensively define what is, and what is not, a management contract.

If you have questions, contact the Pillsbury attorney with whom you regularly work, or the authors below.

Blaine I. Green (bio)
San Francisco
+ 1.415.983.1476
blaine.green@pillsburylaw.com

Craig A. Barbarosh (bio)
Orange County
+ 1.714.436.6822
craig.barbarosh@pillsburylaw.com

Daron T. Carreiro (bio)
Washington, DC
+ 1.202.663.9021
daron.carreiro@pillsburylaw.com

[24] *Id.* at *12.
[25] *Id.* at *11 (citing *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)).
[26] *Id.* at *11, n.13.