

Casino tribes in others states defaulting on debts — with few consequences

By **Malcolm Maclachlan** | 10/07/10

Last November, the Mashantucket Pequot Tribal Nation in Connecticut failed to make \$7 million of a scheduled \$21.25 million payment on a \$500 million debt. The collateral on the deal was their Foxwoods Resort Casino. If they had been a normal business owner, they would have gone into a default, and creditors could have gone after the casino.

But the Mashantuckets aren't a normal business owner. They're an Indian tribe, with the rights of a sovereign nation. Legally, the creditors couldn't take the property or force the tribe to pay. Standard & Poor's lowered the tribe's credit rating to D, and Moody's followed. But with the casino pulling in \$700 million in profits a year, even during the downturn, it's not like they had an immediate need to borrow more money.

In fact, Michael Thomas, the tribe's council chairman at the time, acknowledged the tribe had the money to pay. But with 2009 marking the first time Indian casino profits dropped from the previous year, making the payment would have meant that tribal members would have gotten smaller payments — something he refused to do, even though some tribal members were getting \$120,000 a year in payments.

Other tribal council members later ousted Thomas and worked out a plan to repay the debt. But similar scenarios are playing out elsewhere: There have also been large defaults by gaming tribes in Michigan and New Mexico.

The month after the Mashantuckets defaulted, Wells Fargo Bank sued the Torchis Economic Development Corporation for failing to make interest payments on a \$46.6 million debt on bonds sold on their behalf in 2008.

Torchis is owned by the Lac du Flambeau Band of Lake Superior Chippewa Indians, owners of a large tribal casino in Wisconsin. They had borrowed the money for an expansion project that was cancelled in the economic downturn, and also lost much of it on out-of-state casino projects that never panned out. Less than two weeks later, a federal judge threw out the lawsuit on the grounds that the original deal had never been reviewed by the National Indian Gaming Commission and was void. In fact, the opinion included some of the most devastating words an investor could ever hear: "Without prior approval, the entire contract is void." Unless Wells Fargo manages to win on appeal, Torchis will be able to keep the money.

The sole bondholder is Saybrook Capital LLC of Santa Monica. John Schotz, a partner with Saybrook, said that Wells Fargo has appealed the case up the federal Seventh Circuit Court of Appeal, with oral arguments set to begin on Oct. 20. He said the requirement that general counsel at the NIGC review is not binding, despite the judge's claim to the contrary. At the time of the deal, the tribe's own bond counsel said the deal didn't include an invalid management contract that would have voided it, and that the tribe had waived their sovereign immunity.

"Two years later, because they made a bad investment in a deal in Natchez, Mississippi, that we had nothing to do with, they decided they don't want to pay," Schotz said.

One of the expert witnesses Wells Fargo has called is Bill Newby, director of gaming for UBS Investment Bank. According to the judges' reading of the law, Schotz said, 24 of the 30 tribal gaming loan deals Newby has designed in his successful career would be invalid.

The tribe's treasurer did not return a call seeking comment.

So far, nothing approaching this scale has happened among California tribes. Nelson Rose, a Los Angeles attorney who writes about gaming law, said he doubts we'll see a default the size of the Torches or Foxwood cases with pop up in California. For one thing, several of the top gaming tribes wisely pulled back from gambling expansion projects when the economy turned south.

But there is also no easily accessible public record of what debts tribes have piled up, or who they owe. If a major debt default does come up, it could catch even experts in the field by surprise.

"You've got a real problem if you have an industry with literally billions of dollars in loans that might be invalid," Rose said. He noted that Foxwood alone has over \$2 billion in outstanding debt.

One bit of good news is that the Torches and Mashantucket cases are very different, said Howard Dickstein, a well-known tribal attorney with the Sacramento firm Dickstein and Zerbi. The Torches situation appears to be a case of experienced bond professions wading into an area they knew nothing about - tribal law.

"The issue there is that lenders and their lawyers drafted loan agreements that were really not enforceable under current federal law without approval of certain federal agencies, which they didn't bother to obtain," Dickstein said. "I think it was really a failure to draft an enforceable agreement."

The contract Wells Fargo wrote up would have been perfectly workable with a normal bonded loan, Dickstein said. But the provisions that would have had the creditors essentially taking over casino operations aren't legal in Indian country.

"It certainly is a wake-up call to lenders and their lawyers," Dickstein added.

The Foxwood case actually has elements that could be considered encouraging, according to Los Angeles-based attorney, Sanford Millar, who specializes in tribal tax law and online gaming. The other tribal council members came to their senses and decided that the tribe had to think about their long-term interests.

"You're better off coming to terms with your creditors and preserving your reputation in the community, because you never know when you're going to have to go back [for more loans]," Millar said. "If you stiff a vendor, that vendor is never going to do business with you again."

While the creditors in the Foxwood case didn't make the same kinds of drafting errors that Wells Fargo did, Millar said, they still would have had problems calling in the debt if the tribe hadn't changed leadership. One much-talked about remedy would be seizing the valuable items inside of the casino - and none would be more valuable than slot machines. But that raises even more problems.

"Don't they need to get permission to enter Indian property to do that?" Millar asked.

The machines, themselves, meanwhile, are often not owned outright but leased from a technology provider like AGT.

"You can't just go in and say „We want the slot machines,“" Millar said. "They're owned by a third party. They're not yours for the taking. If it's server-based, they don't want people messing with their software."

So where does the industry go from here? Dickstein sounded an optimistic tone.

"I think lenders and tribes are chastened," Dickstein said. "It was just too much expansion too fast, with assumptions about an ever-expanding market that just didn't happen."

But there are still reverberations. Other gaming tribes have also seen their credit ratings slashed. At the New England Gaming Summit on Sept. 21, several speakers said banks were cutting the amount of money they would consider lending on tribal casino projects.

Meanwhile, lenders, bondholders and tribes are surely poring over the fine print of billions of dollars of existing deals—and bondholder lawsuits could result.